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Financial Brief: Recent Market Volatility

Friday, February 28, 2020

Over the last several days, the U.S. stock market (as measured by the S&P 500 Index) fell by more than six percent, more than erasing 2020's year-to-date gains. The catalyst for this resurgence in volatility appears to be 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. Over the weekend, it became clear that the virus has spread to other parts of the world and that containing it may be a challenge, 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. Normally, those expectations are relatively static and predictable.

Periodically, however, new factors enter the discussion. 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 adjustment 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.

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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. And that will take some time.

During this period of recalibration, we should expect continued market volatility. Market drops, like the one we experienced this week, 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 in more than a year.

As always, a well-diversified portfolio tailored to your personal financial goals 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 us if you have questions or concerns.