Coronavirus & Markets 26th February 2020

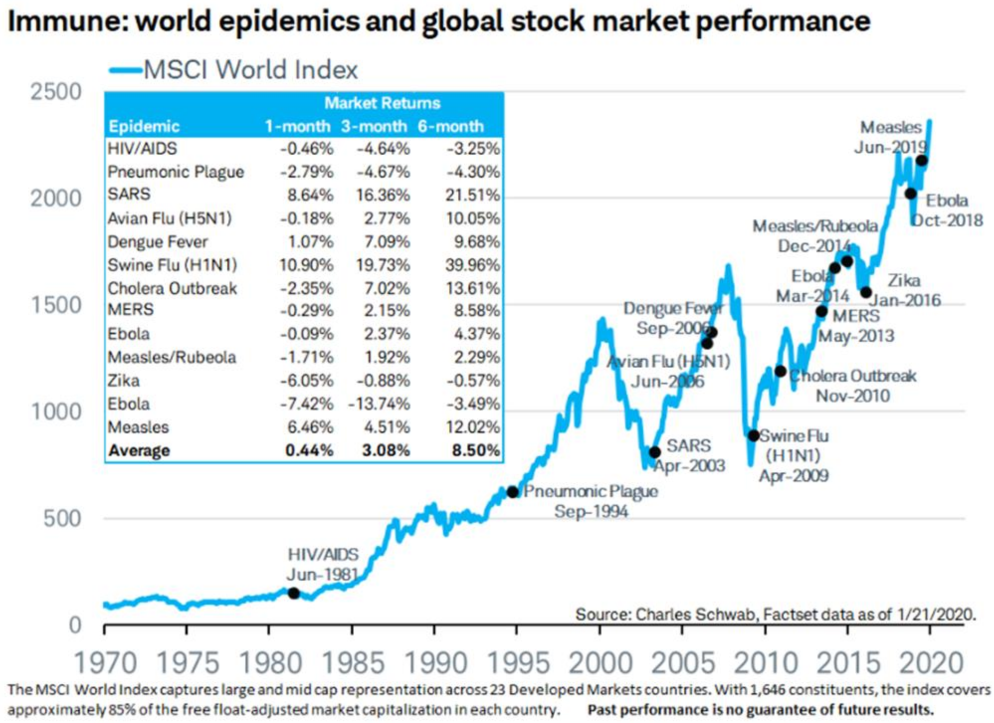
Global equity markets have experienced their worst 2-day slide in 4 years due to coronavirus fears. There are now 79,407 cases of coronavirus in 32 countries and 2,622 deaths, according to the most recent reports with the World Health Organization warning for a pandemic.

Opinions on the effect to global markets are controversial. On one hand, many Wall Street analysts claim that investors should sit tight. Historically, 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 below 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

Data are similar for equity performance across the globe based on data from Charles Schwab. 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):



	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%**

On the other hand, there are also those who are more pessimistic. According to a recent Wall Street Journal article The Coronavirus Scare: This Time Is Different, "*even if health authorities get a grip on the outbreaks, counting on an economic and market recovery may be wishful thinking. Epidemics are of course older than humanity and economic scares as old as markets, but the confluence of a potential pandemic with today's complicated and interconnected world is unique. Globalization has magnified local disruptions, government stimulus is already at once-unthinkable levels and, both ominously and hopefully, technology is far more advanced than during the last truly global pandemic. There realistically are now two broad scenarios. One is that the virus is contained through herculean efforts by health workers in China, South Korea, Japan, Italy, Iran and wherever else it crops up. That will mean rolling disruptions for months. The scarier scenario is that all that occurs and the virus spreads globally anyway*".

As we wrote in our last monthly commentary, we really do not know how this will play out, and like you, we read the scenarios and try and assess the impact on portfolios. Our conclusion is almost inevitably the same. There are always many worries, and the markets have never had a positively clear road ahead when one can invest without worries. Never. It is only hindsight that brings such clarity.

From our experience, panic selling leads to lower longer-term returns in general. Our portfolios are invested for the long term based always on the risk attitude of each client.

The reason we give our clients investor questionnaires is to ensure that their portfolio structure reflects their risk profile. Risk profile has to do with long-term investment objectives and not with market outlook. If one is happy to take on more risk, for potentially more gain, then they should expect that in the short and medium term, their portfolio values might fall. If one cannot tolerate falls, they should be invested very conservatively. As an example, if an investor has a "balanced" risk profile, they can expect that their portfolios will move about half as much as the equity markets move, both on the upside and downside.

Should we (the Elgin Investment Committee) fear an imminent big fall in the markets, all we would do is take our risk to the lower end of the spectrum of each risk profile.

For example, a balanced risk profile normally has 50% in equities. We would take it down to 40%. Conversely, if we are bullish, we would move it up to 60%. What we cannot do is take far more radical steps as we would be violating our clients' mandates for keeping within a certain risk profile and achieving their long-term investment objectives. We cannot attempt to time the markets as we only have about a 25% probability of getting it right. That is, a 50% chance of getting the timing right to sell, and a 50% chance of getting it right to buy back in. Almost inevitably, this will lead to losses for the client. For now, we remain neutral in our portfolios, much as we were at the beginning of January when the Coronavirus hit the news. It is worth mentioning that many of the world's biggest markets including the US and Europe hit multiple all-time highs in the following 6 weeks, even as outbreak and as it got much worse.

As managers, we attempt to add value through diversification and by investing in what we consider are the best securities/funds available within each client's risk profile. As Miles Johnson from the FT recently put it: *Short-term thinking and market timing are the enemies of successful investing. Professional investors should focus on doing the best job they can for their clients, not trying to predict the monthly direction the markets cork will bob in the macro sea.*

There are some cases however in which clients can reduce their risk profile. For example, those investors who will soon need cash. Again, this is not an opinion that the markets will continue to fall – it is just good risk management, having in mind that in the shorter-term markets tend to be unpredictable, while in the longer-term markets tend to generate positive returns. Similarly, clients who cannot "sleep at night" watching markets fall should reconsider their risk profile and leave the implementation to us. We can never tell them how much risk to take. What we can do however is based on their instructions to lower their risk profile and reassess their long-term strategy.

Knowing that human emotion can be much stronger than cold logic, if, despite your risk profile, you still want to bail out of equities, please let us know and we shall oblige. The difficulty will be when to tell us to get back in.

The Elgin Analysts' Team