Legacy Trust

Investment Perspectives

Global Coronavirus Outbreak Impacts Markets

February 2020

Laina M. Mills, CFA, CFP®
Chief Investment Officer

Key Takeaways

- Equities have sold off sharply in recent days on the continued global spread of the coronavirus
- The impact of the outbreak on the global economy will be a drag on U.S. growth in Q1 but should recover later in the year
- The U.S. is facing this new global challenge from a position of economic and financial strength
- We expect to see additional equity market volatility until more is known about the outbreak, but we encourage investors not to react to short-term thinking

The coronavirus outbreak has disrupted markets and driven stock prices sharply lower over the last few trading sessions. While the disease has so far had little direct impact on the U.S., a number of countries across the globe have reported an increase in cases, raising concerns about the impact of a possible global pandemic given the interconnected nature of today's modern economy.

The outbreak, which began in early December in Wuhan, China, was publicly disclosed in early January but didn't gain global attention until the first human transmission recorded on January 20. Since that time, the number of confirmed cases has increased considerably and now stands at more than 80,000, with over 2,700 deaths (98% of which have occurred in China).

Markets reacted by selling off in late January, only to recover and reach new highs in early February as China appeared to be taking significant measures to contain the virus through quarantines and travel restrictions. As recently as one week ago, it appeared that these actions were proving effective, and the rate of new cases has slowed. However, several other countries including South Korea, Japan, Iran, and Italy reported new cases over the weekend, indicating that the global implications may still be in the early stages.

There is still much that is unknown about the virus including the amount of time during which an infected person can give the disease to others, making containment challenging. Early studies have showed that the fatality rate is higher amongst older adults with pre-existing conditions, and the overall estimated fatality rate is below that of SARS or MERS.

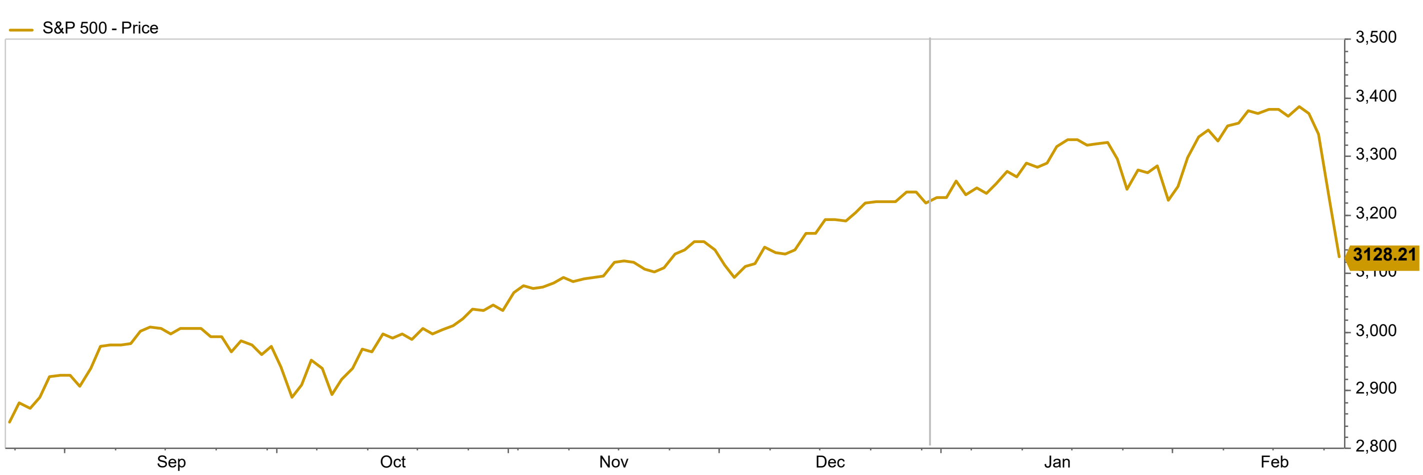
It is challenging at this early stage to quantify the impact of the outbreak on economic activity. In the case of the SARS epidemic from the early 2000s, the outbreak resulted in an overall economic loss of $40 billion, or 0.1% of global GDP in 2003. It should be noted that at that time, China accounted for a much smaller share of global GDP – 4% compared to 17% today. Ultimately the global growth impact will depend on the severity of the outbreak worldwide, which is still too early to predict with any accuracy at this time.

U.S. businesses have little direct exposure to the Chinese economy. Only about 2% of revenues from S&P 500 companies in aggregate come from China. Nevertheless, China is a center of global supply chains and the inevitable slowdown there will impact a number of U.S. companies. Apple's announcement last week that it would miss revenue guidance due to supply chain disruptions in China spurred additional market scrutiny on the indirect impact on U.S. companies. As a result, Goldman Sachs is estimating that the outbreak will negatively impact U.S. growth will by 0.8% in Q1, but that the economy will go on to recover the loss in Q2-Q3.

Investors should recall that the U.S. is confronting this new global challenge from a position of economic strength. Consumer conditions, housing, and labor all point to a healthy, growing economy. Manufacturing activity, which slowed in mid-2019, has recovered back into expansionary territory and services remains robust. From a market perspective, while the large single-day selloffs early this week have been alarming, recall that the S&P 500 gained over 30% in 2019 and seeing a short-term pullback is not surprising under any circumstances.

Ultimately it is still too early to make reasonable estimates as to the impacts of the viral outbreak on the economy and markets. Much more will be uncovered in the coming weeks. If new cases of the virus slow meaningfully by the end of Q1 and we see Chinese laborers going back to work, we can feel more comfortable about the path to recovery in the near-term.

Despite this period of uncertainty, we encourage investors not to fall prey to the short-term thinking that has been consuming the financial news. While there are clearly real human risks at stake that should not be minimized, the investment impact of the outbreak is likely to be short term. Fixed income investments have rallied and will continue to provide a near-term cushion for balanced investors who rely on their portfolios for regular cash flow needs, allowing equity investments to ride through the volatility that is likely to accompany the news surrounding the outbreak until we have clearer indications that the virus has been contained.



Source: FactSet Research Systems
Data as of 2/25/2020

Legacy Trust | 99 Monroe Ave. NW, Suite 600 | Grand Rapids, MI 49503
PH: 616.454.2852 | TF: 1.800.519.3705 | F: 616.451.3312 | legacygr.com