

## Markets start the week in flux over coronavirus concerns

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After an historically volatile week in the financial markets, global markets have opened the week in a steep drop. European stock markets were down more than 7%, while Asian markets dropped 3 to 5%.

In the U.S., an early drop in stock prices triggered market mandated “circuit breakers.” These trading rules are put into effect to blunt the effect of a cascade of falling prices that can feed on itself in illiquid and disorderly markets. The first level is a halt of trading when the market is down 7%, followed by a 15-minute “cooling off” period before trading resumes. We saw that in the market this morning. Another circuit breaker would take effect if stocks reach a 13% downside limit on the day.

### What caused the sell-off?

In short, the market is now paying attention to epidemiologists and public health experts who are gaining a much better grasp on the rapid spread of the COVID-19 epidemic rather than to central bankers or politicians.

In the past week, the statistical models that public health experts used to forecast the exponential growth of viral outbreaks appear to be coming to fruition. The number of countries reporting infections is rapidly increasing, while the total number of worldwide cases is multiplying at exponential rates.

Italy has now taken the extreme step of quarantining entire areas in the northern part of the country. In the U.S., Seattle has become a so-called “hot spot” of infection and is beginning to take steps to try to suppress further transmission. In short, this is now clearly not a short-term health crisis but is one that needs a rapid and coordinated response.

Currently, it is impossible to understand the full impact of the COVID-19 outbreak both from a public health perspective and an economic perspective. However, clearly the environment is profoundly changed from just a month ago. Here are a few things to consider:

- There is increasing evidence that this outbreak cannot be contained globally, but it can be suppressed if strong action is taken. China has demonstrated this with its very assertive response. Currently, the growth rate of infection in China has declined considerably.

- The virus is now moving rapidly into the rest of the world, including the U.S. Many countries, including the U.S., appear to be ill-prepared for this type of public health crisis. In the U.S., although \$8.5 billion has been quickly authorized to fight this problem, it will take time to put together an effective plan to deal with the outbreak.
- Economic activity will be hurt in the short term, which could lead to an economic downturn. However, after more than 10 years of healthy economic expansion, a downturn should not be surprising. Fortunately, in the U.S., consumers entered this volatile period in very good shape, with historically high employment, rising incomes and relatively low debt.
- Oil prices have crashed as a result of both the realization of sharply lower economic activity and production disagreements between OPEC and Russia. The collapse in oil prices could be a severe blow to the shale industry in the U.S.
- The financial markets may take time to stabilize. Near-term volatility is nearly assured, while potential further equity market declines are very possible.

When this crisis winds down—and they always have—it will be important to consider the basic market fundamentals of long-term earnings prospects, inflation, interest rates, debt and liquidity. Earnings will be very difficult to gauge for a few quarters, if not the balance of 2020, and corporate debt levels are relatively high.

These factors will be serious headwinds to a swift recovery in market prices. However, a strong and long-lasting countervailing tailwind may come from exceptionally low inflation and bond yields, coupled with central bank policies that are likely to pump up liquidity to help stabilize the capital markets.

In summary, this situation is likely to persist for an undetermined period. Investors need to be prepared for this and stick to their long-term plan. Two old adages come to mind here: “the horse is out of the barn already” and “this too shall pass.”

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