

A closer look at the market downturn

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As the stock market continues to drop in the wake of the coronavirus epidemic (COVID-19), investors may be wondering what's behind the continued sell-off.

Markets are becoming increasingly concerned that the impact of the virus may lead to a global economic downturn. Markets have also been underwhelmed by the response of governments and central banks to limit the economic and financial damage.

The World Health Organization has declared the outbreak a global pandemic as COVID-19 has spread to more than 110 countries. While new cases have slowed significantly in China, the growth of cases outside of China has been increasing rapidly.

Elsewhere in the world, countries are implementing measures to mitigate the spread of the virus. For example, Italy, which has seen a sharp spike in cases, has shut down all retail shops except for grocery stores, pharmacies and a few others, in addition to limiting travel and large gatherings.

Similar actions have also taken place in the U.S., including cancellation of many events and conferences, closing of schools and college campuses, a ban on travel to and from Europe, suspension or postponement of the major professional sports leagues, and cancellation of March Madness.

These measures, while helping to slow the spread of the COVID-19, impact economic activity, which affects the expected earnings of companies and their stock prices.

Uncertainty continues

Presently, there is a high degree of uncertainty over the future course of the virus and the extent and duration of the economic damage. This uncertainty fuels the high level of volatility in markets.

- Markets have been disappointed with the actions taken so far by the government to react to the crisis. Although the Federal Reserve (Fed) has cut rates and implemented other measures to support the functioning of the markets, fiscal stimulus plans are currently unclear.
- Stocks have fallen sharply, but this decline is from record levels. While we have entered a “bear market” with the S&P 500[®] down more than 20%, we are at levels last seen in early 2019, just a little more than a year ago. Valuations are becoming more attractive, but uncertainty over future earnings persists.

Calming measures

So, what is needed to help calm markets?

- Steps by the government to mitigate the impact on the economy and markets, including fiscal and other measures to support both households and businesses impacted by the economic slowdown.
- Further steps by the Fed to provide liquidity to the markets, including rate cuts and an infusion of money into the economy. An end to the oil price war triggered by Saudi Arabia and Russia, which has caused oil prices to collapse.
- Greater certainty over the severity of the COVID-19 outbreak, particularly a decline in the growth rate of new cases. Such a decline has already taken place in China.

We expect market volatility to continue but ultimately decrease as markets gain increased clarity on the global pandemic and the economic fallout. That would allow markets to find a level that is appropriate based on the risks.

It's important to remember that the U.S. economy was structurally sound heading into this crisis, with low unemployment and strong household finances.

In summary, this crisis will pass with time as others have before, and markets will begin to price in a recovery. Although volatility and uncertainty are likely to persist for a period of time, we see the potential for a quick market move upward as the uncertainty lessens. While investors should be prepared for these possibilities, it is important to put short-term volatility in the perspective of a long-term financial plan.

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