INVESTMENT COUNSEL AND MANAGEMENT

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Effect of Previous Viruses on the Markets

The rapid spread of the Wuhan virus has forced economists and market participants to confront a series of questions that are almost impossible to answer. The outbreak has the potential to cause economic and market dislocations. But the scale of the impact will ultimately be determined by how the virus spreads and evolves, which is almost impossible to predict, as well as how governments respond.

At this stage, there are three useful things we can say about the potential economic and market fallout.

The first is that, while past epidemics offer some clues about the possible economic impact, the parallels are inexact. At the risk of stating the obvious, no two viruses are the same. The economic backdrop to the current Wuhan virus is also different from previous epidemics. While it’s tempting to draw comparisons to the SARS epidemic in 2003, China’s economy is now much larger and more closely integrated into global supply chains. An economic shock in China is now more likely to spread to the rest of the world.

The market backdrop is also very different. The SARS virus hit at a time when global stock markets were starting to bottom out following the bursting of the dot.com bubble. In contrast, the Wuhan virus has hit ten years into a bull market for equities.

The second point to make is that the steps to contain the virus – rather than the virus itself – are causing most of the economic damage. It is therefore significant that the response by China’s government has been both faster and more extensive than was the case with SARS.

The third point to stress is that economic dislocation caused by the virus will spread across sectors over time, and this will have implications for the scale of the impact on the rest of the world. The initial disruption was concentrated in the Chinese travel and tourism sectors. But the disruption is now spreading to domestic industry, as factories that should have been opened last Friday following the Chinese New Year holiday remain shut. Given that China is now at the heart of many global supply chains, this will have knock-on effects around the world, but the economic repercussions are unlikely to derail the global recovery.

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As far as the effects on U.S. markets, epidemic-based market panics tend to be short-lived as the diseases are quickly brought under control (6-7 months in the case of the SARS virus).

According to Dow Jones Market Data, the S&P 500 posted a gain of 14.6% six months after the first occurrence of SARS back in 2002-03, with an interim drawdown of 15% (against the backdrop of an overall declining market). About 12 months after that point, the broad-market benchmark was up 20.8%. See table, below, for historical post-epidemic U.S. stock-market reactions.

Epidemic	Month end	6-month % change in S&P	12-month % change in S&P
HIV/AIDS	June 1981	-0.20%	-10.73%`
Pneumonic plague	September 1994	8.22%	26.31%
SARS	Spring 2003	14.59%	20.76%
Avian flu	June 2006	11.66%	18.36%
Dengue Fever	September 2006	6.36%	14.29%
Swine flu	April 2009	18.72%	35.96%
Cholera	November 2010	13.95%	5.63%
MERS	May 2013	10.74%	17.96%
Ebola	March 2014	5.34%	10.44%
Measles/Rubeola	December 2014	0.20%	-0.73%
Zika	January 2016	12.03%	17.45%
Measles/Rubeola	June 2019	9.82%	N/A
			-Source: Dow Jones Market Data

Global markets, as measured by the MSCI All Countries World Index, reacted similarly. In this context, all else being equal, drawdowns during the early phases of epidemic-based market declines might be viewed as buying opportunities.

It is reasonable to expect that U.S. Treasuries, as an international "safe-haven" asset, may continue to rally until the Wuhan coronavirus is contained. (That is what occurred during the 2002-2003 SARS epidemic, but, in addition, the Fed was in the process of lowering the fed funds rate by 75 basis points over this time period.)

Source for the information in this update is SSW Research, Capital Economics, Dow Jones Market Data.

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