Market Extra

How the stock market has performed during past viral outbreaks, as coronavirus spreads to Italy and Iran

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U.S. equity markets have experienced turbulent trade recently as investors keep watch of a deadly viral outbreak of COVID-19 in China. There are now 79,407 cases of COVID-19 in 32 countries and 2,622 deaths, according to the most recent reports.

However, gauged by the market's performance during the onset of other infectious diseases, including SARS, or severe acute respiratory syndrome, Ebola and avian flu, Wall Street investors may have little to fear that the pathogen will sicken a U.S. stock market that finished 2019 with the best annual return in years and finished Thursday trade at all-time highs.

That said, many investors are recommending caution amid the current bout of coronavirus that was reportedly first identified late last year in Wuhan City, China. The ability of the virus to halt travel and harm consumption, particularly in Beijing, are some of the ways an outbreak is likely to have economic implications that could wash up on U.S. shores. "Risk velocity – the pace at which major risks and 'black swan' events can affect asset prices – is elevated in today's markets compared to 10 years ago for three key reasons," said Seema Shah, chief strategist at Principal Global Investors, in a research note, referring to the theory for the impact of unexpected events on markets and economies, popularized by Nassim Nicholas Taleb in his book The Black Swan: The Impact of the Highly Improbable.

The strategist said a social-media driven news cycle, the interconnectedness of global supply chains and a pricey stock market, make Wall Street more vulnerable to a black swan.

"External shocks can derail economic trends and abruptly alter market sentiment. Not all risk is economic policy or monetary," wrote David Kotok, chairman and CIO at money manager Cumberland Advisors, in a recent research note.

On Thursday, the Dow Jones Industrial Average **DJIA, -6.085%**, the S&P 500 index **SPX, -5.731%** and the Nasdaq Composite Index **COMP, -5.013%** all had been trading near records up until Monday.

However, investors have been attuned to updates on the spread of the disease.

Historically, however, Wall Street's reaction to such epidemics and fast-moving diseases is often short-lived.

According to Dow Jones Market Data, the S&P 500 posted a gain of 14.59% after the first occurrence of SARS back in 2002-03, based on the end of month performance for the index in April, 2003. About 12 months after that point, the broad-market benchmark was up 20.76% (see attached table):

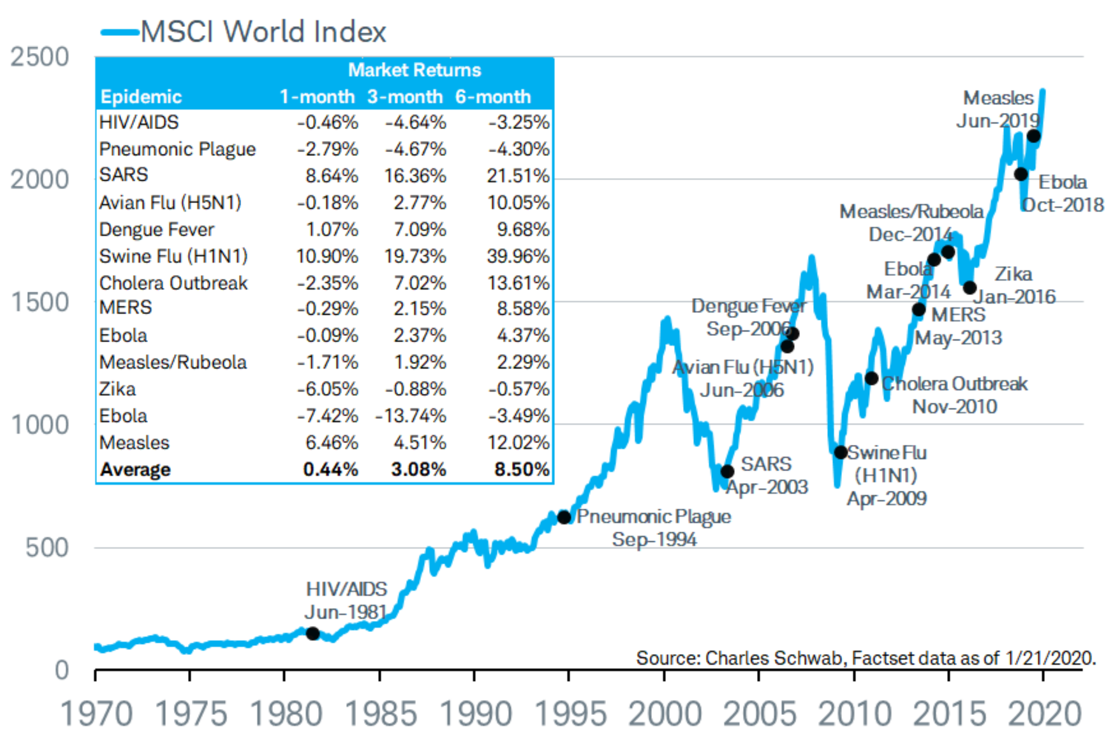
EPIDEMIC	MONTH END	6-MONTH % CHANGE OF S&P	12-MONTH % CHANGE OF S&P
HIV/AIDS	June 1981	-0.3	-16.5
Pneumonic plague	September 1994	8.2	26.3
SARS	April 2003	14.59	20.76
Avian flu	June 2006	11.66	18.36
Dengue Fever	September 2006	6.36	14.29
Swine flu	April 2009	18.72	35.96
Cholera	November 2010	13.95	5.63
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*

SARS resulted in a total of about 8,100 people being sickened during the 2003 outbreak, with 774 people dying, according to data from WHO and the Centers for Disease Control and Prevention.

Separately, the S&P 500 rose 11.66% in the roughly six months following reports of the 2006 Avian flu virus — a fast-moving pathogen also known as H5N1. The market gained 18.36% in the following 12-month period.

Data are similar for equity performance across the globe based on data from Charles Schwab, tracking the MSCI All Countries World Index **892400, -2.04%**. The index has gained an average 0.4% in the month after an epidemic, 3.1% in the ensuing six-month period and 8.5% a year later (see graphic below):

Immune: world epidemics and global stock market performance



	Market Returns		
Epidemic	1-month	3-month	6-month
HIV/AIDS	-0.46%	-4.64%	-3.25%
Pneumonic Plague	-2.79%	-4.67%	-4.30%
SARS	8.64%	16.36%	21.51%
Avian Flu (H5N1)	-0.18%	2.77%	10.05%
Dengue Fever	1.07%	7.09%	9.68%
Swine Flu (H1N1)	10.90%	19.73%	39.96%
Cholera Outbreak	-2.35%	7.02%	13.61%
MERS	-0.29%	2.15%	8.58%
Ebola	-0.09%	2.37%	4.37%
Measles/Rubeola	-1.71%	1.92%	2.29%
Zika	-6.05%	-0.88%	-0.57%
Ebola	-7.42%	-13.74%	-3.49%
Measles	6.46%	4.51%	12.02%
Average	**0.44%**	**3.08%**	**8.50%**

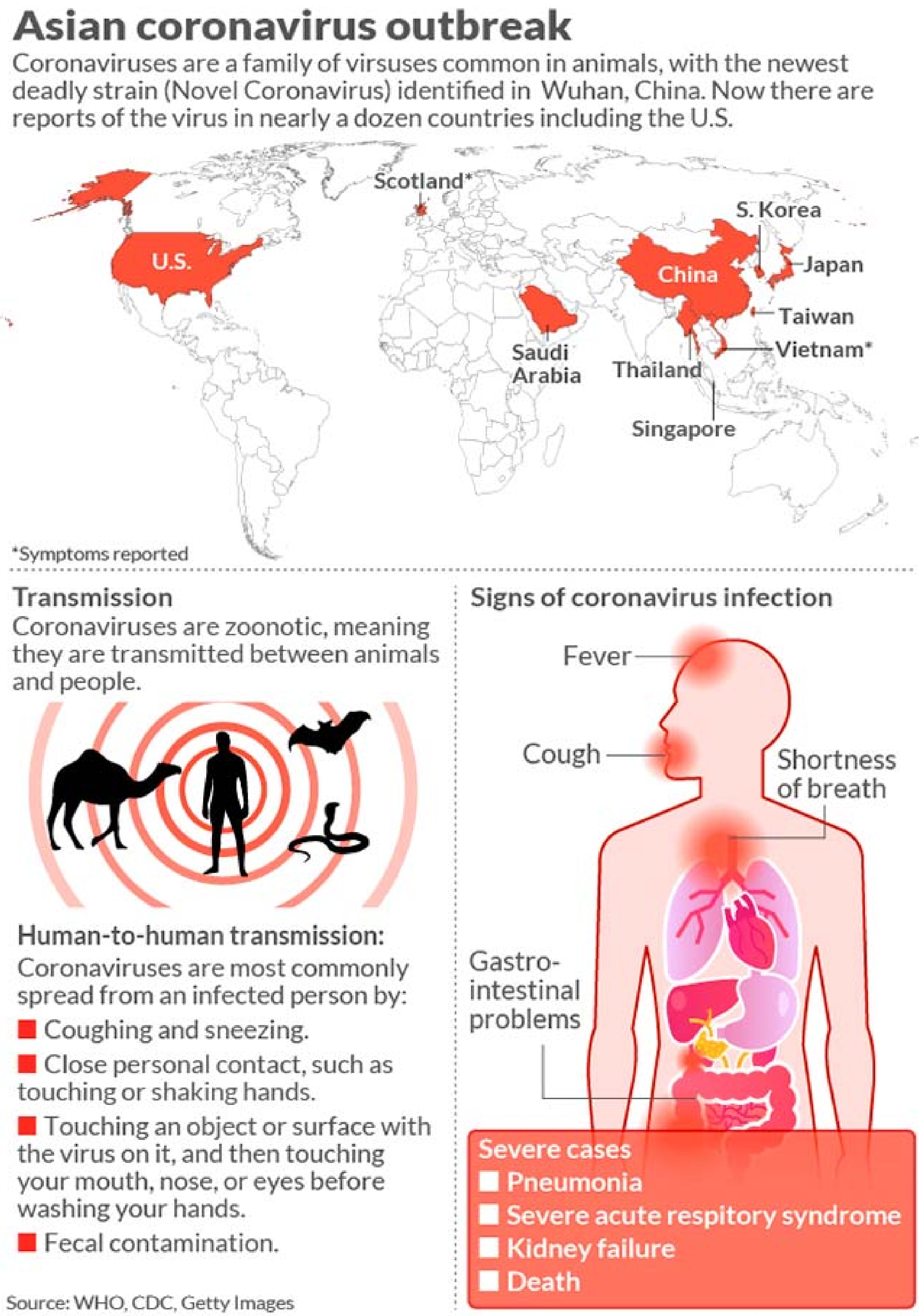
The MSCI World Index captures large and mid cap representation across 23 Developed Markets countries. With 1,646 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. **Past performance is no guarantee of future results.**

The severity of the virus, ultimately, will dictate the market’s reaction and just because indexes had managed to shrug off the contagion from outbreaks in the past doesn’t mean that will be the case this time.

For one, coronavirus occurred during the important Lunar New Year, when Asia tends to see peak travel and consumer spending.

“There are concerns that the coronavirus may spread quickly within and beyond China, causing economic and market damage. This is particularly a concern as travel ahead of the Lunar New Year is getting underway,” wrote Jeffrey Kleintop, Charles Schwab’s chief global investment strategist.

The Wall Street Journal reported that the incubation period for the virus is around 14 days, citing health officials. People are most likely not contagious before symptoms develop.



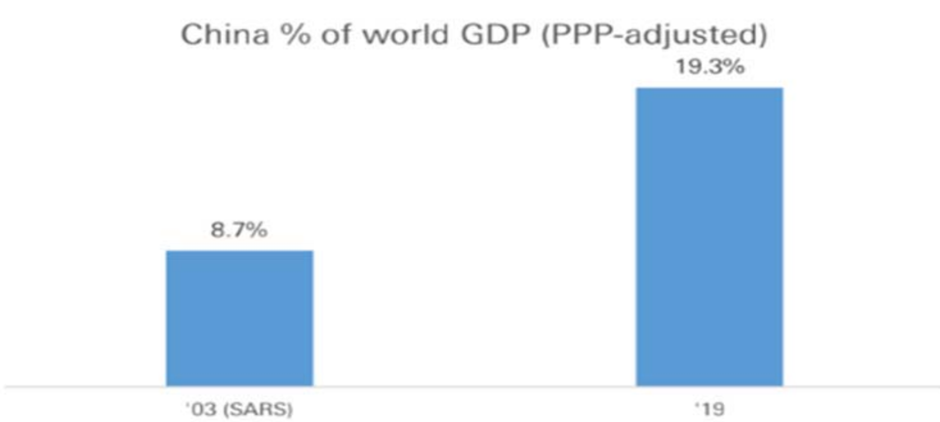
A pandemic couldn't come at a worse time for China's sluggish economy, which slowed to 6.1% rate of annual growth last year, according to gross domestic product figures released last Friday, which reflected the lowest reading for Beijing in nearly three decades.

Experts emphasize that it is important not to generalize the potential for unexpected results from epidemics on economies and markets.

“We cannot draw any fixed conclusions about the effects of pandemics upon stock-market performance. Equity markets react unpredictably to the unknown; nevertheless, such events should not be examined in isolation, but viewed in common with other prevailing market conditions,” according to a 2006 report commissioned by Fidelity Investments and cited by Bloomberg News.

Indeed, potential disruptions to China’s economy and factories could be significant because the country’s share of the world economy by some measures has climbed to 19.3% in 2019, according to data from the International Monetary Fund (see attached chart). That compares with an 8.7% share during the 2002-03 SARS outbreak, according to data from the International Monetary Fund.

Figure 7: China's rising share of world GDP



Source : IMF, Deutsche Bank