Key Questions

Are Investors Concerned Enough About the Coronavirus?

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While we caution against concluding "all clear" in terms of heightened risk levels, being out of the market has risks, too.

Several weeks ago, shortly after news broke that a new and potentially lethal virus was on the rise, we wrote a personal account of our experience from an investment perspective during the SARS scare in 2003.

The primary message of this article centered on the notion that investors typically overestimate the impact that exogenous events have on financial markets. If an investor's portfolio is diversified and properly aligned with short / intermediate liquidity needs and longer-term aspirations, often the best thing to do when such events first occur is very little. That's because doing nothing affords an investor with an immensely important elixir from which to draw when uncertainty intensifies: the passage of time.

About the time we published our earlier article in late January, risk assets around the world were stumbling. Those regions closest to the epicenter of the virus were hurt the most, but all equity markets across the globe were falling on fears of a potentially weakened economic outlook. Here in the US, the S&P 500 Index briskly fell over 3%.

Since then, however, stocks recouped their losses and US equity indexes quickly climbed to new highs. This begs the question: Are investors sufficiently concerned about the coronavirus (now labeled COVID-19)? Said differently, have all related risks been fully priced into asset prices such that all bad news is now known and the worst is over?

In our view, we caution against concluding "all clear." Just a few days ago, a well-respected health scholar stated, "We are several weeks away from really knowing what we are dealing with here." The true economic impact of COVID-19, therefore, is still not yet fully knowable.

More specifically, because the virus may take up to 20 days for those who are infected to succumb to it or recover, it is simply too early to quantify the scope of this challenge. Furthermore, it is reported that only people with severe symptoms have been tested; those with milder symptoms have not. Finally, despite China's vigorous efforts to contain the spreading of the disease, it remains to be determined if they will be successful. Another epidemiologist described the current condition as one where "the available data does not yet allow us to decisively reject the hypothesis of a global pandemic."

In sum, this is a very fluid situation with limited and incomplete information. Hopefully, China's (and the world's) containment efforts will prove effective as vaccine manufacturers race to a cure. Investors need to acknowledge that members of the infectious-disease community are on high alert.

Moreover, in pure economic terms, the COVID-19 virus is a two-edge sword with potentially knock-on effects related to weakened demand from Chinese consumers and disruptions in the global supply chain.

Regarding the latter, as of 2015 (the most recent time period on which such information was available), China accounted for nearly 30% of global exports. At a time when an increasing number of businesses are reliant on just-in-time inventory, idle Chinese factories could cause meaningful disruptions, putting pressure on companies' profit margins. These pressures could materialize as early as next month.

Nonetheless, investors should recognize the presence of several strong countervailing elements that are supportive for stocks, forces that were strengthening immediately prior to COVID-19. Most notably, earnings growth was poised to reaccelerate in 2020 as trade tensions eased. Additionally, the Federal Reserve, on the heels of lowering interest rates three times in 2019, repeatedly affirmed that interest rates would remain low while it also enacted other measures to ensure ample liquidity was readily available. Even near-term growth prospects in Europe had begun to look stronger than they have in years.

To be sure, the COVID-19 virus adds an element of risk for being in the market. However, there are risks in terms of lost opportunity if investors are out of the market. Thus, we continue to believe that a balanced approach between stocks and bonds relative to one's strategic asset allocation targets makes prudent sense until many of the "unknown-unknowns" become better understood.

For more information, please contact your Key Private Bank Advisor.

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