Coronavirus and Equity Markets
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Initially, as people were wrestling with this issue, they were looking at it really through the lens of the SARS epidemic a number of years ago, and that manifested in a short-term supply shock. But investors were able to look through that to a recovery on the far side.

And the problem at this time is, as this has spread further in the world, it has migrated from just that supply shock to a demand shock as well, as businesses are closing and economic activity grinds to a halt.

As people have wrestled with this, they've had to reevaluate what the ultimate impact has been. And this has driven the extreme volatility we've seen in the equity markets over the last few weeks and the roughly 10-12% drop we saw again this week, depending on the market you are in. The impact of this crisis is likely to be deeper, but it still will have a recovery on the other side. We will come out of this. And in fact, we're likely to have a bounce back in many sectors as we refill inventory and rebuild some of the held back demand.

But in the interim, balance sheet strength is going to prove critical. Companies that do not have the strength to sustain will likely fail. And it's important for our portfolio managers to be very vigilant about that balance sheet strength and sift out those that are likely to undergo severe stress. From a factor perspective, deep value remains the most challenged part of the market, but even areas like dividend yield, which you would typically expect to be much more protective, have proven difficult as well.

Really, the only places to hide have been in low beta and in profitability, from a factor perspective. And using the US as a proxy, only consumer staples and big box retailers have been able to hold up in this environment.

Still, we have to figure out the difference between the long term and the short term—focusing on what's going to be permanently impaired, what will emerge on the far side, and perhaps even snap back, and in some businesses that might change. We're likely to see changes in our behavior as citizens in light of this: more remote working, different kinds of travel for business and the like, and certain industries like cruises and other parts might be permanently impaired.

The government is likely to get involved to bail out certain industries. That's going to include some restrictions, however, and, and activities like share buybacks, which have been a big part of earnings growth for many companies, seem to be coming under political pressure, certainly here in the US from both sides of the aisle. So, we're likely to see strings attached to any kind of relief package for different industries.

But we can look to China and what's been going on there. And they're three months into this and recovery seems to be settling in a bit. We are lucky in the US to be benefiting from being kind of last in this chain and learning from the experiences of Asia and then Europe. And most encouragingly, we are seeing governments around the Western world become much more focused on this problem, much more activist in imposing travel restrictions, lockdowns and the like—not just in places like Italy and Spain, but now today in New York and California. And we're likely to see more of this. And that's a big part of that demand destruction that we talked about. But coordinated action on both the policy fiscal side, bailing out, and the social distancing that we're all experiencing, are all designed to try to limit the strain that this puts on the health care system and ultimately limit the spread of the virus.

So, we're going to have to live with this for a while. From a technical perspective, from what our portfolio managers are doing, we need to be very cautious with traditional factor and risk models: they are not working the way they normally do. It really requires more in the form of judgment and, and horse-sense to navigate this. Our PM's at the margins are de-risking the portfolios and diversifying their holdings a bit. This makes sense in light of much higher volatility, to take down risk in portfolios.

And from a trading perspective, it's important to say that, you know, while we are seeing lots of volume in this very volatile market, liquidity is there, but it's, it's a little bit more challenged. You are seeing bid-ask spreads in the depths of markets being a little bit weaker. We were able to get our trades done, but the cost of executing those trades is going up a bit and we'll have to live with that for a while.

So, in conclusion, tough markets, but it seems like governments are starting to get their arms around this problem. We're seeing the actions put in place to try to stem the spread of this. And as portfolio managers, we're just going to have to focus as we can on separating the short term from the long term and understanding what companies will be impacted and what their business models might look like in the future.