

Virus Spread Rattles Markets

February 2020

- The coronavirus outbreak has accelerated, amplifying concerns about global growth and corporate earnings.
- We anticipate short-term market volatility due to uncertainties related to the virus and its global economic impact.
- Longer-term, we expect business activity will return to normal.

The coronavirus outbreak has accelerated in recent days, amplifying the anxiety of already-concerned investors about its impact on global growth and corporate earnings. As a result, global equity-market volatility has increased and share prices have declined. These events have understandably brought back some of the investor fear felt during the 2008 market meltdown.

We expect volatility to continue for the short-term—as long as the extent of the impact on global economic activity remains unknown, which will likely be until the virus runs its course. But once it does, we have every reason to believe that business activity will return to normal.

Market indicators: mixed messages

We are seeing a mix of current global economic news:

- Initial (“flash”) US Purchasing Managers Index (PMI) readings for February were surprisingly negative—with services at 49.4 versus an expected 53.3, and manufacturing at 50.8 versus an expectation of 51.5. (PMI readings are viewed as an indication of future economic activity. Readings above 50 are considered expansionary/positive. Those below 50 are considered contractionary/negative).
- On the other hand, eurozone flash PMIs improved unexpectedly. Manufacturing moved closer to expansion territory, increasing to 49.1 from 47.9 (beating the forecasted drop to 47.5). Services rose to 52.8 from 52.5 (surpassing an expected deceleration to 52.2).
- Last week, China’s top leaders pledged a more proactive stance in fiscal and monetary stimulus, with the goal of limiting the outbreak’s impact on gross domestic product growth. If engaged, the efforts are expected to be broad-based. China also recently announced measures to alleviate debt pressures faced by small businesses as well as a temporary value-added tax exemption. Should the spread of the coronavirus slow, this

stimulus boost could provide a tailwind to China’s domestic economy and create the potential for a quicker recovery.

- As of last Friday, 24 February 2020, S&P 500 Index blended revenue growth showed some upside surprise for the fourth quarter of last year. FactSet showed blended earnings growth for the Index in the final quarter of 2019, at 0.9% versus an expectation of -1.7%, with 87% of companies reporting actual results. In addition, there are encouraging results on the revenue side. Fourth-quarter blended revenue growth came in at 3.6% versus 2.9% forecasted, with 66% of companies beating top-line estimates. Obviously, the concern is in the future earnings guidance coming from companies after they evaluated the impact of the outbreak on their businesses. Of the 89 companies in the S&P 500 Index that issued their future earnings-per-share guidance, 61 guided lower for the first quarter of 2020¹—but that’s more or less in line with five-year averages. Anecdotal comments from US companies have mostly noted supply-chain disruptions due to reduced business activity in China.

Portfolio managers: business as usual

The coronavirus only became a prominent investor concern about a month ago. As such, we have seen little impact on the general views of our international and emerging-markets managers’, their ability to carry out their investment processes, or the way our managers cover stocks. While this could change if the problem persists, we would anticipate any disruption to be temporary.

In terms of on-the-ground activity, although mainland China is essentially shut down and Korea is on high alert, other cities (including Hong Kong and Singapore) are still accessible despite much less traffic. Singapore, in particular, is mostly business-as-usual despite the cancellation of large gatherings like conferences.

¹ Source: FactSet

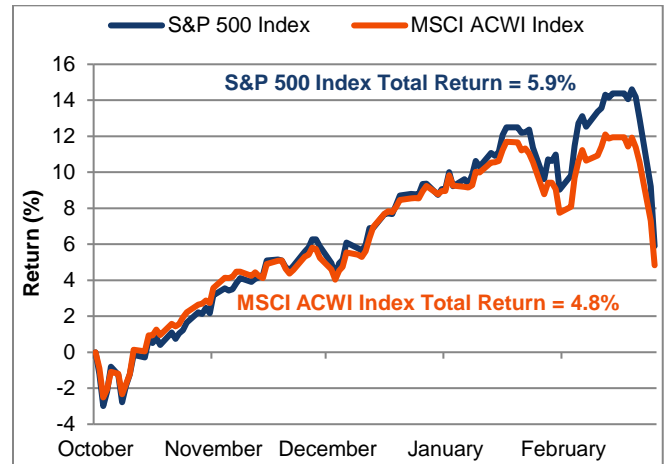
While investment manager research trips may be cancelled, phone and virtual meetings are still taking place, and networks of contacts continue to provide the same level of information, research and local insight.

Markets: muted outlook

As for the impact on stocks, the biggest uncertainty is how long this virus will last. Unfortunately, the forecast changes daily and there are many unknowns. While our managers are closely monitoring the situation, they have not made material changes at this point.

It's also worth noting that major equity markets are still well-above where they started the fourth quarter of 2019 despite the sharp decline over the last few days (Exhibit 1) Extending that outlook back in time would reinforce the significant gains equities have posted in recent years. Some degree of pullback, whether virus-driven or not, is to be expected.

Exhibit 1: Equities are Still Up



Source: Bloomberg, SEI
Net total returns from 10/1/2019-2/25/2020
Past performance is not a reliable indicator of future results.

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