February 24, 2020

Weekly Viewpoint

Jitters over the Coronavirus Weigh on the Market

Performance for Week Ending 2.21.2020

The Dow Jones Industrial Average (Dow) dipped 1.38%, the Wilshire 5000 Total Market Index[SM] (Wilshire 5000[SM]) lost 1.09%, the Standard & Poor's 500 Index (S&P 500) finished off 1.25% and the Nasdaq Composite Index (NASDAQ) declined by 1.59%. Sector breadth was negative with 10 of the 11 S&P sector groups finishing lower. For the week, The Technology sector (-2.53%) was the worst performer followed by Financials (-1.26%) and Communication Services (-1.24%). The Real Estate sector bucked the trend, finishing flat (0.0%).

Index*	Closing Price 2/21/2020	Percentage Change for Week Ending 2/21/2020	Year-to-Date Percentage Change Through 2/21/2020
Dow	28992.41	-1.38%	+1.59%
Wilshire 5000	34065.95	-1.09%	+3.59%
S&P 500	3337.75	-1.25%	+3.31%
Nasdaq	9576.59	-1.59%	+6.73%

Market Observations: 2/17/20–2/21/20

After posting solid gains over the past couple weeks, the major market indices finished the holiday shortened week lower reflecting conflicting signals on the containment of the coronavirus epidemic and worries on how the virus may impact global growth. Early in the week, Dow-component and tech-bellwether Apple warned that its revenue may fall short of forecasts due to the coronavirus outbreak in China. The company said revenue this quarter will fall short of its targeted range as the virus has limited iPhone production and curtailed demand in China.

Despite the pullback, the S&P 500 and Nasdaq Composite hit new all-time highs during the week, and both still remain solidly higher on a year-to-date basis. The market's resiliency may be explained by a review of how past flu epidemics have impacted markets.

The conclusion is that these episodes tend to be relatively short lived and any associated selling pressure has generally proven to be a buying opportunity.

While this time could prove different due to the much larger importance of China to the global economy, the People's Bank of China has stepped up efforts to limit the economic impact of the viral outbreak by lowering both short- and long-term lending rates this week. The central bank also plans to offer credit support to businesses hurt by the epidemic, while the government earlier in the week pledged other forms of assistance including technological aid in bolstering supply chains. There is little doubt the Chinese economy will take a large hit to growth in the first quarter, however, according to the historical "playbook," pent up demand over the course of the next couple quarters should help make up for the first quarter weakness.

The worries over global growth has sparked a "flight-to-safety" rally in US Treasuries, which in turn has pushed yields lower (note: price and yield move in opposite directions). In fact, the yield on the 30-year Treasury bond hit a new all-time low on Friday. Expectations that the Federal Reserve will lower rates also continues to rise. According to the CME FedWatch tool, there is now an almost 90 percent probability the Fed will cut rates by the end of the year. While the bond markets message is much more pessimistic than the equity markets, stock investors appear to be betting that the Fed will come to the rescue to limit the damage.

Weekly Economic Data: Last week's batch of US economic data was generally upbeat, although the lagged nature of economic reports suggests its too early to conclude the US economy will not face headwinds from the coronavirus. During the week, the Conference Board's Leading Economic Index (LEI) rebounded 0.8% in January, the most since October 2017. Eight of its ten components made positive contributions, led by jobless claims, building permits, and stock prices. On a year/year basis, the LEI gained 0.9%, a modest improvement over the 0.1% y/y rate in the prior month. Elsewhere, the Philly Fed General Business Activity Index surged 19.7 points in February to 36.7. The gain was the biggest increase since June 2009 and to the highest level in three years, as factory activity in the region jumped. This is the second regional index to show improvement this month, a sign that U.S. manufacturing is on an upswing. On the housing front, January building permits, a harbinger of future housing starts, jumped 9.2% to a 1.551-million-unit annual rate, the highest level since March 2007.

Market View: Despite the recent volatility, we continue to believe the Bull Market remains intact and that further upside is likely over the course of the year. While a repeat performance is not likely (the S&P 500 produced a total return of 31.5% during 2019), the macro environment should remain supportive of additional upside. The Federal Reserve is likely to keep monetary policy stable over the course of the year, inflationary pressure is likely to remain muted, and low unemployment/rising wages, should continue to support consumption – the main driver of our economy.

The rally over the past year has been driven almost exclusively by the expansion in the market's P/E multiple, which in turn, has raised concern that valuation levels are looking a bit elevated relative to underlying earnings growth. After very little earnings growth during 2019, earnings will need to become the key driver of forward returns. According to Bloomberg earnings are expected to rebound in 2020 with current consensus expectations calling for 7.9% growth followed by 11.3% growth in 2021.

While further market consolidation cannot be ruled out, the easing threat of a recession in the coming quarters, suggests the bull market should still have some room to run.

The Week Ahead: Fourth quarter earnings season continues to wind down with around 40 members of the S&P 500 scheduled to release results during the week. It will be a busy week on the data front with several reports due out on the manufacturing and housing sectors. Reports of note include; the December Case-Shiller home price index, the Conference Board's February consumer confidence index, January new home sales, the first revision to fourth-quarter gross domestic product (GDP), January durable goods orders, January personal income and spending, and the University of Michigan's February consumer sentiment survey. The Fed speaking calendar will be on the light side, with just three appearances during the week.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

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