19/19 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

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Coronavirus, oil collapse and the equity market falls

Last week, equity markets suffered their most severe one-day drop since 1987. During the week the DJIA fell 10.36%, the S&P 500 8.79% and the NASDAQ 8.17%.

Why the sudden drop?

The question is rhetorical, of course. Ask anyone on the street, Main Street not Wall Street, and they will immediately respond "the coronavirus." With that response, they are 80% correct. The other 20% is the sudden collapse of oil prices precipitated by the Saudi-Russia feud. There certainly are other reasons you can read about but they are closely related to the first two. We, along with many others, have tried to keep a steady pace of information flowing to our clients and friends. No one really knows when this will end. If it behaves like similar viruses in the past, it will slow down in the summer months. But, as we said earlier no one really knows. Of course, the virus itself will not hurt the market, but its effects on the economy will. In this paper, we will dig down and look at some of the feared affects the virus may have on the economy.

Consumer and business confidence

It should be no surprise to investors and analysts that something like this has a bad effect on consumer confidence. Consumers are inundated with news about the spread of the disease. Emotions are contagious, and as emotions become more and more strained and people become effected, they will be frightened in greater numbers.

The presumed affect is that consumers will stay home and stop shopping, going on vacations, dining out and spending money. These reactions are perfectly normal, and no one should be surprised. As an indicator of falling confidence, Morning Consults, a global polling company who takes polls on a weekly and daily basis, reports that in the United States, consumer confidence fell 0.9% in one day, and was down 4.63% since January 1. That was the biggest one day drop in over two years. Japan, England, Germany and France followed suit.

Business leaders see the problem both as a supply-side problem and a demand-side problem. The demand problem is explained by the consumer. The supply fears are related to what is occurring in the developing countries and China. As we all know, American industries, in an attempt to become more efficient, have developed supply chains around the world. Many of these supply chains are in countries that are the hardest hit by the coronavirus. The problem is clear; they will not have enough supplies to continue to make the finished product.

Another problem that has shaken both consumers and businesses alike is a lack of confidence in leadership. Readers will recall that the most severe drop in the markets came on the day after President Trump made a televised presentation about how the Administration was going to handle the crisis. His program was pretty much universally panned.

The subsequent press conference was more positively received, and the market regained most of the previous day's losses.

Is this the end of the expansion and bull market?

This, of course, is the big question. Heretofore in this paper, we sound pretty bearish, but there certainly are reasons to be optimistic.

The biggest question is how long the virus crisis lasts and how bad does it get. There is no definitive answer to either question, but we did discuss the question in last week's publication.

Weekly Market Insights (cont'd)

An interesting point is, in the modern world, contagious disease doesn't have to prevent consumer spending. Also, in the twenty-first century, consumers don't have to leave their homes to shop, as mall owners are finding out.

Consumer sentiment can change quickly. If consumers gain confidence that there is strong leadership, and they see progress, confidence can return in a hurry.

The virus appears to be slowing in China, which is the principal country where U.S. supply lines are situated. If the slowdown continues, then the supply line problem may no longer exist.

An interesting point is, as U.S. companies try to meet demand, they will be drawing down inventories. If this persists for more than a quarter, they will be seriously short. This, in turn, could produce a severe inventory shortage, and would create a lot of economic activity as businesses try to restock, which will give the economy a boost.

The Fed

As we write, the Federal Reserve announced a major easing. They have lowered the Federal Funds rates to near zero. They also announced that they will purchase $500 billion in government bonds and at least $200 billion in mortgage-backed securities.

This will certainly help the housing market and, more importantly, may boost confidence in investors. It will be interesting to see if this Fed move creates a large short covering move. In any case, it hopefully will help settle the financial markets. But two things are necessary, a vaccine and…

Fiscal Policy

Ideally, this monetary stimulus will be followed by a powerful fiscal policy move, led by the recently announced agreement between the Administration and Congress. That will be the proverbial icing on the cake.

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