

MARKET STRATEGY VIEWPOINT

What We Know So Far

February 25, 2020

We believe there has been a clear economic impact from the coronavirus across all world economies, although forecast visibility remains limited.

The connectivity of global supply chains and the importance of international sales to U.S. means the coronavirus should have some domestic economic impact as well.

The disease remains largely concentrated in mainland China, yet recent spread to other regions of the world, and the steady increase of known cases, remains troubling.

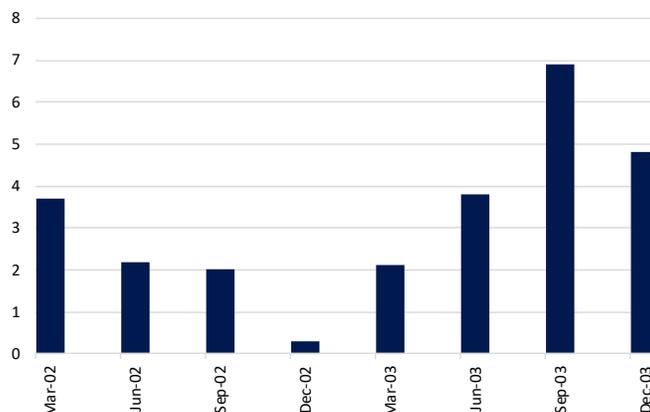
Coronavirus Covid-19 Impacts Difficult to Forecast

Given the fluidity of the problem and the daily changes in the population affected by the disease, the economic impact associated with coronavirus Covid-19 is decidedly difficult to forecast. Early expectations for Covid-19 impacts have been built around past knowledge of the 2003 SARS virus (another coronavirus strain) outbreak, which was largely contained and short-lived. The first SARS case was detected in the fall of 2002 and the pointed concern over the disease extended to July of 2003. It infected 8,098 people and caused 774 deaths according to the World Health Organization. The domestic economic effect was short-lived as well, as SARS negatively impacted U.S. GDP in late 2002 and early 2003, but growth snapped back late in 2003. Covid-19 has already infected more people, caused more deaths, and the rising trajectory of known cases remains problematic.

So far, forecasters are building-in only modest Covid-19 effects into their GDP projections. However, the International Monetary Fund has warned that protracted virus effects could put downward pressure on its recent forecasts. On Feb 22nd, the IMF announced it was reducing its 2020 China GDP forecast from 6.0% to 5.6%. The previous forecast was only just set in January. Also on Feb 22nd, the IMF also adjusted down its World GDP forecast by 0.1% to 3.2%. So far, 53 cases (2/25/2020) of Covid-19 have

Figure 1: SARS Economic Impact—U.S. GDP Quarter over Quarter % Chg. 2002-2003

Source: Bloomberg



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Control of Covid-19 seems to be the primary line of defense and vaccine availability may be 12-18 months out, according to the U.S. government.

been reported in the U.S., according to Johns Hopkins University, and the economic influence, in terms of current forecasts, appears limited to-date (see Table 2). However, China's slowing is expected to negatively impact the global supply chain. The ramifications, we believe, are likely to be negative for international companies and world economies, including the U.S. Overall visibility into Covid-19 effects on corporate profits and overall U.S. GDP growth remains limited, and many current forecasts include only "base-case" outcomes. Further extension of the current pandemic may see forecasters begin to build-in more severe scenarios.

It appears understanding and control of the disease will be the first and most important line of defense for health institutions. The National Institutes of Health (a U.S. governmental agency) has indicated that a vaccine for Covid-19 could be 12-18 months away even with expedited approval from necessary agencies. Various private and public institutions in China, the U.S., Europe and Australia are currently working on a vaccine.

The number of Covid-19 cases and deaths has been increasing daily, although mortality rates, relative to SARS, remains low.

Table 1: Covid & SARS Life Impacts—Data as of February 25, 2020

Source: U.S. Centers for Disease Control and Prevention, Johns Hopkins University

Covid-19	Confirmed Cases	Total Deaths	Total Recovered
Total	80,289	2,704	27,840
Mainland China	77,660	2,655	27,587
Japan	160	1	22
Italy	270	7	1
U.S.	53	0	5
SARS	8,098	774	7,324

Capital Market Impacts

From a capital market perspective, we believe investors were initially anticipating Covid-19 could impact economies and markets similar to the 2003 SARS case. That is, a quick handle on the Covid-19 disease could mean swift alleviation of economic impacts and result in a material economic recovery. However, the rising trajectory of Covid-19 cases and the world spread of the disease has now caused doubt in those earlier expectations.

Given the height of equity valuations and the recent run in equity prices, we believe it stands to reason that capital markets would undergo some asset price correction. The lack of visibility around Covid-19's economic ramifications may keep volatility relatively high over the near-term. This could mean intermittent days of both materially positive and materially negative equity market performance.

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We anticipate current volatility and likely negative economic effects from Covid-19 will have western central banks, and potentially fiscal policymakers, taking measures to offset some near-term conditions. Asia-Pacific central banks have already pulled several levers in their attempt to add stability to the financial and economic system. In the current environment, western central bank action could be positively reflected in asset prices, although the uncertainty over Covid-19 may still prevail.

In this forum, we have been relatively cautious on capital market conditions coming off a Q4 2019 that, we believe, caused some excess in asset prices. We postulated that some gains in Q4 could be “given back” through a modest asset price correction in Q1 or Q2 of 2020. The presence of Covid-19 uncertainty only serves to amplify that near-term concern.

While we believe the ingenuity of the global health community and some passage of time will cause the alleviation of intensified disease concerns, we believe prudence demands that investors now take time to ensure their capital market risk profiles fit their current life-cycle stage. We believe well-calculated equity exposure should be maintained, although high-beta impulses that may have been brought about by the recent equity run should be repressed and redirected.

Table 2: GDP Year-over-Year % Growth Rates and Current Forecasts

Source: Bloomberg consensus estimates

	2015	2016	2017	2018	2019	2020E	2021E
U.S.	2.9%	1.6%	2.4%	2.9%	2.3%	2.0%	1.7%
Eurozone	2.1%	1.9%	2.5%	1.9%	1.2%	1.3%	1.4%
U.K.	2.4%	1.9%	1.9%	1.4%	1.4%	1.4%	1.5%
Japan	1.3%	0.5%	2.2%	0.3%	0.8%	0.7%	0.5%
China	6.9%	6.7%	6.9%	6.6%	6.1%	5.6%	5.8%
World	3.5%	3.4%	3.8%	3.6%	2.9%	3.2%	3.4%

Bloomberg consensus forecasts may differ from that of the International Monetary Fund.

These estimates are subject to change based on the trajectory of Covid-19 cases, additional clarity on economic impact, and other factors.

Risks

Investors should be aware of the risks associated with all portfolio strategies, and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance, our macroeconomic theories, and the effectiveness of strategic and tactical portfolio approaches.

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