TAKING STOCK: THE IMPLICATIONS OF COVID-19 AND THE FEBRUARY 2020 MARKET CORRECTION

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BLOG POST

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Stocks suffered their worst weekly decline since 2008 amid intensifying fears of the new coronavirus (COVID-19). This wave of risk aversion also pushed Treasury yields to record lows with the potential to fall even further. In a first since the outbreak, last week saw a greater number of new COVID-19 cases appearing outside China, including the United States, than in China where the virus originated in the Wuhan province at the end of December.

Investors are worried that a widespread pandemic could be a drag on investment markets and the world economy, and potentially tip the US, which is in the late stage of its economic cycle, into a recession. Another unknown factor spooking investors is the disruptive impact of COVID-19 on the Chinese economy—the second largest in the world after the United States—and global supply chains. The Chinese economy is about 10 times larger and is far more intertwined with the rest of the world than it was during the SARS outbreak in 2002. China's crucial role in supply chains for many major multinational corporations heightens uncertainty around the future earnings and growth outlook of these companies. While forecasting the precise economic impact of COVID-19 is inherently difficult, the IMF expects a meaningful reduction in China's first-quarter economic growth. It estimates a 0.1% decline in world GDP growth, according to its baseline view, which would put COVID-19's global impact in line with recent epidemics. However, the economic reality can differ greatly depending on the spread of the virus and the impact on consumer confidence.

While the most effective defense against the spread of COVID-19 is the simple act of frequently washing hands, we believe investment portfolios will be best protected by a disciplined rebalancing approach aimed at preserving strategic risk targets. To this end, we encourage investors to maintain a diversified portfolio in the face of an uncertain market environment. We do not, yet, see a clear opportunistic buying opportunity for equities as the recent sell-off brings the S&P 500 back to levels seen only this past October. The recent nosedive of stocks and the uptick in volatility should be a reminder that a 10% market correction is relatively commonplace, and the scale of the market drawdown appears less severe when viewed through the lens of the massive gains in 2019. Amid the strong wave of risk aversion, investors have an opportunity to realize gains in government debt and raise cash levels or set aside an extra month of cash on hand, to serve as dry powder should we see further market dislocations.

To be sure, every epidemic is different. COVID-19 appears to have a higher rate of human-to-human transmission than recent outbreaks (2012 MERS and 2002 SARS - both strains of coronavirus), but a higher rate of recovery. While these epidemics did increase market volatility, they did not have an impact on global growth levels as infection rates declined. Another comparison is to the seasonal flu, which rarely moves markets but can have a high death rate. The willingness of governments and central banks to step in to bolster market sentiment is poised to help mitigate the economic impact of the new coronavirus. Still, the key fear factor for

a novel virus is uncertainty over how extreme the disruption can be. We are closely monitoring the situation and its impact on markets and portfolios. Our expectation is market volatility will remain elevated as the virus is likely to spread to all corners of the globe. Should we see further declines in equity markets, we will reassess our views relative to the potential economic impact as more data become available. Watch this space for more on this topic.

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