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Investors React to Spreading Coronavirus

The U.S. stock market (as measured by the S&P 500 Index) has fallen by 15 percent since reaching an all-time high last Wednesday, more than erasing 2020's year-to-date gains. The catalyst for this dramatic move appears to have been global investors' assessment that the novel coronavirus has entered a new phase—and that the virus's economic impact would be larger than previously thought. According to news reports, the virus is spreading to other parts of the world and containing it may be a challenge, potentially forcing investors to reassess their expectations for the markets.

The U.S. stock market (as measured by the S&P 500 Index) has fallen by nearly 15 percent since reaching an all-time high last Wednesday, more than erasing 2020's year-to-date gains. The catalyst for this dramatic move appears to have been global investors' assessment that the novel coronavirus has entered a new phase—and that the virus's economic impact would be larger than previously thought.

Governments and the medical establishment had sought to isolate the virus in China and a few other spots where it had taken root. According to news reports, the virus is spreading to other parts of the world and containing it may be a challenge, potentially forcing investors to reassess their expectations for the virus's influence on corporate earnings, gross domestic product, and other key measures of economic activity.

As we know, the capital markets trade on a complex web of expectations. For example, analysts and investors study factors such as consumer spending and interest rate trends, inflation expectations, and assumptions about the cost of creating and delivering goods and services as they assess the prices of stocks they own (or are considering buying or selling). Normally, those expectations are relatively static and predictable.

Periodically, however, new factors enter the discussion. And, as we know, the markets like certainty, so when a new factor—like the coronavirus—comes along, market volatility is sure to follow as investors recalibrate their expectations. This recalibration can take time as new information and a better understanding of the risks and impacts emerge.

As we consider the coronavirus's potential disruption and economic and market impacts, we need to establish a framework for evaluating the risks. We are focused on categorizing risks between short- and long-term risks. In our judgement, the great majority of the economic and market risks stemming from the coronavirus are short term in nature. For example, while many Chinese factories may be closed for the next month, the factories are still in place; They were not destroyed as if by war or natural disaster.

Barring a cataclysmic increase in mortality, the affected workers will be able to return to their jobs as this virus declines. Of course, not all businesses will have the financial reserves to weather the storm and reopen, so the initial recovery period could be uneven. However, once this virus wanes, we expect the economy to get back on track.

Meanwhile, policy makers around the world are stimulating—and will continue to stimulate— their economies. Weakening economic growth in the U.S., Europe, and China before the virus outbreak had already prompted central banks to stimulate their economies. No doubt, they will add further stimulus to reengage global growth in light of the virus's impact. China has already taken action: Chinese regulators have carried out 23 easing measures to battle the virus's fallout, including cutting rates and injecting funds into the Chinese banking system.

With nearly 1 in 10 people in the world staying home from work, global growth in the first quarter of 2020 is likely to be poor, so investors should brace themselves for some ugly economic data. Corporate earnings should suffer as well. However, If the virus is on the wane by the end of March, it is likely that investors will ignore Q1 earnings and decide to look forward.

While the loss of life and the virus's human impacts are very concerning, as an investor, it is important to separate fact from news-driven hyperbole about the financial markets. And that will take some time.

During this period of recalibration, you should expect continued market volatility. Market drops, like the one we have experienced, can be disconcerting. But, as we often point out, a market pullback of 10 to 15 percent during a calendar year is normal—and we have not seen volatility like this since the financial crisis.

As always, a well-diversified portfolio tailored to your appetite for risk and personal financial goals and objectives is the best long-term strategy and can help provide the peace of mind necessary to stay the course through volatile markets. We will be tracking the virus's spread—and resulting economic impacts—actively and will keep you apprised of what we learn. In the meantime, please reach out to your CAPTRUST financial advisor if you have questions or concerns.

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