MarketTrax

SPECIAL COMMENTARY: COVID-19

Mark Teichner
Chief Investment Officer

Equity market valuations coming into 2020 were on the higher end of historical levels, a result of optimism on the progress on trade negotiations with China and passing of the USMCA agreement, strong domestic employment and consumer spending trends, low interest rates, and expectations of continued moderate economic growth. There was no immediate catalyst for concern.

FACTOR **Coronavirus**	**FACTOR** **Public Health**
FACTOR **Economic Decline**	**PRODUCT** **Market Volatility**

The outbreak of the Coronavirus, now recognized as COVID-19, originated in China and has now spread rapidly with concentrated outbreaks in Italy, South Korea, and Iran, with early incidences in the U.S. Its highly contagious characteristics and no readily available vaccine has caused heightened concern and has materially changed global economic dynamics. As of today, reports indicate 120,000 of reported cases worldwide and over 4,000 deaths. In the U.S., the numbers are presently small, consisting of over 1,000 cases and 32 deaths. Those over 60 years old have a higher death rate and risk, as do those with cardiovascular disease, diabetes, chronic respiratory disease, hypertension, and cancer. However, roughly 80% of COVID-19 cases are considered mild with symptoms similar to the flu.

Public health officials and the media have been very vocal regarding the risk of the virus spreading rapidly, which has caused widespread changes in behavior and reduced business activity, especially where large groups of people are in close proximity. Group events and conferences have been canceled, which in turn has caused travel plans including hotel, airline and cruise ship bookings to also be withdrawn. While restaurants in Atlanta didn't seem to be suffering this past weekend, traffic at the margin has slowed in shopping malls and other public venues. In response to these health warnings, fear and uncertainty has spiked, reflecting the unknown duration and magnitude of these health concerns.

Fear has spilled over into the public security markets, leading to elevated market volatility, downward price action on risk assets, including stocks and high yield bonds, and an aggressive flight to safety move into risk free assets, primarily Treasury securities. At one point over the last several days, the 10-year Treasury note was quoted at below 0.50%, over 1% below the yield just one month prior. Equity markets are down in "bear market" territory, with the S&P500 down 20% and smaller cap. Russell 2000 Index down over 25% from their peaks just one month ago.

As a result of disruption in supply chains and the rapid decline in economic activity, public companies have withdrawn their earnings outlook, with no clear position on when business conditions will return to normalcy. Many market participants, in turn, are taking a short-term, sell first and ask questions later approach, preferring the comfort and certainty of cash/money market holdings.

The downward move can be partially attributed to the increased utilization of electronic, computer-based trading algorithms, with models based on earnings revisions, price momentum, and other trend following factors. These same factors also contributed to the market's rise. However, in an uncertain market, liquidity dries up, market makers withdraw capital, and small trades cause significantly greater price movement as compared to normal trading environments.

While we are not epidemiologists and have no idea on how the virus will spread or how many people will ultimately become ill, we recognize the dramatic efforts being taken by Government officials are meant to prevent the rapid spread and potential overwhelming of our health care system. We take solace in the news of the rate of new cases in China and South Korea are beginning to slow and economic activity starting to return to normal, understanding aggressive efforts to contain the virus have been successful in those countries.

From a financial perspective, efforts are being made to provide the market with liquidity and policies to reduce the potential financial risk to businesses and consumers. Unfortunately, some of these policies are unlikely to cause consumer willingness to spend. We fully recognize there will be a hit to earnings over the next quarter or two, which is likely to induce a recession. However, based on solid economic backdrop in the U.S., we anticipate a rebound in the second half of the year once the virus dissipates or a vaccine is created. A business's value, and its stock price for publicly traded companies, is determined by its longer-term business fundamentals. While we always recommend some cushion through moderate allocations to cash for near term spending, using history as a guide, investors who can look beyond the near-term uncertainty and focus on the five-year horizon and beyond will most likely be well rewarded by maintaining an appropriate allocation to equities and similar growth oriented asset types.


Mark Teichner

TMI
Trust Company
Specialized Trust Services