CLARO ADVISORS

Claro Market Insights
Avoid the Pandemic Panic
Don't let fear drive your investment decisions

Recent concerns over the spread of the COVID-19 virus (coronavirus) beyond China has led to a very strong reaction and a change to the near-term outlook in financial markets for investors. What we are currently seeing is a "risk-averse" sell-off in stocks and a "flight to safety" as gold and U.S. Treasury assets have surged. Following the sharp decline in stocks this past Monday and Tuesday, the S&P 500 is now down -3.2% on the year and is off -7.8% from its all-time high achieved just last week.[1] As a matter of fact, the stock markets have quickly given back the entire "Santa Clause rally" and even erased all the gains that have occurred since Thanksgiving. Up to this point the markets had proven quite resilient despite the virus fears, as company earnings have been better than expected. But as markets have advanced and achieved their higher valuations, they have also become more vulnerable to pullbacks.

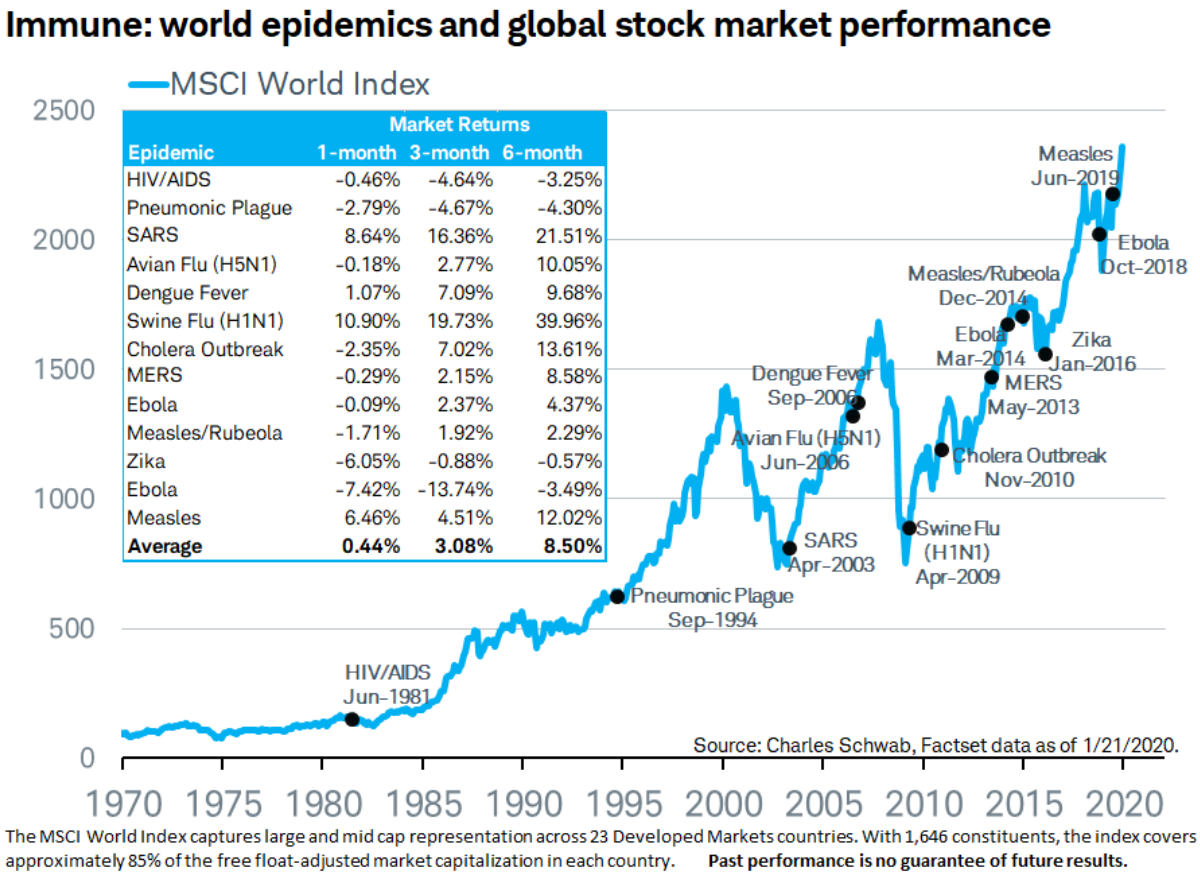
Meanwhile the 10-year Treasury yield has fallen to an all-time low of 1.31% and gold is approaching a 7-year high at $1,650 per ounce.[2] The bond market, itself, has been showing concerns about stalling economic growth for a while now as the yield curve inverted back in early 2019. But following a pivot on monetary policy and a few rate cuts by the Federal Reserve to ease financial conditions, the curve did actually steepen again for a few months. Yet, with virus concerns peaking since the beginning of the year, Treasury buyers have returned, long-term yields have once again fallen, and the curve is again inverted with the 10-year/3-month Treasury spread now negative. Typically, this can portend to slowing economic growth, but we believe this is more reflective of global growth issues than those specific to the United States as U.S. economic conditions and labor markets have remained robust.

Why the quick turn of events for financial markets? Simply put, people expected the Coronavirus to be contained by now. Instead that is clearly not the case and people are fearing that the virus will spread as a worldwide pandemic. Not only is this troubling for the health of many around the globe, but it is expected to have a negative impact on global economies as well. Economic recessions were already being forecasted in Germany and Japan, with slowing growth anticipated throughout Europe, Asia and Latin America.[3] Weaker demand and the impact of tariffs from the Trade War had already slowed global trade and disrupted supply chains. So, it wouldn't take much to make things worse and the concern of a pandemic is now expected to impact trade even further. The view is that a prolonged stall in economic activity with workers and factories on lockdown will exacerbate things and send the global economy into a recession. Hopefully that can be avoided. Central banks and governments will now likely be called upon to respond even more so to help stimulate global economies through monetary and fiscal policy, despite having limited resources to do so.

Not all the news is pessimistic, however. There are reports that the virus is peaking and slowing down and the global medical community is rallying efforts to produce treatments for the virus. Companies such as Gilead and Moderna have even already submitted drugs and vaccines for testing which may prove effective. So, while any loss of life is tragic, hopefully additional losses can be prevented. When it does become contained and the threat dissipates, we would expect economic activity to return as well. Looking

[1] https://ycharts.com/indices/SPX
[2] https://www.treasury.gov/ and http://www.gold.org
[3] https://www.conference-board.org/data/globaloutlook/

at some past examples of outbreaks, such as the Zika virus in 2016, Ebola in 2014 and SARS in 2003, we saw some initial negative reactions as near-term demand and supply chains were impacted. However, while these episodes proved to slow growth, they did not stop it altogether. And as fears mitigated, economic activity quickly resumed, and markets responded positively.[4]



Epidemic	Market Returns 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.**

Therefore, we would caution against over-reacting to headlines and avoid selling into a panic. As a matter of fact, for long-term investors, it really shouldn't be necessary to sell unless you just happen to need the money tomorrow. It is much more prudent to hold steady through these types of declines and if you do own stocks of some good companies, to potentially add to shares on broad market selloffs. From a portfolio construction standpoint, the increase in market volatility and weakness may, in fact, create opportunity for long-term investors to continue to build out their investment portfolios. And while it might not be tomorrow or the next day when the virus is stopped, and even if there is a more extended pullback in markets, you will be glad that you didn't panic and instead actually remained invested.

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February 26th, 2020

[4] https://www.marketwatch.com/story/heres-how-the-stock-market-has-performed-during-past-viral-outbreaks-as-chinas-coronavirus-spreads-2020-01-22