4 Markers We're Watching for Coronavirus Progress

April 9, 2020

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We entered the new year with fresh economic momentum fueled by global central bank rate cuts and a tamping down of the trade war. Global markets rallied until mid-January, at which point news of a novel coronavirus outbreak in China emerged. Initially, the virus was believed to be confined to China, and U.S. markets continued pushing forward as domestic economic data improved. The S&P 500 hit an all-time high by Feb. 19.

Then it became clear the virus wouldn't be confined within borders, as infections rose in Italy, Iran and South Korea. Today, there are infections globally, with the U.S. leading the world in confirmed cases. And as that reality began to bite, we tipped into bear market territory faster than any time in history. In just 16 trading days, the S&P 500 fell 20 percent before ultimately finding its low point (as of this writing) on March 23, 2020, down 34 percent.

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With no vaccine and no scientifically proven treatments, countries implemented social distancing as a first line of defense against the virus. That, as we now know, has led to widespread business closures and quarantining. Unfortunately, the remedy to limit exponential growth in new cases severely dampens economic growth. Case in point: U.S. weekly initial jobless claims posted their lowest levels since 1969 on Jan. 31 (201,000) and remained historically low on March 6 (211,000). Two weeks later, jobless claims on March 20 reached 3.3 million, which then doubled to a fresh 6.6 million new claims the following week. For context, the previous record for initial jobless claims was 695,000 in October of 1982.

Viewing the economic slowdown from a different angle, Moody's Analytics noted that as of the final week of the quarter, 41 states had ordered some business shutdowns to stem the virus' growth. That caused daily output at the end of March to fall roughly 29 percent from the first week in March.

To say that the virus took the market and policymakers by surprise is an understatement. Now, economists are aggressively rolling back economic forecasts and warning about the future of equity markets. While we believe data-driven economic forecasting has vastly improved over the years, we think this shock throws a wrench into even the most sophisticated models. At this point, we would take any economic forecasts with a grain of salt because we're dealing with a virus. No one knows for certain how it will progress or how long current shutdowns will endure.

Our Framework For Dealing With Virus Uncertainty

Most recessions and bear markets begin with economic excesses that need to be purged. Sure, we may look back years from now and upon reflection see something in the system that was truly broken. But we didn't see signs of damage before the coronavirus. We believe the underlying economy, even 11 years into an expansion, entered 2020 in a good place. The most important component of the U.S. economy, the consumer, spent the entirety of the recovery paying down debt and increasing their savings. The U.S. banking system had similarly repaired its collective balance sheet and is far stronger than it was in 2008.

These comments provide little solace now, but we do believe that, much like with a virus, if you are stronger and healthier at the onset, you're more likely to fend off its worst effects and recover sooner. We believe the underlying fundamentals of the U.S. economy were healthy heading into this unforeseen shock. That could help things get back on track a little more easily. But what does the path ahead, or progress, look like?

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Given the uncertainty inherent in current economic forecasting right now, we're instead looking forward with a broad market recovery checklist. After all, the virus is the root cause of the economic and market downturn, and our ability to deal with and adapt to it will determine when markets push toward new highs. To see where we're coming from, it's helpful to view the current situation as a valley. The coronavirus pushed an otherwise healthy economy into this valley. Unfortunately, no one knows how deep or wide it is. However, we think medical and economic interventions can help shrink the size of this valley, and there are several markers we can look for along the way to see if we're making progress.

Marker 1: Fiscal and Monetary Aid

Given the sudden stoppage in the economy due to social distancing, we have called for and expected aggressive monetary and fiscal policy actions from leaders around the world to stem the fallout. Putting this into our economic valley description, policymakers are backing up dump trucks of aid to fill the economic valley with liquidity for markets along with aid for businesses and consumers. The aid will keep as many people as possible from falling too far or fast into the valley. We haven't been disappointed on this front, as both fiscal and monetary policymakers have aggressively and quickly responded to unprecedented economic deterioration in the past several weeks.

The sheer speed has been impressive. It took only weeks for policymakers to release a large aid package, compared to the nearly one and a half years it took during the Great Recession of 2007-09. The actions this time have been massive, likely approaching $6 trillion dollars, or nearly 30 percent of U.S. annual gross domestic product (GDP).

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We do not expect this relief package to cure all our economic woes. But the ultimate goal is twofold: "buy economic time" while we quarantine and organize our virus response; and, two, limit the damage so that our climb out of the valley is a little easier.

While this plan is not perfect, it can be modified. There will certainly be disagreements on the details of future relief/stimulus packages, but the desire to do more is shared by both parties. In terms of progress, we give this marker a check and believe it absolutely has stemmed deeper market declines and helped push equities higher.

Marker 2: Getting Resources Where They're Needed

The next and most immediate milestone is making sure medical resources are channeled to the people and places most impacted by the virus. We need to make sure our frontline heroes have the right tools to help them safely battle the virus and save lives. Some experts are forecasting a peak in cases in the coming weeks, and if we can show that our medical system is strong and catching up, this will be a big confidence marker for the country and the financial markets.

Marker 3: Scientists Get a Win

We need to see that science, not just social distancing, is turning the tide against the virus. We've made strides on basic testing, but now we need to hear more about potential treatments and, ultimately, a vaccine. There is a huge global research endeavor underway involving both the private and public sector. In the coming months, we are going to get better information on the results of a host of clinical trials.

Marker 4: A Plan to Reopen

Ultimately, the focus will shift to how we get the broader economy up and running again. We cannot remain in our homes and keep businesses closed forever. We need to have a plan that works, even absent a treatment or a vaccine. Unfortunately, the coronavirus could be with us for some time, which means we should have a plan to live alongside it while allowing the economy to function as normally as possible.

In order to have a plan, we need better data and expanded testing. More and better data improves the decisions we make, which can ultimately lead to better economic and health outcomes. We need to know how many people have already been exposed to the virus, not just people who are sick and have been tested. It would be especially helpful to know who got the virus but only experienced mild symptoms or were even asymptomatic. In Iceland, for example, where they have done more random serological testing, almost 50 percent of the cases were asymptomatic.

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This will help on three fronts: identifying potential spreaders; deciphering a mortality rate and projecting future cases to manage hospital resources; and, finally, gauging how, or if, immunity works after people recover (which could help determine who can go back to work first, for example).

The speed and pace that we click through the above markers will dictate how long this bear market and economic contraction lasts. When and how we hit these markers remains uncertain, but even in the face of this uncertainty, we are optimistic that we will recover in due time.

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A Review Of The Two Prior Bear Markets

The bear market and mild recession of 2001 was accentuated by the 9/11 terrorist attacks. No one knew how and for how long terrorism would impact our lives. People had similar reservations about flying in the wake of 9/11 as they do now, for example. Unfortunately, terrorism hasn't vanished from the planet since 2001, but the economy has recovered, people started flying again, and society adapted.

The bear market and recession of 2007-09 evoked arguably a bigger existential question: Would the financial system as we know it survive? At the time, that question was difficult to answer. Well, as we now know, the financial system survived, and the economic growth over the past decade speaks for itself.

While today's uncertainty is high and the outlook is currently cloudy, we remain optimistic that we'll find the answers we need. The market will eventually return to new highs. We are not trivializing the potential for the virus to take us on a path of difficult twists and turns in the coming quarters —financially and personally. Rather, we are simply expressing optimism in our collective resiliency and ability to adapt to changing circumstances.

How Should Investors Deal With Virus Uncertainty?

We firmly believe that long-term financial success isn't built on your behavior during the "good times"; anyone can invest and own stocks during periods of relative calm and certainty. We believe financial success is built on your behavior during the "hard times," or when uncertainty is high and the outlook appears bleak. We're in the middle of one of those hard periods.

With that in mind, we believe there are two foundational rules for wealth accumulation and preservation.

Create a financial plan and adhere to it. Inherent in each plan is an assumption that the world is an uncertain place and unpredictable things are going to happen. Your plan must reflect this reality, and assets should be matched to the goals they are intended to meet. Simplistically put, cash and bonds are for your nearer-term needs, while stocks are for your intermediate to longer-term goals.

Don't fall prey to emotions and behavioral hurdles. We all know that we are not supposed to panic when others panic. We all know that, historically, those who have said, "This time is different" have always been proven wrong. Yet the urge to act during events like these is high.

The most common way people mentally try to side-step the above rules is by asking whether they should get out of the market now and jump back in when the coast is clear. The answer to this is emphatically no. The market is moving 5 to 13 percent each day, both to the upside and downside. No one can predict what happens from one day to the next, but if you miss the market's biggest upside days because you "got out" just to get back in the market, you severely handicap future returns.

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We also note that the hardest decision if you chose to sell is trying to figure out when the bottom has occurred and whether it's time to get back in. For example, after the economic relief package was put in place the market rallied 20 percent over a three-day time period. Was that the bottom? No one knows. But if you decided to sell on March 23, you would currently have a hard decision to make, never mind the missed return.

As an aside, much chatter and commentary has been that the recent 20 percent rally is like the one that took place after the Troubled Asset Relief Plan (TARP) was approved in October 2008. Then, as now, the market rallied heavily over a similar time period only to fall again before we hit the ultimate bottom on March 6, 2009.

We actually take some solace that many believe we have not reached the bottom. Consensus does not have a flawless track record; and if March 23, 2020, was the bottom, we could have people jumping back into the market to try and catch up.

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Many are advising that this can't be the bottom because the economic data has not bottomed. We disagree with the underlying logic because we believe if you wait for the data to change you are going to be far too late. That's because the virus is the root cause of the economic data collapse. If economic data recover, that means the virus has already been controlled, and the market will have priced that in. Take this hypothetical situation: Markets would probably rise sharply the moment a successful coronavirus vaccine is announced. But the vaccine's efficacy won't impact economic data for weeks or months after. That's what we mean by being late.

Here's an example that isn't hypothetical: The unemployment rate in the Great Recession did not peak until October 2009, seven months after the market bottom in March 2009.

Whether or not we've reached the bottom already or will later, long-term investors will likely not be disappointed either way. Perversely, during times like these when uncertainty is elevated, the potential forward payment (i.e., return) for taking investment risk is also high. Indeed, even if a person invested in October 2008, they did not end up being disappointed on a one-, three-, five-, or even 10-year basis (provided they didn't lose the faith and then panic before that ultimate bottom). We believe this time will prove to be no different. Time in the market will continue to outperform timing the market.

Don't Fear Future Changes

There has been much discussion about how this event will forever change the future. We agree that there will undoubtedly be changes to our economy and society as a result of this virus, but we don't believe that should be a source of fear. Every single recession and major event results in change, but many of those changes are also positive. Put differently, society is always shifting, but a capitalistic economy always adapts.

As an example, air travel was forever changed after 9/11. We still fly with additional security measures that we likely don't even notice anymore. More positively, the comments made above about consumers having solid balance sheets and banks being better capitalized are a direct result of the aftermath of the Great Recession, and the roadmap that policymakers are using to respond to this crisis was hatched during that time period.

As we continue moving through this event, we will be thinking about the changes and how their implications could change the investment environment in the coming years. However, what will not change is our continued focus on having a plan, adhering to that plan during the good and bad times, and importantly, investing with a diversified portfolio and long-term focus. History has proven that no matter what the unforeseen event may be, this is the proven method to long-term financial success.