Coronavirus Update & Where Do We Go from Here?

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An Update on the Coronavirus

Brad McMillan, Commonwealth's Chief Investment Officer, shares a framework for thinking about the coronavirus crisis, focusing on the virus itself, its economic effects, and the market implications. Viewed through this lens, it seems the virus is controllable, as seen in China and South Korea. Further, the widespread panic has been a positive, enabling governments to put effective restrictions in place. Still, we're starting to see the economic damage, with layoffs and business shutdowns. Are we headed toward another 2008? Watch this latest video to learn more.

The Coronavirus Pandemic: Where Do We Go from Here?

Authored by Brad McMillan, CFA®, CAIA, MAI,
Managing Principal, Chief Investment Officer, at Commonwealth Financial Network®

As we all know, there's a lot going on in the world right now, with the Coronavirus pandemic being top of mind for many. But with so much information swirling around us, it can be hard to discern the big picture. That is, where are we now and where do we go from here?

To answer those questions, we need a framework to organize all the news surrounding the Coronavirus. Within that framework, the three different issues we should consider are (1) the virus itself and the pandemic, (2) the economic impact of the pandemic, and (3) the financial market implications of that impact. By considering them individually, we can gain some clarity.

The Virus Itself: The End of the Beginning?

The base question is whether the virus is controllable or not. And the answer is yes. In the absence of restraints, the virus will spread-as we saw in China, in Italy, and in the U.S. But when proper restrictions are put into place, it can be brought under control. This idea has been proven in China and South Korea, and Italy is now reportedly stabilizing. Here in the U.S., we understand what has to be done, and we are now doing it. This is the end of the beginning.

Unfortunately, we are not out of the woods just yet. Everyone now knows what to do and why, as well as what the stakes are. If we just stay home, things will eventually get better. But there is usually a lag of about two weeks between the time that restrictions are put into place and when new cases stabilize. So, we can expect the news here to get worse for a while. We are likely past the point of maximum danger, but we are not past the point of maximum impact. Even as the rate of spread slows, expanded testing will make it look like things are getting worse. Expect to see that story in the headlines.

The Economic Damage: 9/11 or 2008?

The economic damage is certainly real. But going forward, the question is whether the next year will look like it did after 9/11-or like 2008.

Right now, the resemblance to 9/11 is much greater. The pandemic is an outside shock to the economy, which has generated fear and will slow consumer and business spending, much like 9/11. As such, like 9/11, the economic impact could pass once the fear does. That is the base case: real damage, but then a recovery as confidence returns. The economic impact will, however, likely be worse than after 9/11. The slowdown in spending is very likely to be worse and longer lasting this time, which could (over time) turn the 9/11 into another 2008.

This scenario is something we must keep in mind, but whether it happens will depend on whether government policy is sufficiently supportive to both workers and businesses affected by the drop in demand. Here, the news is good. The Federal Reserve (Fed) acted fast and hard to provide monetary stimulus. Unlike 2008, the Fed has clearly stated it will do what it needs to do in order to avoid a crisis. The federal government is also in the process of responding with economic support. While that process is not yet complete, signs are that any necessary support will be available, minimizing the chances of another 2008. There will be economic damage, but with proper policy support, it is likely to be limited.

Financial Markets: What's the Damage?

Finally, when we look at the markets, we see a clear expectation that the pandemic will continue and that the economic damage will be substantial. While that still may end up being the case, policy actions both here and around the world have made that substantially less likely in the past week. Signs are that the pandemic will be brought under control and that the economy will get enough support to weather the storm. Make no mistake, there will be damage. But from a market perspective, the question will be whether the damage is greater than markets now expect, or less. Signs are that the damage will be less, which should support markets going forward and eventually enable a recovery.

A Look Ahead

The crisis is not over. We can certainly expect the headlines to keep screaming and even get worse over the next couple of weeks, which could keep markets turbulent. We know, however, what is needed to solve the problem and that those measures are largely in place. By keeping the framework discussed here in mind, we will be prepared for those headlines and able to see the gradual improvement underneath them.

This is a difficult time for everyone, and worries are surging. Although those worries have allowed for the necessary policy changes to solve the problem, worry is always difficult. As we move forward, keep in mind that while the concerns are real, so is the policy progress. In the not-too-distant future, we are likely to see the virus brought under control here just as we have seen in other countries.

My staff and I deeply appreciate the continuing opportunity to work with you. Please let me know if you have any questions or requests. Thank you.

Sincerely,

Paul S. Bonapart, JD, RFC, AIF®, President
Financial Security Planning Services, Inc.
520 Tamalpais Dr, Suites 103 & 104
Corte Madera, CA 94925
(415) 927-2555
www.FinancialSecurityPlanning.com
CA Insurance License No. 0808412

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