

What Does the Coronavirus (COVID-19) Mean for the Markets?

After initial resilience to news of the coronavirus (COVID-19) outbreak in China, markets fell early this week upon news of the disease’s continued spread in Asia, Europe and the Middle East. The outbreak’s spread is unpredictable and has potentially severe consequences, representing a black swan market risk that often manifests itself in the following ways:

- Near-term equity sell-off resulting in increased volatility
- Rationalization of valuation multiples from recent highs (in this case, decade highs)
- Reduced expectations of future GDP and earnings growth

However, despite the gravity of the situation from a global health perspective, it is important to note that past disease outbreaks over the last several decades have not led to permanent loss of capital for investors who exercise patience during bouts of sudden market volatility, even if GDP and earnings growth suffers in the near term.

We continue to advise investors to resist prematurely reacting to the current headlines and to stay the course, as we remain vigilant regarding additional developments. We have prepared for these sorts of risks in our portfolio positioning by being slightly underweight equity allocations relative to long-term targets, despite the consensus optimism that prevailed at the onset of 2020.

Contextualizing the Market Impact of Epidemics

Historically, fear from major epidemics has caused market sell offs and bouts of near-term volatility. Yet over the long-term markets have proven resilient and recovered these losses. During significant outbreaks such as SARS, avian influenza, MERS, Ebola and Zika, the MSCI World Index saw performance fall up to 9% over periods of 1 to 6 months only to recover afterwards. See Figure One. As a comparison, since January the MSCI World Index has dropped nearly 4% as the coronavirus (COVID-19) outbreak has continued to spread.



Figure One: MSCI World Index Returns Following Major Disease Epidemics 1970-2020

([Charles Schwab, 2020](#))

Wetherby NEWS

Coronavirus Spreading but Shows Promising Decline in China

Among the many somber headlines, there is also promising news that the number of newly confirmed coronavirus cases is now on the decline in China, where the virus was initially discovered and where most cases have been reported. The mortality rate also remains limited thus far at 3.3%. This could indicate that the Chinese attempts to control the disease are working and over time confirmed cases should continue to decline in the country.

While reported coronavirus infections in China seem to be slowing, new cases are increasing beyond China's borders. Over the past month, only 1% of new daily infections occurred outside China, but over the past few days, approximately 20% of new cases are outside China, increasing concerns that COVID-19 will reach a more global scale and thus become a pandemic (e.g., HIV/AIDS, swine flu). With growing outbreaks of the coronavirus in Italy, South Korea and Iran, major health organizations such as the World Health Organization and the Center for Disease Control now question whether it is possible to prevent the virus from additional global spread.

Our Conclusion

It is still too early to tell what the ultimate impact of COVID-19 will be on people, countries and markets. While the COVID-19 outbreak will likely dampen GDP and earnings growth around the globe in the first and second quarter, we already prepared clients' portfolios for a downturn despite the market optimism through the start of the year. Further, counterbalancing the potential downside of weaker earnings growth is the fact that valuations are more reasonable given this correction in the markets. We remain on high alert regarding the potential impact to client investments.

We caution against trying to time short-term market swings and being too reactive in a market environment that reflects significant fear. In such market conditions, our investment philosophy remains resilient: maintain a long-term horizon, diversify across multiple asset classes and maintain a disciplined approach to rebalancing portfolios to reduce the risk of asset allocations becoming unintentionally skewed by significant price swings.

As advisors, we hold our clients' trust in highest regard and are always available to discuss market conditions. Please reach out to your Wetherby team with any questions.

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