The Coronavirus and the Global Economy: Part II

March 2, 2020

For investors in the equity markets, the past week has been traumatic. Even though the economy continues to gain strength, the ongoing threat of the coronavirus and the impact on the global economy continued to reverberate through financial markets. Due to the cancellation of many corporate and public events to keep people safe, transportation and travel and leisure companies have nosedived. As a result, we expect to see downgrades to many company earnings and a lower forecast for total economic growth for the balance of 2020.

While equity markets plunged around the world by record amounts, investors flocked to the safety of government bonds and interest rates collapsed. The ten-year government bond yield fell to a record low of 1.13%! Monetary authorities are indicating a 25-50 basis point cut in the fed funds rate, a key factor in pushing rates even lower. The idea that such rate cuts will somehow alleviate the impact of the Covid-19 virus appears misplaced as there is not a problem of demand but a potential shrinkage in the supply of goods and services as businesses curtail production to stop the spread of the virus. There are other options in the Fed's toolbox. For example, the Fed bought mortgage-backed securities when the bond market was on the verge of collapse in 2008. Income investors who depend on interest on their savings may see a major drop in that income for the balance of 2020 contributing to lower consumer spending. Bond investors are huge beneficiaries of this interest rate downturn, but such gains may be temporary if there is a short-term surge in prices due to a slowing supply of goods and services. Inflation, even if temporary, might trigger a selling panic in the bond market. A good strategy would be to move some funds out of bonds that have rallied into a diversified stock portfolio that targets income as a primary objective.

The global reaction to the coronavirus appears to be an overreaction to a "flu" virus that has a different name. There has been virtually no reaction to the traditional annual flu virus that produces upwards of 30,000 deaths in the U.S. every year. And little has been mentioned about the locust plague in Africa where 20 million people could face starvation. The Covid-19 panic may continue as the number of cases and deaths increases around the world. One positive outcome is that the global healthcare community is collaborating to develop a vaccine that cures not only this virus but future viruses that are likely to emerge in coming years.

Long-term investors are likely to see buying opportunities in this decline. The virus panic will end, and economic activity will bounce back. The problem is what happens between now and then. As we have said, expect continued volatility until we can see some light at the end of the tunnel.