Weekly Market Insights: Special Edition

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Panic!

The spreading of the coronavirus, particularly its introduction into Western Europe, caused panic in the equity markets for the past two days. Certainly, the spread of a very contagious virus is an important event and one that health authorities and the general population must take very seriously. The question we must try to answer is, does the coronavirus pose a long-term threat to the global economy and, therefore, the equity markets?

We will approach these questions in three ways: 1) Does it appear likely that this virus will be long lasting? 2) What are be the principal dangers to the economy? 3) Is the economy and, therefore, the equity market in strong enough shape to withstand the shock?

The answer to the first question is clearly beyond our competence, but we can pay close attention to what those in the medical community have to say. The majority of those who study epidemics answer no, the coronavirus will not be a long lasting problem. There are a number of reasons for this. There is an extraordinary amount of research underway to find a vaccine to prevent, and medicines to alleviate, this virus, and there seems to be a great deal of progress. Governments around the globe have taken exceptional measures to isolate the problem. There is a lot of talk that the process of finding a vaccine and bringing it to market is cumbersome and takes quite a bit of time. This, of course, is true, but on the positive side, similar epidemics tend to come to a halt during warm or hot weather. Summer is near, and that by itself should dramatically slow the spread of the coronavirus. This will give medical authorities and government officials (FDA) time to complete their tests. So, the answer to the first question is, no the evidence argues against a long lasting bout.

The second question has to do with both sides of the economy, aggregate supply (AS) and aggregate demand (AD). We all know the argument concerning AS. Many supply chains are located in Asia, which alas, is where the virus is most prevalent. There certainly will be supply problems. We see this now in the automobile industry and, no doubt, it will spread to other industries. Interestingly, it is aggravated by a process that is rightly hailed as a positive development—just-in-time inventory management. In any event, the disruption will have to last much longer than anticipated to cause terminal damage to the global economy and the U.S. economy, in particular.

The concern about the AD side of the economy is that consumers will be immobilized and stop spending. This is unlikely to be a serious problem in western economies. There was plenty of warning about the dangers of the coronavirus and precautions have been underway for a while. In modern economies, there is very little need for consumers to gather in large groups. Online shopping will be a big positive.

Our view is that both sides of the economy will see some damage. Next, we must answer how much and how long.

The U.S. economy is in very good shape. Earnings are quite reasonable; employment and wage growth are both positive and expanding. The economy is not particularly dependent on the international sector, and there is an extraordinary amount of liquidity in the system. Most importantly, U.S. and global governments do not appear to be panicking.

When the virus struck, the U.S. economy was very strong. Europe, although not really strong, was getting along, and equity prices reflected strong economies and positive future earnings. Then, panic struck and the herd of investors all tried to escape at one time. This, of course, accelerated the fall in prices, creating more fear.

We believe it overdone. The economy remains strong. Will there be a slow down? Almost certainly, but we believe it should recover rapidly.

An interesting observation—this goes a long way in reaffirming the argument for periodic rebalancing of portfolios. This is where the rebalancing has benefited in spades.

We are following this closely and will keep you apprised as the situation evolves.

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