COVID-19, a new coronavirus, is showing potential of developing into a pandemic, hopes of successfully containing the virus deteriorated significantly over the weekend with news of fresh outbreaks in Italy, South Korea and Iran, bringing the virus to a total of 30 reported countries. Early indications that the virus could spread by air as easily as influenza and that infected people could be contagious early on – before they show symptoms – have only increased official concern. In short, while there continue to be more unknowns than knowns about COVID-19, the risk of a global pandemic is looking more likely.

Equity markets, which have been relatively unaffected by these concerns in the past has this week had several straight days of significant losses and increased volatility across all sectors. Is COVID-19 going to be a temporary disruption to growth or the cause of a deeper downturn may not be determined for some time. Investors will likely have to contend with lower yields and heightened volatility for several months.

Many comparisons have been drawn between the coronavirus and the SARS outbreak in 2003. Since then China has become a much greater player in the global economy. It’s now the world’s second-largest economy, behind the United States. China is now also a key player in the global supply chain and Chinese consumers play a big role in global demand.

The virus-related disruption looks like it will next engulf South Korea, Japan, Italy and parts of the Mid-East as many governments have started to close public venues, events and restricting travel over the weekend in the face of hundreds of new cases. The chipping away at activity across these large national economies at a time when the world was already suffering from a dip in growth presents a potential threat of a global recession, or at the very least a bout of weak activity that could be a drag on the U.S. economy.

The good news is that the U.S. economy remains the largest and most resilient of the large developed nations. U.S. growth ended 2019 at 2.1%, slightly above trend, and household consumption – which makes up 70% of the economy – remains supported by a low unemployment rate and high consumer confidence.

This does not mean the U.S. economy is immune against the virus. First, U.S. industry is dependent on inputs from China and the rest of Asia. Chinese manufacturing has already fallen sharply, which could cause a disruption in the global supply chain should it be sustained. Business sentiment could be impacted either because of falling international demand or because of
uncertainty surrounding these global supply dynamics.

But by far the largest risk is that the outbreak impacts U.S. household consumption. For now, this seems unlikely; consumer confidence is much more closely tied to job availability and wage growth. Should the worst-case scenario materialize and a domestic outbreak require some type of quarantine, clearly the impact to the consumer, and thus the economy, would be significant. This remains an outlier event with a small perceived probability for now.

Looking ahead, we expect volatility to remain heightened. There are multiple sources of uncertainty already, including looming U.S. tariffs on select European goods and a U.S. presidential election that could see a policy debate with sharply differing views. The uncertainty surrounding Fed policy in reaction to the virus is enough to add to volatility.

Most analysts continue to see the COVID-19 outbreak as only a temporary disruption and are using the SARS outbreak as a model, anticipating one quarter of extremely weak growth that quickly and entirely reverses given rapid resolution. However, the current situation has already deviated from the SARS episode in many ways and could stand to have a more lasting impact.

Market drops are an unavoidable feature of investing. What matters is how you respond—or, more to the point, don’t respond. Sometimes the best action to take is no action at all. Your portfolio is built for your time horizon and risk tolerance, so we continue to recommend that investors focus on diversification and rebalancing with an emphasis on quality growth at reasonable prices.

The information provided here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice. The investment strategies mentioned here may not be suitable for everyone. Each investor needs to review an investment strategy for his or her own particular situation before making any investment decision.

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