Beacon Trust
INNOVATING WEALTH STRATEGY

February 27, 2020

Coronavirus Update

Given the volatility in the stock market, we believe it is appropriate to follow up on our prior thoughts on the Coronavirus (COVID-19) epidemic. As of the time of this writing, there are 81,400 confirmed cases of Coronavirus across 37 countries with 2,770 deaths, resulting in a mortality rate of 3.4%.

In our view, it is likely that the virus will continue to spread on a worldwide basis, but the economic impact will be limited primarily to the first two quarters of the year and that the drop in equity prices may eventually result in some good buying opportunities. Diversification, a staple in our risk management approach, is working as intended. Although equities are down year to date and the S&P 500 is in correction territory, high quality fixed income securities are up, as are interest rate sensitive securities, such as utilities, real estate, and infrastructure. Traditional “safe haven” investments, such as gold and portfolio protection strategies, are also in positive territory.

To put things into perspective, there have been 26 corrections since World War II in U.S. stock markets. The average loss was 13.7% over a four month period. It has historically taken four months on average to recover. Corrections are normal and expected. They often provide investors with an attractive entry point for a pending investment.

Companies most impacted by the spread of COVID-19 are those reliant upon China’s supply chain, travel companies, energy companies, and those firms that rely on China for a material part of their sales, such as luxury goods companies, auto companies, and some technology companies. We expect earnings and GDP to be reduced globally, but don’t yet see the U.S. moving into a recession unless consumer confidence drops substantially for an extended period of time.

The financial media tends to focus on the areas with the largest losses, but there are always countervailing effects at play. The drop in interest rates has moved the benchmark 10-year Treasury Note to an all-time low. The drop in rates makes it cheaper to finance or refinance things (e.g., home, car, college tuition, etc.), effectively putting money in consumers’ pockets. The market is pricing in that the Federal Reserve will cut short-term rates three times this year (0.25% each cut). Lower interest rates will eventually make equities relatively attractive again. China is starting from a higher level of interest rates, 4%, and is enacting fiscal stimulus, as well as interest rate and reserve requirement cuts.

In most circumstances, the investor fear and the disruption to global supply chains delays demand but does not destroy it. For example, a single car has about 30,000 parts. If a manufacturer is missing a steering wheel, for example, it can’t ship the car. This delay pushes back demand for the car, iPhone, etc. but doesn’t eliminate it. A planned trip to Italy, for example, may instead result in a trip within the U.S., such as to Yellowstone Park. The same substitution effect is true for many other products and services as well. We are monitoring conditions closely but believe the prospect for a second half economic rebound remains good. The life of a typical epidemic is 3-6 months and health conditions tend to improve in the spring.

As always, we recommend maintaining a diversified portfolio with an appropriate level of risk, and keeping a long-term investing horizon as the best ways of navigating volatile markets.

If you have any questions or would like to have an in-depth discussion, please feel free to reach out to any of your Beacon team members.

Beacon Trust Investment Committee

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