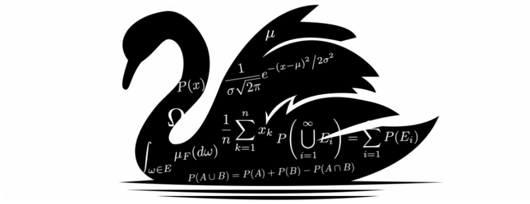
Is the Coronavirus the Black Swan to Trigger a "Black Bat" Market Crash?

Greetings!



In the 2008 book *The Black Swan: The Impact of the Highly Improbable*, [1] Nassim Taleb described the onset of unexpected but impactful Black Swan events, like those which precipitated the 2008 financial crash. The author set out three criteria for a Black Swan event:

1. The event is a surprise to the observer
2. The event has a major effect
3. At the first recorded instance of the event, the event could have been expected [2]

In December 2019, the first outbreak of the coronavirus disease 2019 (COVID-19) caused by the SARS virus was identified in Wuhan, China. The virus, which originated from an infected bat, has now sparked a global crisis about a new public health epidemic. However, the coronavirus isn't just an urgent public health issue; it has the potential to trigger an economic catastrophe with Black Swan conditions - or rather, "Black Bat" conditions. Specifically, the vulnerability in both the equity and bond markets compounded by the weaker global government positions could cause the most severe financial crisis since the 2008 crash.

Criteria 1: The Coronavirus and its Effect Was a Surprise to the World

As the first reports of the coronavirus hit the front pages of the newspapers, I was in Davos during the World Economic Forum with CEOs and other world leaders from January 21-24. While there were many important discussions regarding climate change, income equality (and getting a VIP ticket to see Lenny Kravitz at the Salesforce party[3]), the imminent threat of the coronavirus wasn't yet clear to the global elite. These 3,000+ world leaders were lucky. A Singapore conference that began a few days earlier on January 19 resulted in four confirmed cases of the coronavirus of the 109 participants.[4]

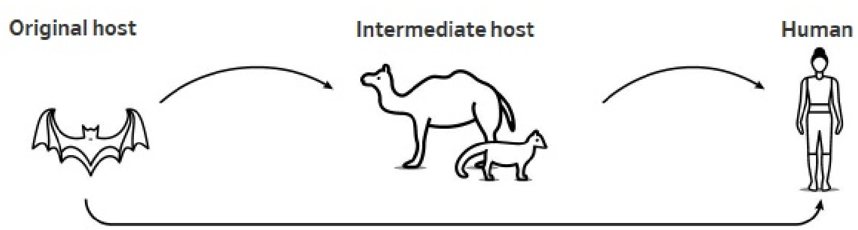
Matt Damon, a frequent WEF attendee, was noticeably absent this year from Davos -- perhaps his Contagion experience prompted him to not show? Or, maybe he and his buddy Ben Affleck

(Batman) are working on a rescue plan?

Criteria 2: The Coronavirus Has a Major Effect

The coronavirus has the potential to have a major economic and financial event even if it were to be confined to China. While the related SARS virus erupted in China in 2002[5], the role of China in the global economy has grown exponentially since this time. China only officially entered the global economy in 2001 when it joined the World Trade Organization. In 2003, China was the world's sixth-largest economy and since this time it has dramatically urbanized and globalized to become the world's second biggest economy. According to the International Monetary Fund, China now accounts for 39% of global growth[6] and had surpassed the US to become the world's largest trader at 12.4% of global trade.[7] Chinese tourism and consumption spending also would have a global negative impact.[8] The WSJ explains how the "World Economy Shudders as Coronavirus Threatens Global Supply Chains."[9] Even if the Corona Virus had been contained to China, the country's prominence in global trade would impact the global economy.

Yet, the Coronavirus has expanded far beyond China. Figures as of February 24, 2020 show 2,712 deaths of 49,776 coronavirus cases across 41 countries, from China to Italy.[10] Major global conferences such as Barcelona's Mobile World Congress have been cancelled. CNBC reports that, "the coronavirus outbreak has caused the cancellation or postponement of more than 24 exhibitions and conferences worldwide, hammering the $2.5 trillion trade show industry (which) is having damaging ripple effects across the hotel, airline, entertainment, marketing, restaurant and other industries."[11] Even Facebook has cancelled its San Francisco-based conference due to concern over the virus that erupted in a small village in rural China. ***Globalization has created exponentially growing and quick ripple effects of a disease that may have once been limited to a small region.***



Source: *The Wall Street Journal. See details below.*

Criteria 3: The Corona Virus and its Impact could have been Expected

The 2011 film "Contagion" featuring Gwyneth Paltrow and Matt Damon depicts how a virus, which originated in Asia from pig and bat viruses, prompted an international pandemic. The writer Scott Burns had consulted with scientists from the World Health Organization and was inspired by the 2003 SARS and the 2009 flu pandemic.[12] Research on SARS and MERS show how viruses that originated in bats could be transferred to humans.[13] The Wall Street Journal reported that, "It didn't take long to identify the suspected sources of a deadly coronavirus outbreak in the Chinese city of Wuhan: a cluster of vendors in a downtown market offering carcasses and live specimens of wild animals – from bamboo rats to ostriches, baby crocodiles and hedgehogs… Like many such markets, it also sold wild animals enjoyed as culinary delicacies or used as traditional medicine – an ancient trade Beijing has continued to allow despite warnings that it caused a deadly coronavirus outbreak almost two decades ago and could trigger another global epidemic."[14] Chinese authorities and scientists were all aware of the potential impact of a coronavirus on the globe.

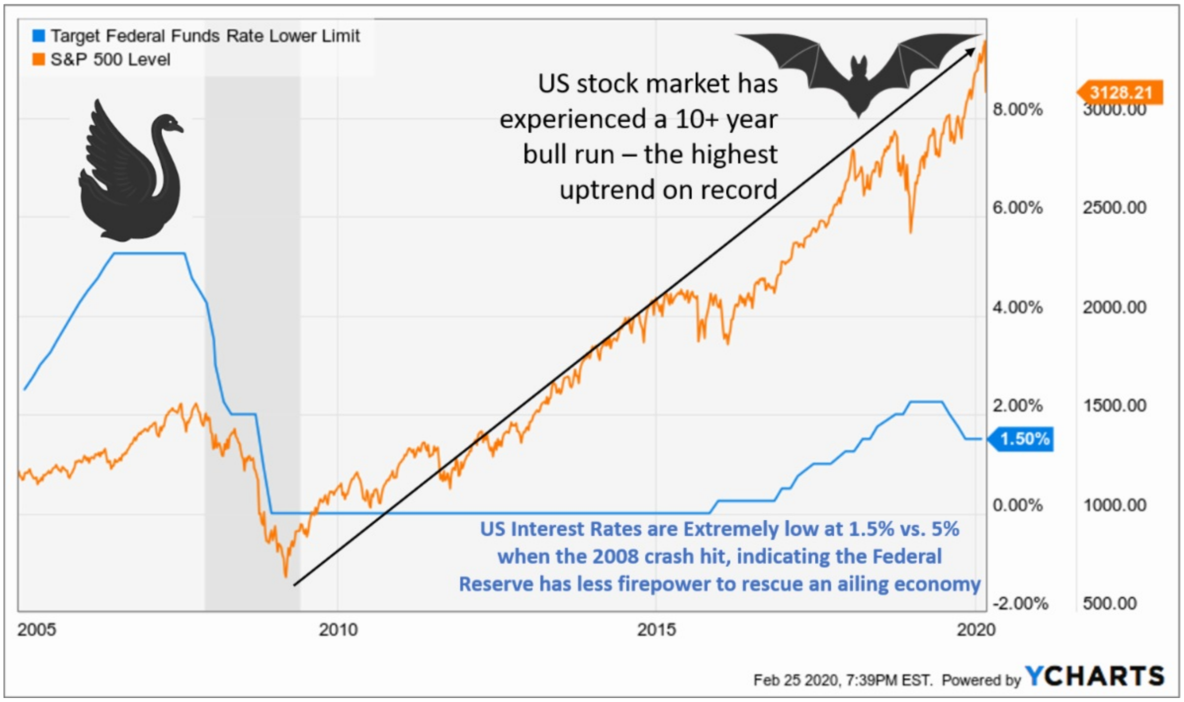
Economic Implications of this Black Swan Event – a Potential Black Bat Market

Crash for both the equity and bond markets

Even if a cure for coronavirus emerged tomorrow, the economic impacts have already been set into motion. Based on the criteria, it seems that the coronavirus could be a Black Swan event and investors may want to consider the potential impact of this rapidly spreading virus on their portfolios. Right now, expectations for the market have halved from first quarter earnings growth from 6% to 3.2% according to Refinitiv.[15] The market seems to be valuing the coronavirus as a short-term annoyance but not to have a lasting impact. However, companies had already started to diversify their supply chains away from China during the US-China trade war and this viral disruption may amplify the move away from China. Companies like Zoom Video and Teledoc are seeing their stock prices surge as videoconference instead of global travel is likely to quicken.

Yet, there may be even more grave implications. Even before the coronavirus asserted itself, the US stock market had the biggest bull run on record[16] and many analysts were concerned that we were "due" for an equity market correction. Yet, the global market might be even more at risk than it was in 2008 when the stock markets around the world collapsed. At that time, the bond markets were strong and global governments from the US to Europe to China worked together to stimulate the economy. In the US, for instance, the Federal Reserve lowered interest rates from 5% to essentially 0 so as to stimulate the US economy out of the 2008 recession. Today, the US Treasury is ~1.5% and, therefore, the US cannot lower the rates as effectively. Similarly, in 2008, the Chinese government launched a massive infrastructure spending spree that revamped its economy and served to stimulate emerging markets around the world who supplied it with raw materials. This time, China's fixed infrastructure needs are lower. Meanwhile, many European countries also have limited ability to respond as they are currently suffering from weak economic growth and negative interest rates. Should there be a global downturn accelerated by the Black Bat disease, the global Central Banks have less capacity to respond. The major governments have less ammunition to fight downturns, as acknowledged by Central Bank governors like Mark Carney.[17]

US Stock Market Is Vulnerable Given a 10 Year Bull Market, and Historically Low Interest Rates



Besides weaker central bank firepower, there are other complications should there be a recession now vs. 2008. In the previous global financial crash of 2008, investors in bond markets performed relatively well and the bond market served as a ballast to falling equity prices. This time, many people are invested in bond funds which do not have the same protections as I warned in *The Wall Street Journal* in 2017.[18] Recently, *The Financial Times* echoed this concern as they wrote that, "Risks build in world's largest bond funds"[19] as the move towards passive investing had lowered the credit quality of bonds in major bond funds.

By definition, black swan events are very rare. However, you may want to protect your portfolio from a potential double-barreled market crash prompted by the spread of the Black Bat virus.

It may be better to be safe than SARS-y.

Please feel free to contact me to discuss your thoughts and situation.

Best regards,
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Marisa (Maya) Joelson is Senior Investment Strategist and Wealth Advisor at Perigon Wealth Management.

Maya has two decades of experience advising top CEOs, policy makers, technology executives, and hedge fund managers, corporate executives, families, and individuals on their investment decisions. She has worked for leading firms in the US and London including Merrill Lynch, Credit Suisse, Renaissance Capital, and Rio Tinto. Her differentiated ideas have been featured in the ***Wall Street Journal, Barrons.***, ***Seeking Alpha*** and the **World Economic Forum**.

She earned a MPA from Harvard, MBA from Kellogg, and BA from Wesleyan. Maya speaks Spanish, Russian, French and English, in reverse chronological order.

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