Stirling Bridge
Wealth Partners, LLC

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A Novel Virus. The Usual Outcome?

Coronaviruses as a class are endemic to human society. It is thought that up to 4% of all common colds are caused by versions of them. Our readers and your intrepid writer likely carry the antibodies that would prove we had suffered from earlier infections.

Of course, the Wuhan bug is something a little different. At first, it was thought that all those infected in China had connections to a large animal market. This would make sense since coronaviruses spend most of their time haunting birds and other creatures. However, reports seem to indicate that it is jumping from person to person as do most respiratory viruses. In the midst of all this, the global health community deserves some bit of praise, we believe, for reacting so quickly. While the response hasn't been perfect in any way, the rapidity with which public measures in the US and abroad have been put into place is astonishing.

From our perspective today, we aim to tease through the myriad of facts and hearsay swirling about to determine what effect, if any, this novel virus will have on China and global economic growth.

If the numbers coming out of China are to be believed, the death rate for the Wuhan virus is 2 – 3%. While certainly lethal, it remains much less deadly than the 2003 SARS virus that claimed 10% of its victims. And most of the folks who have passed away were in an elevated class for risk (think the very old, very young, or otherwise compromised). This is in sharp contrast to the 1919 flu pandemic that claimed a disproportionate number of lives from the healthiest cohorts of society.

SARS reduced China's GDP growth by about 0.8%. Given that the provinces now under travel and work restrictions account for almost 70% of China's economic production, we expect the crimp on Chinese growth to be higher than was SARS, perhaps up to 2%. On a global basis, this means the world's GDP expansion this year might be 0.5% lower than the forecasts previously expected. Almost all of this speedbump should be felt in 1Q 2020, with diminishing effects into 2Q.

And now that we've got a number to work with, we can begin to price securities as we normally would – based upon their earnings, risk, and growth rates.

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On a whole, fundamentals remain sound. As 4Q numbers have been reported, we've seen firm growth and improved forecasts. Two-thirds of companies have beaten expectations so far. Admittedly, some forecasts will now have to be tempered because of the Wuhan virus, but we don't believe a pronounced drop in activity lasting an entire year will be the result.

Corporate margins remain in record territory. Inflation remains subdued. Unemployment is low, with more jobs available than workers. The personal savings rate remains historically elevated (a good thing). Productivity changes are mildly positive. Interest rates spent 2019 dropping, thereby normalizing the shape of the yield curve. Trade policy seems to, at least, not be getting any worse. Banks and our financial system are on firmer footing than in the days leading up to the Great Recession of '08.

Even with the January 31st sell-off, the one mildly troubling sign is the current valuation of big U.S. stocks, i.e. they are on the expensive side. Depending on how you slice the data, stocks today sell over 20 times last year's earnings and about 18.7 times next year's. These are just a little elevated compared to the modern average of about 18. Yet, outside high-flying software companies, opportunities remain for patient investors in small caps, value stocks, and international equities.

We remain optimistic for 2020. But we expect nothing like the stellar returns of '19. As such, throughout the year clients can expect us to remain vigilant and perhaps even right-size client risk profiles by layering in several lower risk alternatives along the way (e.g. bonds). Stay tuned.

Stirling Bridge Wealth Partners, LLC is fortunate to count many of you as clients. In the good times and bad, we remain committed to providing customized investment solutions and robust financial planning wrapped in a package of exceptional service. We thank each of you for your dedication to us and for your trust.

Sincerely

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