



Coronavirus surges and market volatility follows

February 26, 2020

As the number of coronavirus cases rises in new countries, investors reevaluate what could come next.

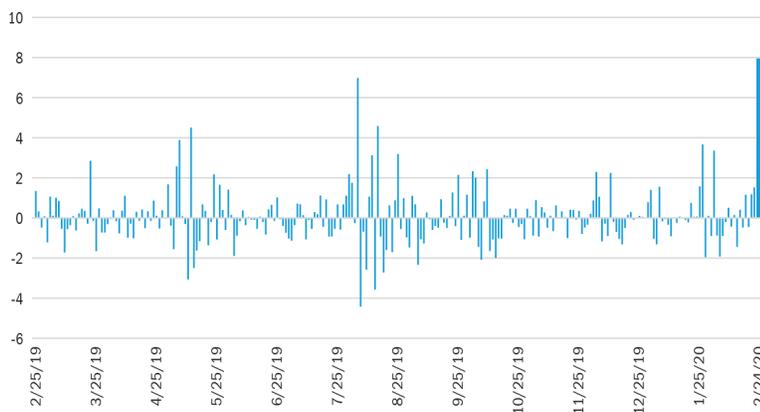
A surge of coronavirus cases outside of China is driving a pronounced flight to quality as investors evaluate the prospect that this viral outbreak will disrupt the global economy more than originally anticipated.

The disruption caused by the virus has already filtered down to earnings. Tech bellwether Apple was the first major U.S. company to announce that it expected to miss revenue projections for the quarter due to the epidemic. The negative impact to Chinese growth has been reasonably anticipated, but the recent news highlighting outbreaks near some of Europe's major financial and manufacturing hubs has ratcheted up uncertainty.

In some regards, the bond market has been reflecting this more concerned state for weeks. The U.S. 3-month/10-year yield curve inverted again on January 31, and the proportion of inverted or flat yield pairs is now greater than 50%.

Coronavirus fears drive equity volatility to a one-year high

CBOE volatility index daily changes



Source: Columbia Threadneedle Investments and Bloomberg



Joshua Kutin

Head of Asset Allocation, North America



Anwiti Bahuguna, Ph.D.

Senior Portfolio Manager, Head of Multi-Asst Strategy

Virus headlines have made risks more prominent.

Judicious exposure to risk was part of the conversation even before the rise of coronavirus cases outside of China. Two key indicators in our work on equity market direction are momentum and volatility. While it's difficult to forecast the progression of a virus, one undeniable result is that market volatility has risen. The VIX (a commonly used measure of market volatility) hit a one-year high at the close of business on Monday, February 24, and other volatility metrics are similarly inflated. Even if the momentum of the long bull market is still intact, the higher volatility keeps us from being too optimistic about equity market opportunities in the short term. At the same time, the fall in yields has made an already-negative real yield (nominal U.S. Treasury 5-year yield minus headline CPI) even more negative. In the past, this has been a warning signal that's coincided with instances of market distress.

Expect central banks to be focused on economic data over market moves in the upcoming months.

In the face of higher volatility and weaker global growth, we expect to see central bankers bring liquidity to the system globally (e.g., deeper rate cuts, bond buying, etc.). But the important question around central bank action is: to what end? Right now, the coronavirus represents a "supply shock" with a rather inelastic supply based in Asia and now Europe because it's hard to quickly change factory locations. Historically, monetary policy has not had an impact on growth when the impediments are supply driven. But if the economic slowdown related to the virus appears to be morphing into a "demand shock," we expect the Fed to ease more aggressively than current market pricing indicates. We believe the data, such as ISM and industrial production, will be the key driver for the Fed, and we would not expect them to act ahead of the data. Smart money will see these economic reports as a lagged impact of what has already been priced into the stock market, but headlines featuring shocks to productivity could cause investor sentiment to get much worse.

Bottom line

While exaggerated market response may create opportunities to add to risk, the current environment suggests a heightened level of caution beyond the immediate short term. Given the uncertainty about containment and the impacts on the global economy, the timeline for "looking through" has likely been extended.



To find out more, call [800.426.3750](tel:800.426.3750)
or visit columbiathreadneedleus.com



Not FDIC insured • No bank guarantee • May lose value

Securities products offered through Columbia Management Investment Distributors, Inc., member FINRA. Advisory services provided by Columbia Management Investment Advisers, LLC.

Columbia Threadneedle Investments (Columbia Threadneedle) is the global brand name of the Columbia and Threadneedle group of companies.

The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Management Investment Advisers, LLC (CMIA) associates or affiliates. Actual investments or investment decisions made by CMIA and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be suitable for all investors. Past performance does not guarantee future results, and no forecast should be considered a guarantee either. Since economic and market conditions change frequently, there can be no assurance that the trends described here will continue or that any forecasts are accurate.