First Trust
ECONOMIC RESEARCH REPORT
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Time to Fear the Coronavirus?

Monday, fear over the Coronavirus finally gripped investors, as both the Dow Jones Industrial Average and the S&P 500 index fell over 3% - the largest daily declines in two years. These drops wiped out all the gains for the year.

Frankly, it's amazing to us that the market had been so resilient! Maybe it's because recent history with stocks and viruses is that markets overreact leading to significant buying opportunities along the way. Over a 38-day trading period during the height of the SARS virus back in 2003, the S&P 500 index fell by 12.8%. During the Zika virus, which occurred at the end of 2015 and into 2016 the market fell by 12.9%. There are other examples, but they all passed, and the market recovered and hit new highs.

Will this happen again? Our view is that it is highly probable.

We aren't trying to be immunologists, and that may make our points moot, but there aren't that many immunologists in the world and the World Health Organization says this is not yet a true pandemic. We're just economists, but looking at the data, and having perspective is always important.

This whole thing is a human tragedy and we would never take human life and suffering lightly. And looking at data can make people appear cold, when in reality all they are trying to do is understand the situation. There are currently 80,088 confirmed cases and 2,699 deaths from the Coronavirus COVID-19 outbreak as of Monday. This is a big number and is still growing, but the pace of growth looks to be slowing.

Much of the pessimism surrounding the virus focuses on the Chinese under-counting the number of infected to save face. However, it's important to note that a shortage of specialized test kits has caused health officials in many countries to rely on observable symptoms for diagnoses, and because Coronavirus mimics the flu and pneumonia in its early stages, it's also possible that authorities may be over-counting as well.

Instead of looking at it from a total confirmed case perspective, we think the number of total active cases provides a better look into what is happening. This measure takes total confirmed cases and subtracts deaths and recoveries. This gives the total amount of people who have the potential to spread the virus further.

According to Worldometer, which aggregates statistics from health agencies across the world, total active cases peaked about a week ago at 58,747 and have since been declining, even with all the new cases we are seeing in South Korea, Italy and Iran (where data is suspect). There have been 30,597 cases with an outcome (2,699 deaths and 27,898 recovered). In other words, the total active cases now stand at 49,923, a drop of 15% from the peak on February 17th.

One death is too many, but to put that number into a little bit of perspective, according to the World Health Organization, in the United States alone for the 2019-2020 season, there have been at least 15 million flu illnesses, 140,000 hospitalizations and 8,200 deaths. Imagine if everyone with an internet connection followed the spread of this annual flu, case by case, hour by hour.

It's true that the death rate from Coronavirus appears to be around 3% in China, which is much higher than the death rate from the normal flu, but like the flu increases with age. However, outside of China the death rate is far less than inside China, roughly 1%. And, there is already a drug that will combat COVID-19 moving toward first phase clinical trials. It took three months for this to happen in 2020, versus 20 months for SARS back in 2002/03 - a testament to advances in drug technology.

From a macro-economic point of view, the real question is how will this impact the US economy over the coming year. In short, our view has not changed. The US we believe is relatively insulated, with a fantastic health system. The US started the year with solid economic data and so far, nothing has changed. In fact, with all the data we already have on hand, we are expecting around 2% growth in Q1. Most of the impact to the US from the Coronavirus will come in Q2.

Capital goods exports to China along with imports from China are sure to be depressed given the struggles to reopen factories abroad. Most Chinese factories are still only operating at about 50-60% of capacity. Shipping giant Maersk has already said it has cancelled more than 50 trips to and from Asia. With China being home to seven of the world's busiest container ports there is bound to be some impact. Inventories in the US will be depleted more rapidly, but once the virus subsides, expect faster accumulation of inventories in the second half of the year.

Revenues and earnings from companies that are highly exposed to China will definitely be affected. China being shut down for a month will have a global impact. But lower earnings in the first half of the year should be made up by a strong rebound in the second half of the year with payback from lost months. Demand remains strong and there has been no visible impact yet on the job market as shown by initial unemployment claims. Supply disruption is the issue.

We suggest looking through any earnings weakness as we expect it to be transitory.

One small nugget of good news is that many companies had already been shifting supply chains from China due to the Trump Tariffs. If they weren't considering it before they will be now as they realize the importance of diversification. Expect this trend to accelerate moving forward.

The US consumer is on solid footing and will continue to be one of the key drivers to US economic growth in the year to come. We believe, just like all the other viruses we have seen over the past decades that have dissipated, the Coronavirus will be no different. Some have suggested that the 1918 Spanish Flu, which killed hundreds of thousands in the US could happen again. No one knows, but 2020, is not 1918. Technology and news move much faster and the US rebounded from the Spanish Flu when all was said and done. We suspect that any drop in earnings or economic activity will be short lived, and more than made up for in the year to come. Don't panic, stay invested.

This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.

Epidemics and Stock Market Performance

Since 1980

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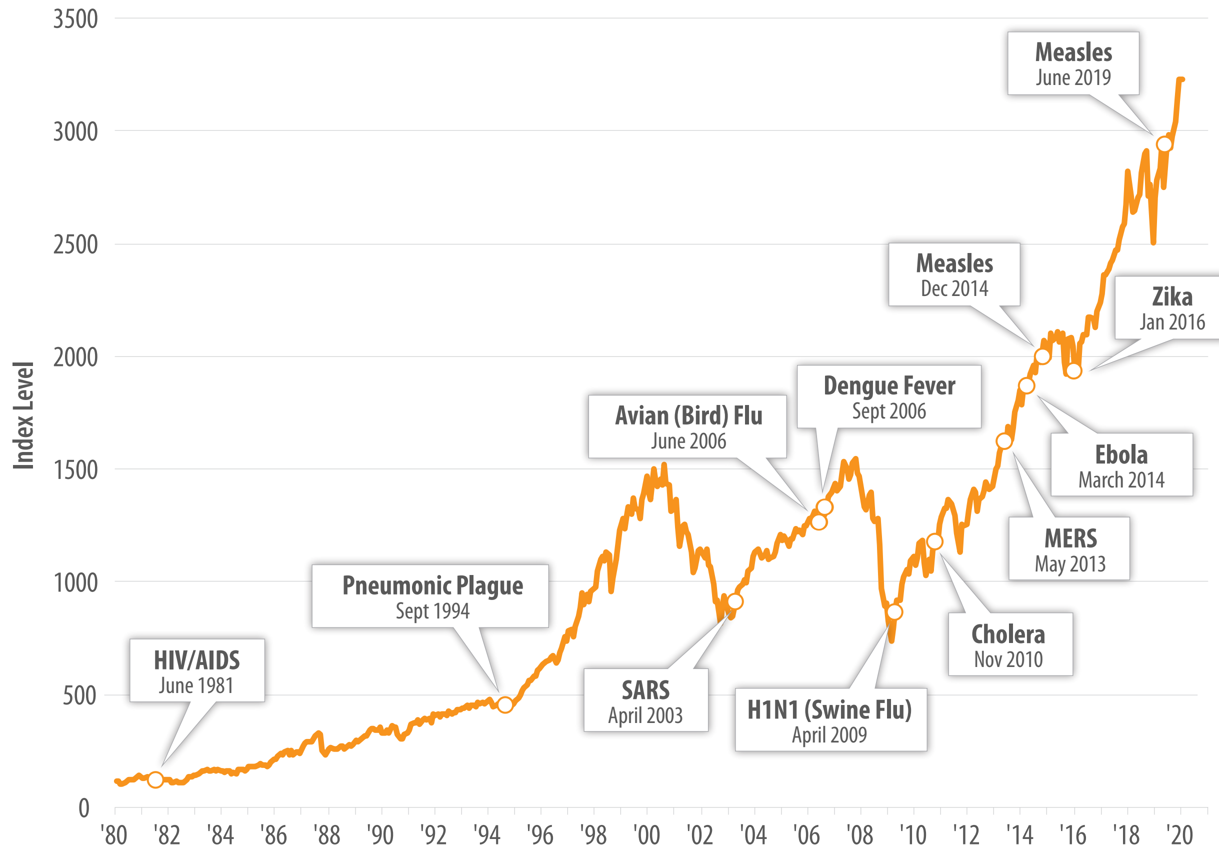
There are many factors that can impact stock market returns, but one concern of investors today is how the stock market will be impacted by a major epidemic or outbreak. Below we look at the historical performance of the S&P 500 Index during several epidemics over the past 40 years. We believe looking at the market's overall resiliency through several major epidemics can give us perspective on the benefits of investing for the long-term.



Epidemic	Date	S&P 500 6-Month % Change	S&P 500 12-Month % Change
HIV/AIDS	June 1981	-6.6%	-16.5%
Pneumonic Plague	Sept 1994	8.2%	26.3%
SARS	April 2003	14.6%	20.8%
Avian (Bird) Flu	June 2006	11.7%	18.4%
Dengue Fever	Sept 2006	6.4%	14.3%
H1N1 (Swine Flu)	April 2009	18.7%	36.0%
Cholera	Nov 2010	13.9%	5.6%
MERS	May 2013	10.7%	18.0%
Ebola	March 2014	5.3%	10.4%
Measles	Dec 2014	0.2%	-0.7%
Zika	Jan 2016	12.0%	17.5%
Measles	June 2019	9.8%	N/A*
	Average Price Return	8.8%	13.6%

Observations

- **6-month** change of the S&P 500 Index following the start of the epidemic was positive in 11 of the 12 cases, with an average price return of 8.8%.
- **12-month** change of the S&P 500 Index following the start of the epidemic was positive in 9 of the 11 cases*, with an average price return of 13.6%.

Source: Bloomberg, as of 2/24/20. Month end numbers were used for the 6- and 12-month % change. *12-month data is not available for the June 2019 measles. **Past performance is no guarantee of future results.**

The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. Returns are based on price only and do not include dividends. This chart is for illustrative purposes only and not indicative of any actual investment. These returns were the result of certain market factors and events which may not be repeated in the future.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial advisors are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

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Staying the Course

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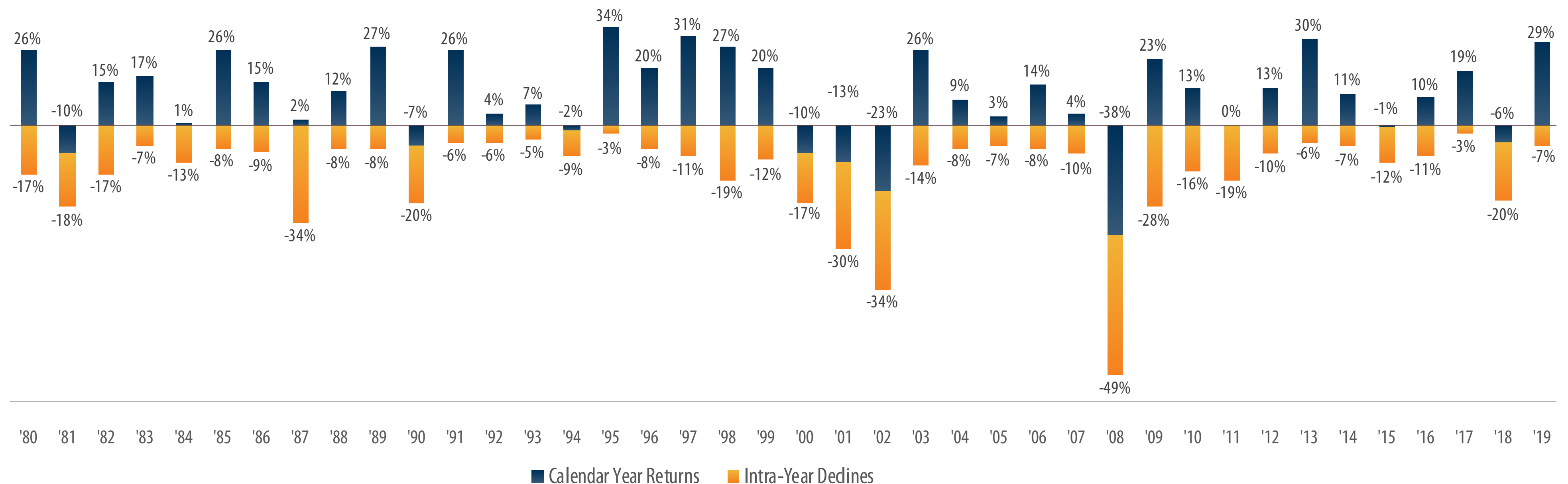
Investors tend to see short-term volatility as the enemy. Volatility may lead many investors to move money out of the market and "sit on the sidelines" until things "calm down." Although this approach may appear to solve one problem, it creates several others:

1. When do you get back in? You must make two correct decisions back-to-back; when to get out and when to get back in.
2. By going to the sidelines you may be missing a potential rebound. This is not historically unprecedented; see chart below.
3. By going to the sidelines you could be not only missing a potential rebound, but all the potential growth on that money going forward.

We believe the wiser course of action is to review your plan with your advisor and from there, decide if any action is indeed necessary. This placates the natural desire to "do something", but helps keep emotions in check.

INTRA-YEAR DECLINES VS. CALENDAR YEAR RETURNS

Volatility is not a recent phenomenon. Each year, one can expect the market to experience a significant correction, which for the S&P 500 has averaged approximately 14% since 1980. Although past performance is no guarantee of future results, history has shown that those who chose to stay the course were rewarded for their patience more often than not.



Source: First Trust Advisors L.P., Bloomberg, as of 12/31/19. The benchmark used for the above chart is the S&P 500 Index. The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. Returns are based on price only and do not include dividends. This chart is for illustrative purposes only and not indicative of any actual investment. These returns were the result of certain market factors and events which may not be repeated in the future. Past performance is no guarantee of future results.

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A History of Market Corrections

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Investors like to avoid stock market declines at all costs, but declines are an inevitable part of investing. A little historical background can help put stock market declines in perspective.

S&P 500 INDEX 1928–2019

Type of Decline	Average Frequency*	Average Length**	Last Occurrence
-5% or more	About 5 times a year	24 days	April 2019
-10% or more	About every 7 months	64 days	December 2018
-15% or more	About every 1.5 years	110 days	December 2018
-20% or more	About every 2.5 years	183 days	March 2009

DOW JONES INDUSTRIAL AVERAGE 1900–2019

Type of Decline	Average Frequency*	Average Length**	Last Occurrence
-5% or more	About 4 times a year	26 days	April 2019
-10% or more	About every 7 months	66 days	December 2018
-15% or more	About every 1.5 years	137 days	December 2018
-20% or more	About every 2.5 years	204 days	March 2009

Source: Bloomberg. As of 12/31/19. Past performance is no guarantee of future results. For illustrative purposes only and not indicative of any actual investment.

*Assumes a 50% recovery rate of lost value.

**Measures from the date of the market high to the date of the market low.

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