Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

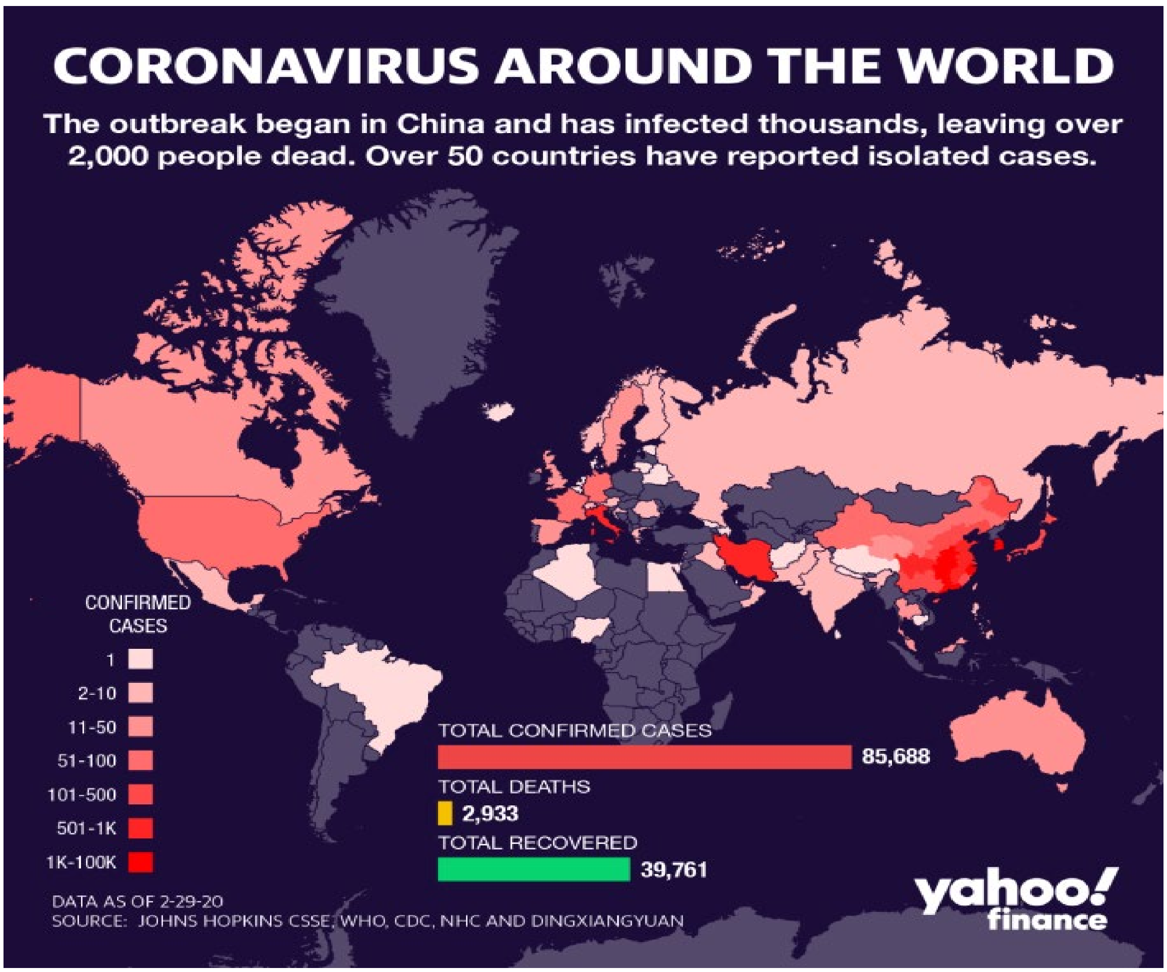
COVID-19 and Markets 2020

The impact of the Virus in early 2020 (02/29/20)

The financial markets have exhibited heightened volatility in 2020. First it started with the impact of the virus on China's economy but, once the virus impacted people in the U.S. (including one that did not have known contact source), an already jittery market fell precipitously during the week of February 24. So, what are some of the facts surrounding this health issue and what might lay ahead?

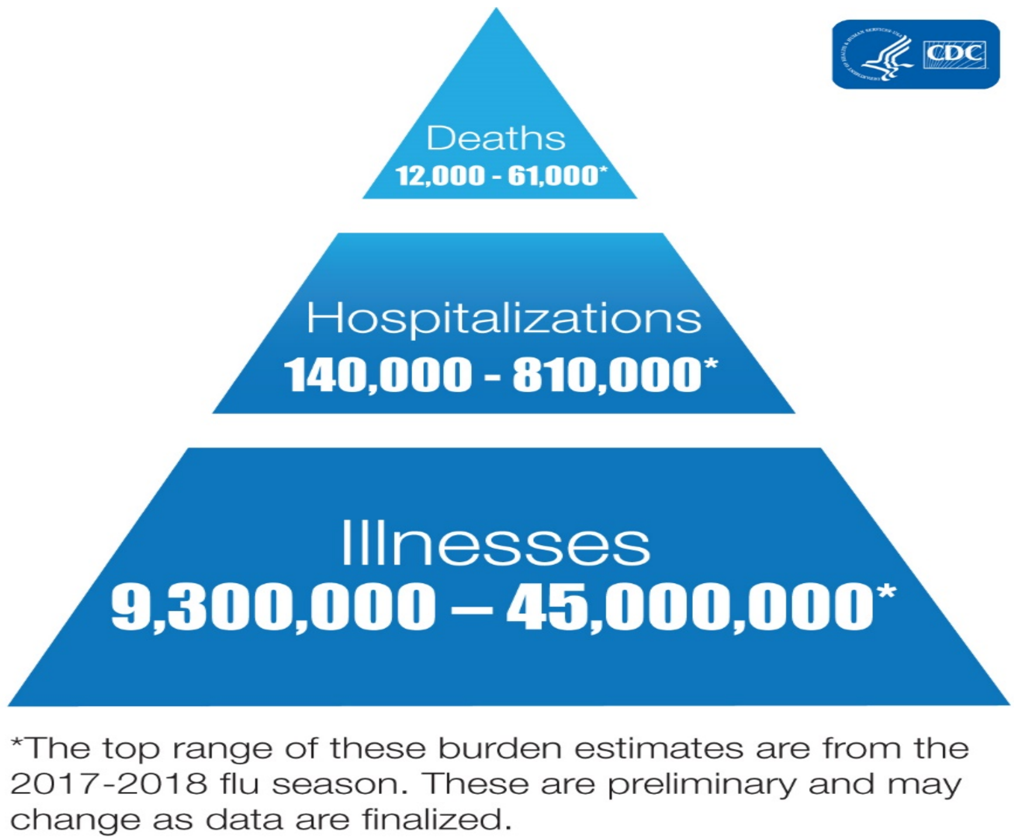
What is the current situation?

COVID-19 is respiratory disease caused by a novel (new) coronavirus that was first detected in China and which has now been detected in 60 locations internationally, including in the United States. It is part of a large family of viruses that are common in people and many different species of animals and similar to MERS-CoV and SARS-CoV. The complete clinical picture about COVID-19 is not fully understood. Reported illnesses have ranged from mild to severe. At this time, however, most individuals in the United States will have little immediate risk of exposure to this virus as it is NOT currently spreading widely in the country. However, it is important to note that current global circumstances suggest it is possible the virus could cause a pandemic. (Source: CDC)



The confirmed cases are approximately 88,000 worldwide that resulted in approximately 3,000 deaths (at time of writing). Current mortality rates are approximately thought to be about 2%. Of the 88,000, over 90% have been in the Wuhan region of China with clusters in South Korea, Italy and Iran. There have been approximately 60 cases identified so far in the U.S. with most them related to the infected cruise ship Diamond Princess.

As a point of comparison, the seasonal flu is responsible for somewhere between 12,000-61,000 deaths in the U.S. annually with somewhere between 9,300,000-45,000,000 infections per the graph below for 2017-18. (Source CDC).



While the situation is rapidly developing there are some positive signs coming out of China. First, the pace of new cases is slowing, and the lessons learned in China will aid in combating the virus. In a well-developed public health system like the U.S. the defense is ramping up quickly with the priority being adequate and reliable diagnostic testing which is under way. Second, the focus will be on treatment of affected persons which, the Secretary of Health and Human services is confident in achieving by the September/October time frame. Finally, the development of a vaccine will take a little longer but, there is a head start given that China has sequenced the genome of the virus. We do recognize the human toll of this health crisis and even one death from this virus is too many. At present the focus should be on taking the same precautions you would to avoid the flu: frequent hand washing, avoidance of face touching and minimizing contact if you exhibit flu-like symptoms. The expectation is that the world will move past this epidemic as it has recently with SARS (2003 and most like Covid-19); Avian Flu (2006); H1N1 - Swine Flu (2009); MERS (2013); Ebola (2014) and Zika (2016).

What is the economic impact?

According to the International Monetary Fund the latest estimate of global growth was slowing from prior forecasts of 2020. China, which is the world's second largest economy behind the U.S., was forecasted to grow by 6.0% in 2020. The containment of the virus in China has caused entire cities of millions of people to be shut down to contain the epidemic. This means workers not going to work, people not shopping and a significant reduction in economic activity. Restrictions on travel and these extreme public-health measures have impacted the service sectors of the economy and factories have been forced to close. A Bloomberg report suggested the Chinese economy was operating at about 50% – 60% of capacity in the week ended Friday, February 21 and the PMI plummeted to 35. The consensus is that the Chinese economy may possibly contract in Q1 of 2020 resulting in a significant reduction to the expected 6.0% rate of growth for the year. The impact in other developed economies may tip some countries into recession. The duration of this situation will dictate the severity of the impact.

In the United States the impact has not been significant so far as the U.S. economy is not heavily dependent on exports but, is driven by consumer spending. Entering 2020 the U.S. economy was on solid ground. The full impact to U.S. companies and consumers will be better known at the end Q1. The impact of the virus on the economy can be felt in three possible ways. First, is a decline in aggregate demand. Just as in China, should the U.S. need to take extreme measures in containment consumer activity would slow. Even before that the recent market activity and the constant headlines about the virus may affect consumer confidence and their propensity to spend. In some cases, the economic activity cannot be recovered and is permanently lost (think about a cruise not taken). Second, multi-national companies, especially those who do business in China, will see a revenue drop in the quarter due to the shut downs in that country (think Disney, Starbucks and Apple). Finally, the significant disruption in the supply chain will affect U.S. companies even if they do not sell multi-nationally. Consider the Tsunami that hit Japan in 2011 which caused parts shortage for a long time after the event. China and South Korea are key manufacturing centers and effects are already impacting the automobile and electronics industries.

The Federal Reserve has indicated they will step in appropriately to support the economy if necessary. The markets seem to be expecting at least one rate decrease based on not only the virus effect but, global economic weakness, current deflationary forces, a strong dollar and a reappearance of an inverted yield curve. The effect of rate cuts may be muted though as lower rates would most likely not incentivize people to spend if they are not confident or, are confined.

What is the market impact?

Entering 2020 the S&P 500 was richly valued. The forward P/E ratio was approximately 19 – high by historic standards. Interest rates had decreased 3 times recently and the market had most likely not priced in events like the 2020 U.S. election and certainly not the unexpected exogenous shock of a virus spreading globally and, specifically, in the U.S. As a result, the market is attempting to reprice risk with currently known, but incomplete, information. The significant decline during the week of February 21 was an assessment of impact on U.S. corporate earnings and the potential result in consumer spending. The S&P 500 dropped by 12.09% during the week which brought the 2020 YTD loss to 8.56%. This is after a 2019 that saw 30% gains in the index. This drop brings the S&P 500 forward P/E down closer to 17 based on expected 2020 earnings (which were expected to grow 8%). The level of the S&P 500 on February 28th was about equal to where it was in mid-October 2019, but we expect volatility to continue during 2020.

What to do?

As you have heard us say many times before diversification and appropriate asset allocation to each individual circumstance is the best approach to these stressful times. We are focusing on quality and valuations in the U.S. markets. We advise against selling based on emotions and remind our clients to keep their goals in mind. As you can see by the chart below the markets “climb a wall of worry” and there is often a reason to sell.

Source: Ritholtz Wealth Management

While volatility is never comfortable it is a part of risk assets. Without asset prices coming down there would be little opportunity to rise. The recommendation is to stay invested and have the proper asset allocation. Timing the market is difficult and missing market up days can be costly. We remind you of the table below which we often reference.

The Problem With Market Timing: Missing The Best Days

20 Years (1/1/1998 - 12/31/2017)

$10,000 Invested in the S&P 500 Index	S&P 500 Annualized Return	Value of $10,000 at the End of the Period	Gain/ Loss	Impact of Missing Days
All 5,036 trading days	7.20%	$40,135	$30,135	--
Less the 5 days with the biggest gains	5.02%	$26,625	$16,625	-45%
Less the 10 days with the biggest gains	3.53%	$20,030	$10,030	-67%
Less the 20 days with the biggest gains	1.15%	$12,570	$2,570	-91%
Less the 40 days with the biggest gains	-2.80%	$5,670	-$4,330	-114%

Source: Yahoo! Finance

Should you have any questions please contact us.

Buffalo Office

1114 Delaware Avenue
Buffalo, New York
14209 United States Phone: 716-883-9595

Jamestown Office

214 West Fifth Street
Jamestown, NY
14701 United States Phone: 716-484-2402