What Might the Coronavirus Do to Stock Markets?

Look no further than the SARS outbreak for an idea of the implications

On Friday, January 24, 2020 news of a second case of coronavirus in the U.S. pushed the stock market down 1% as investors scrambled for the cover of perceived safer assets, including U.S. Treasuries.

News that the Center for Disease Control and Prevention are currently testing over 60 more here in the U.S. is likely to continue to stoke fears that the Chinese virus will impact markets in the U.S. and around the globe. And in just a few short days, the coronavirus has been responsible (partly at least) for:

- Airline stocks in both the U.S. and in China getting whacked as American Airlines and United Airlines are both down about 5% and Air China and China Eastern are down over 14% and 12% over the preceding five days, respectively
- Gaming stocks are being impacted, as shares of Las Vegas Sands and Wynn Resorts each dropped more than 3%
- McDonald's suspended business across five cities in China
- Disney Resort in Shanghai closed

Other groups of stocks have been affected as well and the overall U.S. markets recorded their first weekly loss of 2020 and their worst week since late summer of 2019.

It's Worse in China

The World Health Organization declared an emergency in China but did not declare an international public health emergency – at least not yet.

In China, the outbreak is coinciding with the Lunar New Year and hundreds of millions were expected to travel across China to celebrate. But in Beijing, celebrations were cancelled and cultural sites were closed. The Chinese government locked down 16 cities and restricted travel for over 35 million people.

But, the interconnectedness of our global economies means that the impact from the coronavirus will spread globally, especially since China plays such a massive role in the world's economy. And to reinforce that statement, consider the impact that SARS had almost two decades ago.

The $40 Billion Impact of SARS

In November 2002, an outbreak of SARS – severe acute respiratory syndrome – began in China's Guangdong province, on the border of Hong Kong.

During the SARS pandemic, there were over 8,000 reported cases and 774 deaths, meaning the virus killed 1 in 10 who were infected. Since 2004, there have been no reported instances of SARS anywhere in the world.

Shortly after the SARS pandemic was brought under control, researchers Jong-Wha Lee and Warwick J. McKibbin released a report with the title: *Estimating the Global Economic Costs of SARS*.

The researchers determined that when translated into an absolute dollar amount, the global economic loss from SARS was close to $40 billion. Here is what the researchers said:

"Just calculating the number of canceled tourist trips, declines in retail trade, and similar factors is not sufficient to get a full picture of the impact of SARS because there are linkages within economies, across sectors, and across economies in both international trade and international capital flows. The economic costs from a global disease such as SARS go beyond the direct damages incurred in the affected sectors of disease-inflicted countries. This is not just because the disease spreads quickly across countries through networks related to global travel, but also because any economic shock to one country is quickly spread to other countries through the increased trade and financial linkages associated with globalization.

First, fear of SARS infection leads to a substantial decline in consumer demand, especially for travel and retail sales service. The fast speed of contagion makes people avoid social interactions in affected regions. The adverse demand shock becomes more substantial in regions that have much larger service-related activities and higher population densities, such as Hong Kong or Beijing, China. The psychological shock also ripples around the world, not just to the countries of local transmission of SARS, because the world is so closely linked by international travel.

Second, the uncertain features of the disease reduce confidence in the future of the affected economies. This effect seems to be potentially very important, particularly as the shock reverberates through China, which has been a key center of foreign investment. The response by the Chinese government to the epidemic was fragmented and nontransparent. The greater exposure to an unknown disease and the less effective government responses to the disease outbreaks must have elevated concerns about China's institutional quality and future growth potential. Although it is difficult to measure directly the effects of diseases on decision making by foreign investors, the loss of foreign investors' confidence would have potentially tremendous impacts on foreign investment flows, which would in turn have significant impacts on China's economic growth. This effect is also transmitted to other countries competing with China for foreign direct investment.

Third, SARS undoubtedly increases the costs of disease prevention, especially in the most affected industries such as the travel and retail sales service industries. This cost may not be substantial, at least in global terms, as long as the disease is transmitted only by close human contact. However, the global cost could become enormous if the disease is found to be transmitted by other channels such as through international cargo."

Impact for Investors

The economic fallout from the coronavirus will impact travel, trade, financial networks and just about every single sector one way or another. Whether the impact will be short- or long-term depends on the extent of the outbreak of course.

But before you start unloading your exposure to travel and airline sectors; and before you start stocking up on healthcare stocks; and before you start eliminating your exposure to emerging markets in favor of more developed markets; and before you start moving out of equities into short-term Treasuries, discuss with your advisor.

In fact, before you make any changes to your portfolio allocations, make sure you examine the impact it might have to your overall portfolio and risk profile, as well as any tax implications that you might create.

Your advisor can help guide you through this analysis.