Financially Speaking

Why the Coronavirus Impacts Investments

While meeting with a client last week I took a drink of water that went down the wrong way, resulting in me coughing for the next couple of minutes. Normally that would be a non-event but with all of the headlines about the Coronavirus I felt compelled to explain that I wasn't sick, just drank too quickly.

If you follow the news at all you are most likely aware of the Coronavirus, which first appeared in China and has unfortunately spread to multiple countries around the world, including here in the United States.

While the virus appears to have many similarities with the flu in terms of both the symptoms and how easily it could be spread, the severity of the illness in many that have contracted it and the potentially higher fatality rate has led to a great deal of concern and concerted efforts by governments around the world to limit its spread.

I claim no medical expertise so won't even attempt to comment on how the virus could spread and whether efforts being taken to fight it are either too aggressive or not aggressive enough. I'll leave those discussions where they should be, in the hands of the medical experts who know way more about these things than I do.

What I want to talk about today instead is the recent fall in stock prices and how that relates to the news about the Coronavirus.

As I write this the US stock market is in the midst of another volatile day of trading, capping off what has been a truly see-saw week with the stock market swinging a significant amount in either direction each day. Even that feels better than what we experienced the week before this, when the US Stock market, as represented by the S&P 500 Index, experienced the biggest weekly decline in stock prices since 2008.

You may be wondering how a flu-like virus that, to this point, hasn't been confirmed in a large number of Americans, could cause this type of fall in the price of our stocks – and you wouldn't be alone. So let me attempt to explain.

The price of a stock is largely based upon expectations for the company's future earnings, so when something occurs that changes those expectations the price of the stock will also change. And we already know today that the steps being taken in places like China, Japan and Italy to combat the Coronavirus have had significant, direct economic impacts.

For example, many factories have been temporarily closed, which disrupts the flow of both finished products and parts needed at factories in other parts of the world (think auto parts coming from a factory in China needed to assemble a car in Mexico or even Detroit). Beyond that though is simply the slowing of economic activity as a whole. When people are either told, or choose, to stay home to avoid exposure to others that means that they aren't traveling, going out to eat, attending shows or sporting events. All of that can result in less money being spent, less need for workers and ultimately a slowing global economy – and therefore lower corporate earnings - the fear of which is what is disrupting the stock market so much.

The bottom line is that we don't yet know how much the Coronavirus will actually impact the global economy. Prior viral outbreaks like Ebola, Zika and the Swine Flu also all rattled the stock markets when they first developed but ultimately ended up being dealt with by health experts relatively quickly, allowing the stock markets to bounce back as well. This time could be similar or, if the virus is harder to contain, it could impact the economy for longer.

But even though I don't know how long it will take, what I can say is that I have confidence that stock prices will recover from this decline, just as they have eventually resumed their upward climb after every unexpected event, crisis and recession in history. Good quality companies don't stop making smart decisions because something unexpected happens. In fact, sometimes events like this can be an opportunity for the best companies to shine.

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