The Wealth Report

GLOBAL ECONOMIC IMPACT OF CORONAVIRUS (OR ANY OTHER PANDEMIC)

Overview

We are currently experiencing the fallout of the spread of the COVID-19 coronavirus worldwide, including here in the United States. It's a perfect example of an unanticipated disruption that can wreak volatility in the stock market. And realistically, this epidemic is likely to continue to drive investor uncertainty over the short term. The long term, however, is another matter.

As of this writing, there has been a wave of new coronavirus cases in Italy, Iran, South Korea and the U.S. While the number of infected people in the U.S. is still inaccurate due to the lack of widespread testing, there are signs that the infection rate in China – ground zero for where the virus was first detected – is beginning to stabilize.[1]

Hypothetically speaking, what are the possible U.S. and global impacts of widespread coronavirus or any other pandemic in the future? How can the average investor help protect his financial portfolio during a market downturn related to a global crisis?

After the first U.S. case of "community spread" of the virus (when the source of the infection is unknown) was announced, the reaction on Wall Street was immediate and severe. In the following week, the Dow Jones dropped 12% and the S&P 500 fell by 11%. It was the worst weekly performance for both indexes since the financial crisis.[2]

It didn't stop there. On March 16, the Dow posted its worst one-day percentage decline since Black Monday in 1987.[3] The drop followed a press conference by President Donald J. Trump, who announced the U.S. "may be" headed toward recession and that the virus outbreak in the U.S. could last until August.

The China Factor

Americans may be focused on health fears and their investment portfolios, but this phenomenon has far more widespread impact. In just a matter of weeks, the coronavirus brought China, the second largest economy on the planet, to its knees. China is such an influential factor in this crisis because the country has become perhaps the most significant driver of international business operations over the past 20 years.

Consider that during the last major pandemic (2002-2003), China represented about 4% of global GDP. Today, that share has grown to nearly 20%. Not only does China provide leadership and innovation in the technology sector, but it is a major producer in global supply chains for small- and medium-sized companies throughout the world, including the U.S.[4]

Because China is inextricably woven into the fabric of the world's economy, their problems are our problems. This would have been true even if the epidemic had stayed localized to China and did not spread to other countries.

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Monetary Policy

The Federal Reserve acted swiftly to add liquidity to the economy and restore some confidence to the markets. On March 3, the central bank dropped the federal funds rate half a percentage point to a range of 1% to 1.25%.[5] In a surprise move March 15, the Fed cut rates again, dropping rates to near zero.[6]

However, dropping rates doesn't provide much of a panacea in this situation. The economic impact of the virus will likely reduce consumer demand, so companies borrowing more money won't help much if they don't have the demand to warrant expansion efforts.

While the Fed is primarily focused on sustaining current economic growth, it has very little ammunition left should this crisis escalate further or continue for an extended period of time.

"We do recognize a rate cut will not reduce the rate of infection; it won't fix a broken supply chain. We get that. But we do believe that our action will provide a meaningful boost to the economy." – Federal Reserve Chairman Jerome Powell[7]

Fiscal Policy & Other Responses

The Fed isn't the only entity that can help address the impact of the coronavirus pandemic. In Washington, Congress has passed several economic relief bills with aid packages to provide a comprehensive response to help individuals and businesses affected by the virus. As of March 19, efforts were underway on a third, larger relief measure of up to $1 trillion in aid.[8]

A quick response also is happening among philanthropists. Within weeks of spread to other countries:[9]

- The Bill & Melinda Gates Foundation committed up to $100 million toward efforts to help strengthen detection, isolation and treatment efforts, protect at-risk populations, and develop vaccines, treatments and diagnostics.

- Hong Kong philanthropist Li Ka Shing donated $13 million to assist the Chinese city of Wuhan, which has the highest concentration of infections.

- Jack Ma, founder of Alibaba (China's version of Amazon) has committed $14.4 million toward the cause, allocating $5.8 million of that donation specifically to fund research for a vaccine.

However, the most immediate reaction in times of crises like this one tends to happen within companies directly affected by the virus. U.S. firms whose operations are directly affected by a global outbreak are quick to lend support, logistics and expertise to aid in the recovery. While these efforts are largely designed to protect their own interests, individual companies play an increasingly influential role in providing equipment, supplies and other resources as part of the global economy.

It's worth recognizing that the private sector has the experience and infrastructure to scale up to respond to emergencies, in many cases faster than governments. This is especially critical with this type of pandemic, in which the effectiveness of early response is likely to be the biggest driver in how long the crisis will last and how seriously it impacts countries, businesses and widespread populations.[10]

Sector Impact

Companies in a variety of sectors could experience disruptions, including technology, retail, auto manufacturing, travel and tourism, global delivery and oil prices. On the other hand, other sectors could benefit from the pandemic response, such as health care, consumer staples and in-home entertainment (e.g., streaming services, online gaming and communication providers).

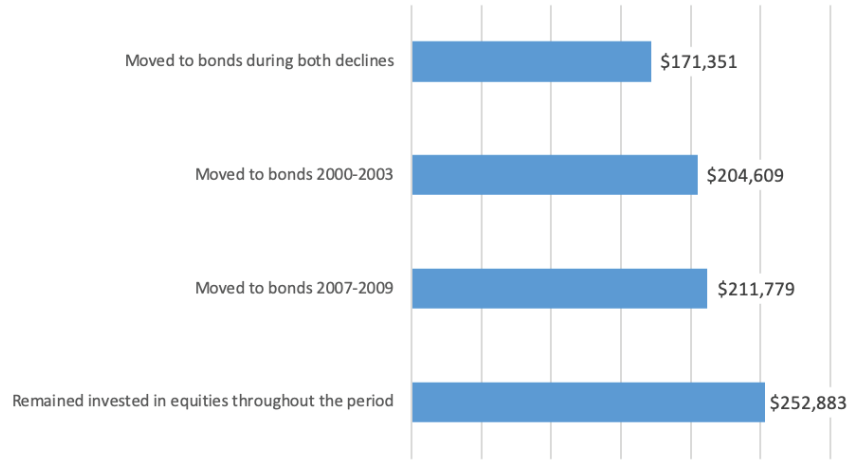
If you want to know what industries could be poised to profit, pay attention to how you and your family spend money over the next month. Amazon, for example, announced on March 17 that they planned to hire 100,000 new workers in the U.S. to fulfill the surge in demand related to the spread of the virus in the U.S.[11]

Panic Impact

With a disruption as significant as the coronavirus, the first reaction of many investors is to panic and sell before their portfolios drop any further. While repositioning assets may be an appropriate strategy for some investors, now may not be the best time to deploy it. Remember the investment edict: Buy low, sell high.

As a visual reminder, the accompanying graph demonstrates how much an investor can lose by exiting the equity market rather than powering through periods of volatility. The chart calculation assumes a $100,000 investment at the start of 2000 and illustrates the total return after 17 years under four scenarios that include moving to a more conservative allocation during two market declines.

Total Return: 2000-2017 [12]



In this hypothetical scenario, the investor's target allocation was 100% to the Vanguard 500 Index fund. The panic scenarios assume the investor moved his money to the Vanguard Total Bond Market Index fund for 12 months after the S&P 500 fell by more than 20% during a calendar year. After being out of stocks for a year, the investor is assumed to have bought back into the 100% equity allocation. This information is not intended to be used as the sole basis for financial decisions, nor should it be construed as advice to meet the particular needs of an individual's situation. Past performance is not an indication of future performance and is not guaranteed.

Investor Options

We don't know how long the COVID-19 outbreak will last, or its long-term impact on the global economy and investment markets. Therefore, it's important that any moves you make in response to the crisis also make sense for your long-term goals and financial future. With this in mind, the following are a few strategies to consider.

- **Hold the line.** Certain stock prices may fall based on how much the company's business model is affected, such as products manufactured in Wuhan, China. However, weigh the temporary price drop against the holding's fundamentals, its track record and long-term growth potential. It is reasonable to expect some companies to be detrimentally impacted by lack of inventory and temporary curbed demand related to the coronavirus, but that may not be a viable reason to sell or reduce your position. Consider longer-term challenges or changes to your own situation before liquidating stocks with a stable record of growth.

- **Bargain shop.** Rather than selling off, consider leaning in. Once you've carefully assessed stocks and believe they will likely rebound going forward, think about whether it makes sense for your portfolio to purchase additional shares during low price swings.

- **Convert to a Roth.** If you've thought about converting tax-deferred assets into a Roth IRA to reduce your income tax bill during retirement, now may be a good time. When prices drop, you'll owe less tax at the time of the conversion and stand to enjoy greater potential for tax-free growth. Also, if you convert early in 2020, you won't have to pay those taxes until you file your return in 2021.

  Keep in mind that a Roth conversion is a taxable event and may have several tax-related consequences. Be sure to consult with a qualified tax advisor before making any decisions regarding your IRA.

- **Transfer your risk.** One way to help reduce your concerns about this virus or any other pandemic in the future is to transfer the risk of loss from your investment portfolio to an insurance company. By repositioning a portion of your assets to purchase an annuity, you can count on receiving insurer-guaranteed income throughout retirement. Knowing that you have a source of reliable income also may provide some relief about maintaining an equity allocation during periods of volatility.

The Wealth Report

Final Thoughts

Many investors have already deployed strategies to help protect their assets from a long-term economic decline. While near-term market volatility is likely to continue in the coming months, the long-term consequences will depend on the length of time it takes to get the contagion under control. For now, it remains unclear if the pandemic is severe enough to disrupt the long-term growth of the global economy. However, this is one of those times when that three-to-six-month emergency cash fund financial advisors recommend may come in handy.

As always, we encourage you to consult with an experienced financial advisor to address specific concerns about your investment portfolio.

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