**WILLIAM BLAIR**

# COVID-19 Implications: Updated Thinking

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# COVID-19 Implications: Updated Thinking

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Heightened concerns surrounding the spread of COVID-19 and the extent of its economic impact are driving significant volatility across asset classes globally. At this point the full impact on the global economy is unknowable, as it depends on the duration and strength of the quarantine now in effect across many locations in Europe and the United States.

The economic impact in China may serve as a benchmark for the scale of economic disruption, and the impact is colossal. Industrial production declined by 13.5% year-over-year in January and February. Retail sales and auto sales (included in overall retail sales) declined by 20.5% and 37.0%, respectively, during the same period. Now that the peak of the outbreak seems to have passed, economic growth is starting to recover, albeit at depressed levels.

The root cause of the market malaise is the sharp rise in the number of new cases worldwide. While estimates for the ultimate spread of the virus are uncertain, it appears that Italy is following China with a two- to three-week lag, while the United States is a further two weeks behind. This suggests that the number of new cases may start to peak in Europe within the next two to three weeks, and in the United States in the next four to six weeks.

Stocks may thus bottom when European case growth peaks, if not sooner. That said, if European curves do not

follow China's curve, quarantines will then remain in place for longer and the rout in the financial markets may be extended.

While equities have entered bear market territory across many developed and emerging markets, we expect our emphasis on owning quality companies to continue to help protect on the downside.

We are being deliberate with the actions we are taking in response to the COVID-19 pandemic and are evaluating opportunities across all regions and sectors by comparing current valuation levels versus our expected long-term growth outlook.

We are actively evaluating opportunities to buy great companies that are now selling below intrinsic value, as well as quality cyclicals where we deem the risk/reward is favorable and balance sheets are strong.

In order to mitigate risk in our portfolios, we are also paying special attention to companies that may have benefited from the benign economic backdrop enabled by low rates and steady (albeit low) economic growth. We are thus re-evaluating the quality of portfolio companies, with an added emphasis on balance-sheet strength. These companies are being stress-tested for the first time in years.

While the damage to the economy is sure to be substantial, monetary policy is providing enough liquidity early, reducing a risk of a funding crisis. Fiscal policy is certain to follow as measures designed to support the economy are already in the works across the globe. The specifics of this will be increasingly important to determine which companies and industries are better positioned to navigate the downturn.

For China, the full brunt of the decline is likely to be borne in the first quarter of 2020, while for both Europe and the United States the lowest levels of activity are likely to be during March and April. This means that GDP contraction (recession) is likely to be spread over the first and second quarters of 2020.

**COVID-19 Update**

COVID-19 infection-rate forecasts vary greatly, as the infection rate depends on the ability for the virus to infect new hosts as well as our health and behavior (including the ability to decrease the spread). The more we implement measures to stop the spread of the virus, including social distancing, the lower the infection rate will be.

If the United States and other countries succeed in implementing measures to decrease the spread of the virus, the infection rate should be on the lower end of the scale. In South Korea and China outside Wuhan, where widespread testing and social distancing were implemented, the infection rate is well below 1%. That said, we may see a small rebound of the virus when more people go back to work.

To put that into broader context, the Swine flu in 2009-2010 had an infection rate of 20% to 25%, infected 60 million people in the United States alone (18% of the population), and caused about 300,000 hospitalizations.

While it is impossible to say exactly when COVID-19's spread will peak, it is reasonable to believe that it could follow a similar pattern as other respiratory viruses and begin to decrease in April or May because of increasing outdoor temperatures and humidity. With increasing outdoor temperatures and humidity our respiratory systems become less sensitive to respiratory infections. Moreover, our behavior changes when the weather gets warmer as

we tend to spend more time outdoors, where it is more difficult for the virus to spread effectively.

While probable, warmer weather is not guaranteed to slow the spread of the virus. Developments in the southern hemisphere should provide insight. Currently in the southern hemisphere, there is no clear evidence of general social spreading. In Brazil, for example, there are 529 cases reported. We expect cases in Brazil will start to increase in May or June when its cold season begins. However, if we see a broad spreading of cases in the southern hemisphere before the weather cools, it would be very concerning. We are thus tracking this carefully.

It is too early to say with certainty if the virus will re-emerge in the northern hemisphere in the fall and winter, but it is certainly possible. However, if the virus does re-emerge, the community should have some immunity, making the overall impact less severe. We are also working on various antiviral treatments and vaccines, some of which we hope will be available next season.

The biggest debate is that while we know all things will pass, we do not know the duration of this episode. We will keep you updated on our thoughts as events unfold.

*Ken McAtamney, partner, is a portfolio manager on William Blair's Global Equity team.*

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