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Continued Market Volatility Around the Coronavirus

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With today's closing levels, U.S. equity markets have now experienced a full 10% correction largely due to the intensifying spread of the coronavirus and the unknown impact it may have on global economies directly and through the disruption of global supply chains. The first confirmed case in the U.S. of a person with no known Chinese travel links appeared to be the catalyst for the roughly 4.4% stock market decline today. This news raises the probability that U.S. businesses will experience disruptions from the outbreak.

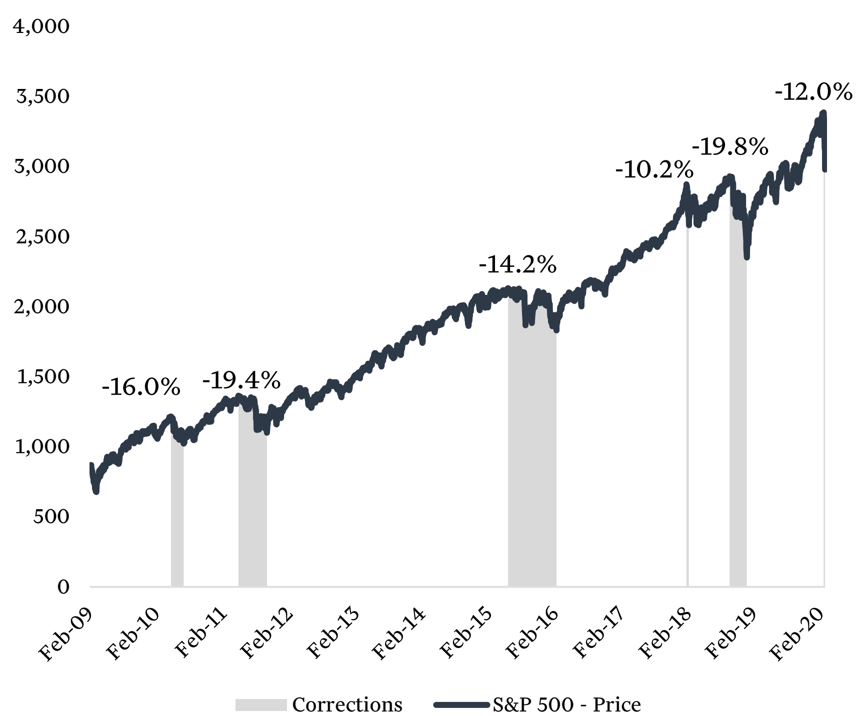
As we attempt to assess the longer-term impact of a situation, which is impossible to calibrate accurately, we will look to discern the difference between a transitory economic growth slowdown, where lost growth is recovered rather quickly in subsequent quarters, and a more permanent impairment. Even if the lost growth is transitory, we must accept that the growth deterioration may not be shallow. First-quarter GDP growth could be as low as 0% in China, and below 1% in the U.S. Notice, we are still expecting growth in both the U.S. economy and corporate earnings for the quarter and the full year. This current base case assessment is subject to change as the situation evolves.

The ten-year Treasury yield moved as low as 1.20% before closing at 1.27%. While the three-month portion of the yield curve is inverted, the more predictive spread between the two- and ten-year widened today. This is a likely sign of an imminent Fed interest rate cut. While some may question the ultimate effectiveness of a rate reduction in what is essentially a supply shock environment, a cut before the regularly scheduled meeting three weeks from now would help market psychology.

Besides the usual safe-haven assets such as U.S. Treasurys and gold, Chinese equities had a positive close overnight, which may be a sign the virus is slowing in China while the impact on the U.S. and Europe is just beginning. U.S. healthcare stocks, especially of those companies that can potentially treat the disease, also had positive returns today. However, most companies that have made announcements over the last few days have generally warned of the negative impact on revenues and earnings at least over the coming few quarters.

As any assessment of the economic impact of the virus is highly conditioned on the potential spread and length of supply chain disruption, recent equity market price drops are likely reflecting a higher magnitude growth shortfall in GDP and earnings than we are currently forecasting. With any valuation excesses having been corrected, the equity markets appear rather attractive at current levels if one believes earnings will still grow for the full year. That said, we believe it's prudent to wait to determine the spread and severity of this novel virus within the major developed market economies, especially in the U.S., before increasing the equity weighting in our portfolios. We remind investors that stock markets regularly experience steep corrections. Since the Global Financial Crisis, the S&P 500 has gone through six such corrections. Each time investors were rewarded for avoiding the temptation to panic.

S&P 500



Source: Factset

Ben Pace is the Chief Investment Officer and a member of the Investment Committee. Prior to joining Cerity Partners, he was Chief Investment Officer, and Head of Global Investment Solutions for Deutsche Bank Private Wealth Management in the U.S. Ben has more than 25 years of experience in investment management. Prior to joining Deutsche Bank in 1994, he managed equity income funds for two investment organizations.