Coronavirus disease 2019: The potential economic impact on your retirement plan

Last updated: March 6, 2020

The global spread of the coronavirus disease 2019 (COVID-19) affects not only public health, but also economic growth. It is still too early to understand the full impact the virus will have, but it clearly creates elevated and unforeseen risk factors for the global economy.

Economic impact

China's actions to slow the spread of COVID-19 disrupted supply chains and negatively impacted global growth. China recently reported that its Purchasing Managers Index (PMI) sank to an all-time low.

Meanwhile, U.S. companies have started to reduce earnings estimates primarily based on these supply chain disruptions. As the virus spreads, the economy will be further affected by attempts to stop the spread of the disease. Anticipated declines in business activity can be placed into two broad categories: business destruction and timing changes.

Examples of destroyed business opportunities include travel canceled as a result of the coronavirus. Those lost fares cannot be recouped. Timing changes include purchases and business activity that will simply be delayed until the virus has run its course.

Analysts anticipate the virus will drag down economic growth in the first quarter, but the potential remains for a strong rebound in the second quarter, barring a severe and prolonged outbreak.

Market impact

RETURN: BROAD MARKET EQUITY INDICES

	1-week	YTD
United States		
S&P 500	-11.44%	-8.27%
Russell 2000	-12.01%	-11.36%
	1-week	YTD
International		
MSCI EAFE	-9.56%	-10.94%
MSCI ACWI	-10.42%	-9.09%
MSCI Emerging Markets	-7.23%	-9.69%
Real assets		
Wilshire US REIT	-11.44%	-8.27%
Bloomberg Commodity	-6.88%	-12.03%

Source: Standard & Poor's, MSCI, Bloomberg. Data as of 02/28/2020

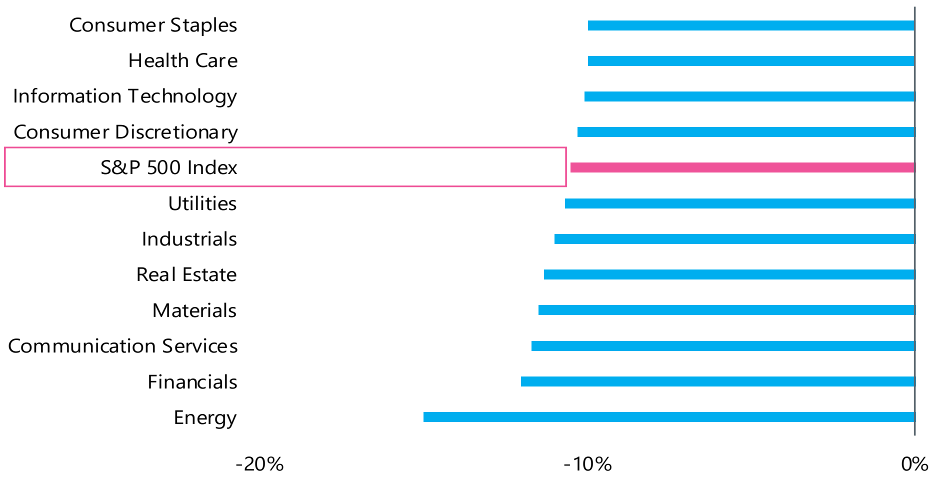
Global markets entered into a fear-driven risk sell-off environment that drove most major stock markets down more than 10% in the last six days of February. The S&P 500 has fallen nearly 16% from its all-time high. Since that time the market has somewhat recovered, but intra-day price swings continue to be dramatic.

Non-U.S. markets have performed mostly in lockstep with the U.S. during this period of global stress. Emerging markets surprisingly out-performed and only lost 7% in the week despite heavy exposure to China.

This is not the first time the markets have sold off due to a virus outbreak. Previous episodes, including SARS, MERS, Ebola, H1N1 and Zika, also generated periods of market volatility during their respective outbreaks. The two worst pullbacks occurred amidst the SARS and ZIKA outbreaks and amounted to a market pullback of -13%. If the severity of COVID-19 is similar to these other viruses, it would imply that much of the downturn may have already run its course.

Many analysts felt the strong performance through 2019, and early 2020 left the market vulnerable to a pullback. As a result, a drop in prices was anticipated. The coronavirus likely served as a catalyst for declines that may have happened anyway.

DECLINES IN MARKET SECTORS



Source: Standard & Poor's, MSCI, Bloomberg. Data as of 02/28/2020

S&P 500 RETURN: ALL SECTORS, COMPANY SIZES, AND STYLES IMPACTED

	Value	Core	Growth
Large	-12.3%	-11.5%	-10.9%
Mid	-12.9%	-11.9%	-10.5%
Small	-12.5%	-12.0%	-11.6%

Source: Standard & Poor's, MSCI, Bloomberg. Data as of 02/28/2020

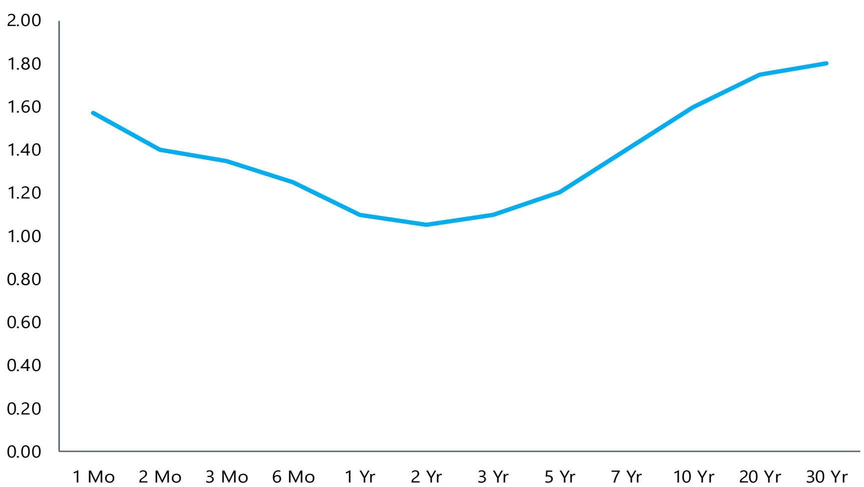
- Defensive sectors and information technology held up best through the decline.
- Energy was the worst sector as oil prices dropped on global slowdown risks.
- Value underperformed growth as this style has larger exposures to energy and financials, the two worst performing sectors.
- The selling was relatively even and broad-based indicating widespread market fear.
- The VIX, also known as "the fear index," soared to nearly 50, which is three times recent levels.

Bond market

When investors flee the stock market, they typically rush to the relative safety of bonds. As a result, bond returns have been strong in this environment.

As bond prices go up, the yields on the bonds move down. The 10-year treasury fell to an all-time low of 0.90%. When these long-term rates fell, the yield curve again became inverted. A yield curve inversion has historically been a warning sign of an upcoming recession. It is important to note that the inversion here may be artificially caused by the effect of the coronavirus. Still, in a surprise move Tuesday, the Federal Reserve tried to stimulate the economy with a short-term interest rate cut of 0.50%. Markets initially responded positively, but later dropped as investors attempted to interpret the move.

TREASURY YIELD CURVE



Source: U.S. Treasure, Data as of 03/02/2020

Advice for retirement plan sponsors

Market declines are a natural, albeit unpleasant, part of the investment process. In times of market stress, many people look for opportunities to make changes that will minimize impact. In reality though, it is often in investors' best interest to resist these urges as the market can rebound from this type of event quite quickly. The 5% rebound from the low on February 24 illustrates this.

Diversification is key to a good 401(k) menu, so now is a good time to review whether your plan has options that held up well when stocks were falling. Now may also be a good time to review whether your target date or other professionally managed default option performed the way you would expect given market conditions. Finally, market declines can provide an opportunity to test whether defensive investment strategies held up as expected.

Plan sponsors may see an increase in questions from participants as a result of the market turmoil. To help participants avoid making rash decisions while giving direct advice, turn the focus to their long-term plans. Ask if they have an investment strategy aligned with their risk profile. The qualified default investment alternative (QDIA) is a great, diversified option for participants who are unsure how to invest.

For defined benefit (DB) plan sponsors, the sharp decline in interest rates could present interesting opportunities to borrow money to fund the plan. This would require a strategic review of the pros and cons of this strategy relative to other options.

Past market events spurred by health outbreaks have been relatively shallow and short-lived. While it's too early to predict the future path of the COVID-19 outbreak, there has yet to be any information that should induce market panic levels greater than those of past outbreaks. In times of stress, it is best to go back to strategies put in place before the downturn. Plan sponsors can turn to their investment policy statement to help provide guidelines and instruction for any decisions they are contemplating during both calm and volatile times alike.

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