The Impact of Pandemics on Global Financial Markets

Capital Partners
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Memories of SARS (Severe Acute Respiratory Syndrome), Avian Flu and the Ebola outbreaks are being rekindled with the spread of coronavirus and global stock markets are reacting.

It is believed the coronavirus started late last year in a seafood and wildlife market (wet market) in Wuhan, spreading from infected animals to humans. As of March 02, there are 89,064 confirmed cases in 61 countries and there have been 3,038 deaths and 45,064 recoveries.

Recently, the World Health Organisation (WHO) declared coronavirus a global emergency. This kind of emergency declaration typically brings greater money and resources but may also prompt nervous governments to restrict travel and trade to, and from, affected countries.

In the past, the WHO has come under fire for sounding the alarm too early, the flu pandemic of 2009 for instance, which dissipated quickly, or too late for Ebola in Africa. But the WHO's current response does highlight the bigger risk as the global population is more mobile than ever before.

Although coronavirus is in the same family as SARS, we are now learning the virus behaves in a different way as it can be contagious during the incubation period, which lasts from 1 to 14 days, making detection potentially more challenging. China is also reacting differently compared to the SARS outbreak, there has been a lot more transparency and quicker reactions; we may travel more than ever, but we also learn quickly from past mistakes.

Market lessons from past pandemic scares

We are not medical professionals so we will not attempt to predict the future path of this epidemic. However, we understand the history of markets and investor psychology, which can provide some background on how the markets and economy may react – some of which has already become clear.

In early February the S&P 500 reached an all-time high on hopes for a potential treatment for the Coronavirus outbreak and the People's Bank of China flooding money into the financial system over several days to stabilize the market. In Australia, the volatility of financial markets seen in January and February has continued into March, with historically significant daily index movement. However at the time of writing the ASX 200 now sits 9% of its recent high, perhaps now beginning to factor in the significant economic drag the COVID-19 outbreak presents.

Looking at the past pandemics, the hit to the global economy is typically limited. For instance, in 2003, the year that the SARS epidemic was first reported, the MSCI Pacific ex Japan Index fell by 13% from January to March. However, markets subsequently rallied strongly, and index recorded gains of 42.5% for the year.

If you go back further in time, the major flu outbreaks; the Spanish Influenza in 1918, the Asian Flu in 1957 and the Hong Kong Influenza in 1968 also had strong global economic impacts and contributed to short-lived recessions.

Let us see how two global equity markets; the S&P 500 and the UK equity market performed around these three significant outbreaks.

The Spanish Influenza in 1918

To date, this is the most significant outbreak and considered a catastrophe where approximately 20 to 40 percent of the worldwide population became ill, and over 40 million people died.

At the time there was then unprecedented movement of people with the repatriation of troops across the globe in the wake of WWI.

The S&P 500 Index fell by 24.7% in 1918 and rose by 8.9% in 1919. The UK equity market rose by 25.4% in 1918 and by 27.0% in 1919.

The Asian Flu in 1957

22 Delhi Street West Perth WA 6005 / T +61 8 6163 6100 / ABN 27 086 670 788 / AFSL 227148

This is the second most significant outbreak, first identified in East Asia and subsequently spread to countries worldwide. Unlike the virus in 1918, this one was quickly identified due to advances in scientific technology therefore the death toll was estimated to be around 700,000 – an horrific number by today's standards.

The S&P 500 Index rose by 24.0% in 1957 and by 2.9% in 1958. The UK equity market fell by 5.8% in 1957 and rose by 40.0% in 1958.

The Hong Kong Influenza in 1968

Within two weeks of the virus in July 1968, some 500,000 cases of illness had been reported in Hong Kong. The virus spread swiftly and by end of December had spread through the United States, United Kingdom and countries in Western Europe. The Hong Kong flu resulted in an estimated over one million deaths.

The S&P 500 Index rose by 12.5% in 1968 and by 7.4% in 1969. The UK equity market rose by 57.5% in 1968 and fell by -15.6% in 1969.

Now, in the midst of COVID-19, it is not very wise to draw any conclusions about the stock-market performance. Equity markets react very quickly to uncertainties and the prices instantly adjust to the new data. So, events like coronavirus should not be examined in isolation but viewed in common with other prevailing market conditions. What makes this outbreak different is the mobility of the global population. The actions taken to date by the Chinese Government in isolating cities will undoubtedly impact economic growth this year, and the longer the isolation, the greater the impact.

Similarly, countries with close links to China like Australia will suffer an economic downturn, just how long it lasts will depend on the control and eradication of the virus.

For months now, markets have been concerned with the state of geopolitics, Trump, trade wars and Brexit dominating the headlines. This left-field event could never have been predicted and is evidence that predicting economic futures and markets is extraordinarily difficult.

If the spread of the virus can't be contained, markets will eventually react to the inevitability of slowing economic growth – we just don't know when.

It is a normal human trait to seek control over our lives, yet occasionally events from left field can leave us feeling exposed. As the COVID-19 drama unfolds, it remains possible that the economic impact could be considerable – only time will tell.

Sound financial planning and portfolio design should always factor in left-field events, whatever they may be, so that a surprise event does'nt upset well laid plans.

As we like to say, 'it is always better to prepare, than repair!

In a world filled with political, economic and social uncertainty, sound financial advice – advice based on evidence and your values and life goals – holds the key to a happier, healthier life. This is what we believe at Capital Partners. And our experience helping hundreds of clients build wealth with purpose bears this out.

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