Insights on the recent market action

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After an extended period of calm, the last couple of weeks have seen market volatility increase and on Monday, February 24, equity markets sold off around the globe due to heightened concern about the Wuhan coronavirus (now officially known as COVID-19). While reports in recent weeks have been positive and indicated that China had experienced a slower pace of growth in the infection rate, we are now seeing more examples of the virus spreading within other nations. Many investors are now concerned about a broader impact on economic growth outside of China.

What caused the market reaction?

In mid-January, markets began to react to newsflow that COVID-19, a novel coronavirus, was rapidly spreading. The reaction was based on concerns that a slowdown in economic activity may impact global economic growth, and these fears led investors to move away from risk assets and into those deemed to be safer, like sovereign bonds. China responded quickly to news of the outbreak, extending the Chinese New Year holiday period, restricting travel, and establishing mandatory quarantines in order to reduce the likelihood that the virus would spread. These measures appeared fairly effective – over the last few weeks data suggested that the growth rate of the infection had slowed considerably, and equity market volatility settled as fears abated. While uncertainty around the economic impact of these containment efforts persisted, the expectation was that the damage would be largely isolated to China's economy and was likely temporary in nature.

In recent days, reports that COVID-19 has spread beyond Mainland China have once again brought the virus to the forefront of the news cycle. Over the weekend, it was reported that more than 30 countries now have at least one incidence of infection, with South Korea, Japan and Italy reporting over 100 cases each. After experiencing some weakness last week on reports of supply disruptions due to stoppage in manufacturing activity in China, equity markets reacted further on Monday, selling off to the tune of 2-4% and sending U.S. treasury yields towards record lows. Investors continue to grapple with the potential impact on the economy of a further spread in the virus and the implications it may have for a prolonged disruption to activity levels.

Looking ahead, the short-term outlook remains somewhat murky. History shows that these types of events tend to be short-lived provided that they do not have a negative impact on the economy. However, the question at this point is the degree to which this virus can be contained and the resulting harm that these containment efforts are having on the broader economy. Our view remains that from an economic perspective, the disruption should be minimal. We are now forecasting global economic growth of 2.9% versus 3.3%, so a 0.4% hit to annualized growth. While not negligible, at this time these expectations are mostly though not entirely attributable to the damage to China's economy rather than expectations of a prolonged or deepening hit to global economies. That said, we remain watchful for further signs of contagion.

The bottom line

From a long-term perspective, it's important to recognize that virtually every year comes with its own set of economic, financial or political events that give investors a reason to remain on the sidelines. The spread of the COVID-19 virus is one of these such events and we remain vigilant for signs of further escalation of the situation and its potential impact to the global economy. While these types of negative shocks almost always lead to weakness in risk assets, equity markets have in the past been resilient and ultimately remained on an upward course over a longer time-horizon. The one thing we know for sure is that the future is uncertain, but investors can benefit from financial markets by investing early, maintaining a long-term perspective and staying invested particularly when invested in a well-diversified portfolio.

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