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An Analysis: The Coronavirus and the Market

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The Coronavirus is a humanitarian tragedy and an economic disruptor. At the beginning of the week, confirmed worldwide cases stood around 79,272 with 77,150 of those inside mainland China. Although, the number of asymptomatic cases could still increase the number of future instances. But good news could be on the horizon with new reports that indicate a decline in the spread of new cases. A lot of unknowns do exist with respect to treatments and the lifespan of the virus. Hopefully the virus will simply dissipate similar to the flu when warmer weather comes.

There is no doubt the virus has major economic implications. Gross output in China is expected to decrease significantly in the first quarter of 2020, but then experience a sharp rebound in growth in subsequent quarters. Chinese production dropped severely after the Lunar New Year. Indicators of economic activity such as daily power consumption, city congestion, and purchased floor space have fallen to multi-year lows. Chinese officials, however, have become more confident that the situation is under control and want people to return to work.

Smaller businesses are at greater risk from the shutdown in high-risk cities in China. Concerns have grown in the ability of small businesses to meet future financial obligations. The Chinese government responded aggressively with multiple interest rate cuts in the economy, policy orders that allow for delayed loan and interest payments, and a requirement for banks to issue new loans to small businesses. The resilience in Chinese stocks in the midst of this scare is quite impressive. After their initial decline when the Chinese government finally admitted there was a problem, stock indexes recovered most of their losses and have held support since then. New counter-policies of monetary and fiscal stimulus have probably been helpful for stock markets in China. Any unintended consequences of the excessive stimulus packages are left to sort out for another day.

US stock indexes experienced two consecutive days of about three percent of losses on news that the virus had spread into other regions of the world. The closedown in China was already a difficult situation for US companies exposed to Chinese markets, but new uncertainties about the actual number of infected people built greater financial risks for companies less exposed to China. Some companies have already warned about upcoming weakness in their future financial reports. Industries engaged in travel and leisure and the movement of goods and services will probably struggle. Evidence can be gleaned in the relative underperformance of stock indexes that represent airlines, transportation, and energy.

The run in US stocks has been impressive since the beginning of 2017. With gains extending into 2020, it is arguably conceivable that prices stretched too far ahead of their fundamentals. The setback caused by the Coronavirus probably produced a healthy correction for stocks that will return prices back to normalized levels. Some global economies are about to unlock major fiscal spending programs as a counter-reaction to any economic slowdown. New stimulus measures can help recover some of the lost economic gains and reaccelerate the earnings of companies. Bond markets are currently repricing for more monetary stimulus in the future, which is seen in the decline of global yields and the all-time record low interest rate of the thirty-year US Treasury yield.

Currently, US bond markets are under the impression that the Federal Reserve will cut interest rates three times in 2020 with a high degree of confidence. The conviction for owning stocks seems brighter if interest rates do remain low or produce further declines. How increased government spending will interact with yields and affect changes is an unclear picture right now.

Financial markets were forced to deal with disease outbreaks in the past. The historical record shows that US stock indexes are capable of impressive performance comebacks after eradication. Admittedly, the Coronavirus spread grew exponentially to the height of the crisis and no one knows for sure how much longer it will last. In these times, it is important to reflect on personal investment principles and realize how diversification works to benefit of most investors. It is obviously a difficult behavioral task to stick to a plan when things change quickly. But without a meaningful plan, the path for wealth accumulation and protection becomes far more challenging.

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