In the past week, as the number of Coronavirus (COVID-19) cases has continued to increase, it has resulted in rising investor fear over what the potential economic fallout may be.

With Thursday's steep selloff in the S&P 500, the US stock market has entered into a bear market for the first time since the end of the financial crisis. They are defined by selloffs of 20% of more from the high. Bear markets often align with significant market volatility and economic downturns.

While the spread of COVID-19 has undoubtably been the catalyst for the selloff, the underlying reasons run much deeper. Going into the year, the US stock market was 'priced for perfection' and susceptible to weakness should something go awry. The virus provided such a spark.

Quarantines, Cancellations, and the Economy

Market volatility has been steadily increasing for weeks as investors digest the economic implications of an uncontrolled COVID-19 pandemic. Serious medical implications notwithstanding, for financial markets, the growing likelihood that sharply reduced consumer spending will cause a recession has ignited a volatility crescendo.

In the past few days, numerous states, businesses, and other organizations have dramatically increased the severity of mandatory quarantines and social distancing efforts. The impact of prolonged, broad-based social distancing may be vast.

Whether it is closing schools and colleges, working from home indefinitely, or canceling athletic tournaments, each of these decisions has an economic consequence. For every postponed event, a worker or business owner faces the prospect of lost wages and revenues. The economic effect of mass quarantines may grind business activity to a halt. Should activity slow significantly enough, economic growth could fall to zero or turn negative.

For these reasons, there is now widespread speculation that significant economic stimulus is necessary as soon as possible.

Economic Countermeasures

There are two main ways to provide economic stimulus to a slowdown: monetary, via central banks; and fiscal, through government action.

Central banks can ease monetary policies by lowering interest rates and pumping liquidity (i.e., cash) into the financial system. How effective these actions would be is unknown. In normal times, lower interest rates may catalyze borrowing and credit expansion, but these are not normal times. Access to low interest loans are unlikely to have an impact on someone's decision to go out to eat or take a trip.

Additional monetary policy measures may at least help stabilize the financial system. The Federal Reserve's recently announced $1.5 trillion funding program should aid in keeping the financial system functioning properly. During times of economic stress, it is important for companies to maintain access to credit, ensuring that the businesses' financial needs can continue uninterrupted.

The other form of economic stimulus is fiscal. Fiscal stimulus is government spending to boost economic growth. It can happen directly via government spending on things or people (e.g., building roads), and indirectly through tax cuts that keep more money in the pockets of the people.

Waiting on Fiscal Stimulus

On Friday afternoon, President Trump declared a national emergency, enabling the executive branch to access and deploy resources beyond the norm.

These include several initiatives to aid hospitals and other medical professionals, business partnerships to aid the fight, adding oil to the strategic petroleum reserves, and suspending interest payments on federally-held student loans. It is expected that additional steps will be released later Friday evening (after the release of this piece).

Additionally, Congress continues to deliberate legislative action. Potential measures discussed include aid for paid sick leave, unemployment insurance for furloughed workers, a suspension of business payroll taxes, and a delay of the April 15 tax deadline. Stimulus addressing potential economic gaps would further alleviate slowdown fears.

At this time, it's uncertain how much the economy will slow. What we do know is that the longer that people are at home and out of pay, or the longer that business are closed and not earning revenue, the more the economy will suffer.

The Oil Price Plunge

As the economy braces for a downturn, the energy industry is bracing for difficulties as well. Widespread restrictions on travel decreases crude oil demand, and in recent weeks, the industry began to fear a potential supply and demand imbalance.

Russia and Saudi Arabia, the second and third largest oil producers in the world, met last weekend with hopes of coming to a production agreement that would help solve the imbalance. Aggravated by opposing geopolitical goals, the two sides failed to come to compromise, and the meeting ended with Saudi Arabia declaring a price war, slashing oil prices, and raising production levels.

Saudi Arabia and Russia often work together to raise oil prices and boost revenues. Although they are incentivized to keep prices elevated, both countries have low production costs. This means that their breakeven price for crude oil is far lower than most Western competitors. As cost leaders, the two nations can make a profit at prices far below most in the US energy industry.

In recent years, the US energy boom has led it to become the world's largest crude oil producer. A prolonged price war spells trouble for the domestic energy industry. It will challenge US exploration and production companies, potentially causing job losses and bankruptcies. While low oil prices benefit the US consumer at the pump, the painful toll they may have on the energy industry is why the overall impact on the US economy is far more mixed.

What We're Doing

We believe that managing money to meet client goals and objectives requires a long-term perspective. Our investment approach does not try to specifically time exact market tops and bottoms, but instead, we seek to generate the growth and income clients need throughout full market cycles.

Market volatility is inevitable. When markets fall, emotions run high, and it is important to not overreact. Selling at the wrong time can seriously impair long-term returns. Our processes are centered around a disciplined risk management framework. All else equal, we would rather be buyers in times of market stress as volatility usually provides an opportunity to invest in good businesses at great prices.

At this time, we believe the market turmoil has created an opportunity to upgrade portfolios. We are actively making changes to client portfolios by either swapping out existing holdings for more attractive positions, or outright increasing equity exposure. Many strong companies with healthy, robust businesses are now trading at increasingly attractive prices.

We believe our disciplined, active investment approach is the best way to manage investment portfolios for the long-term. We continue to be cognizant of clients’ needs across different market environments, in good times and in bad, and our ability to dynamically adjust client portfolios amid today’s volatility demonstrates our time-tested processes in action.