



Going viral

The market's reaction to coronavirus



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Just when geopolitical risks like Brexit, the U.S.-China trade war and the U.S. impeachment trial looked like they were fading into the background, capital markets were handed something else to worry about as the new year began: a new coronavirus, COVID-19, that began sickening people in mainland China.

Of course, it's too early to know for certain whether COVID-19 will develop into a full-scale crisis, but so far one thing seems clear: U.S. equity markets appear to be paying closer attention to the new coronavirus than they did to SARS, a disease caused by a pathogen of similar origin that sickened a large number of people in China and across Asia and created a global health emergency in 2003.

Since the first media reports of the latest coronavirus outbreak broke in late January, COVID-19 has been blamed for three large drawdowns in the S&P 500® Index.¹ Compare that to SARS, which seemed to pass more or less unnoticed by equity investors in the U.S. for much of its run (see chart at right).

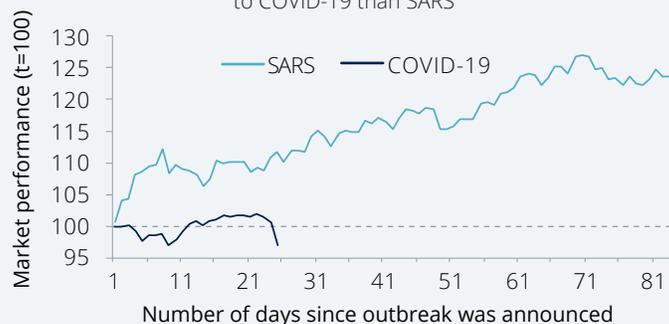
Some of the reasons that U.S. investors might be more aware of this coronavirus than the SARS outbreak are obvious, including the degree to which global markets and industrial supply chains are now tightly integrated, as well as the enormous growth of the

Key takeaways

- U.S. Investors seem to be paying closer attention to coronavirus than they did to SARS, sending stocks lower on at least three separate occasions so far.
- Increased capital market and supply chain integration — as well as the enormous growth of China's economy since 2003 — are probably at least partially responsible.
- Market valuations are stretched, and the economic cycle is more mature than it was during SARS, which could help explain the market's reaction.
- That said, government response has been swift and the outbreak, to date, appears less severe than SARS.
- Unless the outbreak worsens substantially, we believe the global economy should be able to take things in stride.

More susceptible?

U.S. markets seem to be paying closer attention to COVID-19 than SARS

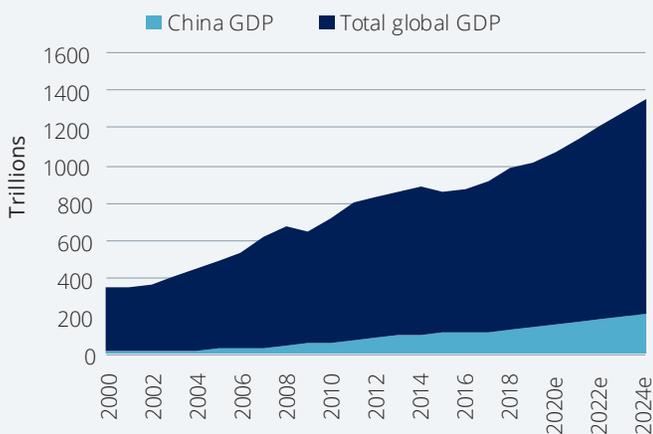




Chinese economy since SARS first appeared in 2003. For example, China is now the world’s second-largest economy behind only the United States and currently accounts for roughly 17% of total global economic output.² That compares to a share of only around 4% during the SARS epidemic, meaning that global economic growth is now far more susceptible to the slowdown in Chinese growth that will almost certainly follow the factory shut-ins and travel restrictions put in place to halt the spread of the new disease.

economic expansion when market valuations are somewhat stretched. By contrast, SARS first appeared just over a year after the 2001 recession hit bottom, when earnings multiples were more depressed and the economic recovery still had lots of room to run. Chinese growth in particular was much stronger at the onset of SARS than it is today, with the Chinese economy just now beginning to re-accelerate from a period of malaise related to the U.S.-China trade war. Simply put, the global economy and the capital markets that reflect them were arguably on a more stable footing during the SARS event than they are today.

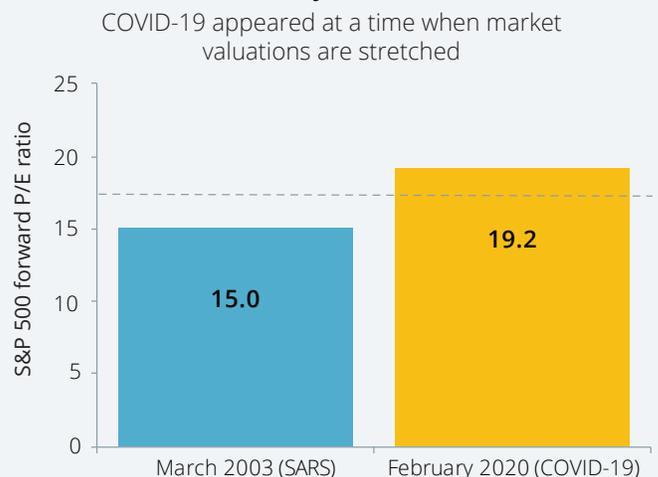
China economy is growing rapidly



Moreover, while SARS cases were largely confined to China and greater Asia, this coronavirus appears much more widespread, with tens of thousands of confirmed infections appearing in nearly 30 countries less than 6 weeks after the initial case.³ That has led to fears that COVID-19 could have much farther reaching effects than its predecessor from a geographic perspective, even if the disease’s morality rate is substantially lower than SARS.

Finally, of particular concern to equity investors is the fact that this outbreak could prove to be particularly ill-timed, because it comes after of a long period of

Poorly timed



Source: Bloomberg

That said, there are plenty of reasons to think that COVID-19 might not develop into the crisis that some investors worried about when they sent major U.S. and global market indices lower in late January and February. Governments in China — where both outbreaks originated — and across the globe appear to be applying lessons learned from the SARS epidemic to great effect: travel restrictions, information sharing, economic stimulus and



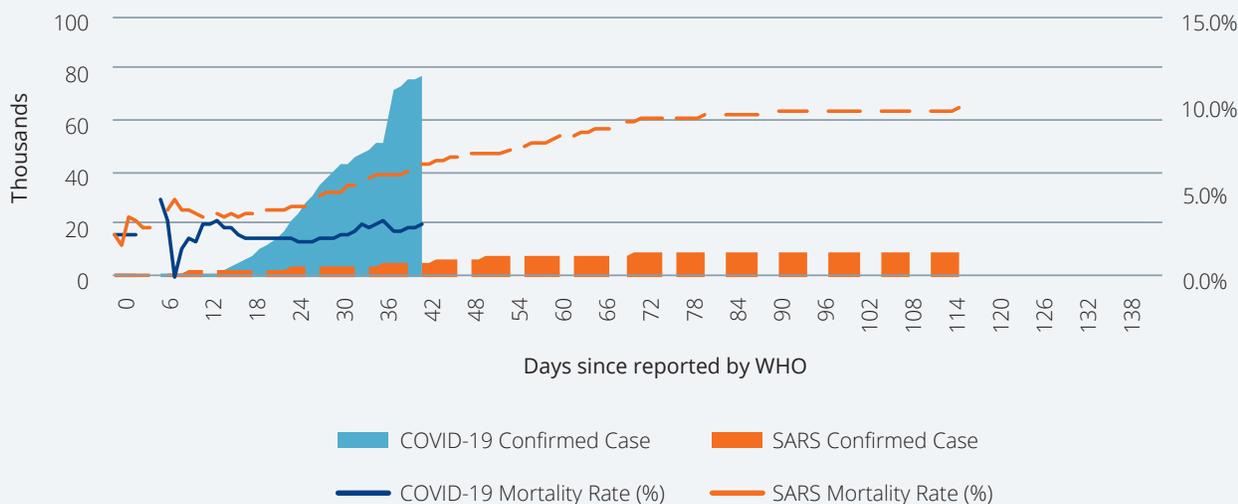
other efforts designed to limit the impacts of the disease have progressed far more rapidly this time. Moreover, while the current coronavirus is clearly more contagious than SARS, mortality rates are also significantly lower (and by some reports are roughly on par with seasonal influenza). If these estimates remain intact, that should give investors some comfort that COVID-19 may not be the cycle-ending black swan that some have feared.

In any case, the lack of an even bigger reaction by the market suggests that investors are betting on a V-shaped recovery — that is, a quick and powerful return to normal — after the outbreak subsides. And even if the economic costs ultimately prove to be material, recent experience also suggests that the worldwide economy should be able to bear those costs fairly easily, unless the outbreak gains significant

momentum or mortality rates increase substantially. That makes it hard not to see motives behind the recent sell-off as something other than fears about the coronavirus outbreak itself and perhaps more about a correction in stock prices that was overdue anyway given the strong run-up we've seen since the end of 2018.

But regardless of whether the U.S. market's recent reaction to COVID-19 was a rational response to illness-related uncertainty or an overdue correction of past excesses, the best way to navigate volatility like this is to resist the temptation to panic and stay the course. Although the unfortunate reality is that volatility like this may be here to stay until the coronavirus runs its course, experience has proven time and time again that cool heads typically prevail.

COVID-19 is more contagious but less fatal





1 The S&P 500 Index fell roughly 2.4% between Friday, January 24th and Monday, January 27th, and another 1.8% on January 31st. In addition, the index fell 3.4% on February 24th. In all three cases, the Wuhan coronavirus was a commonly cited cause for the sell-off.

2 IMF.org.

3 CDC.gov/2019-ncov.

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