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Viruses & Economic Impact

What started as a *Coronavirus Correction* has now spilled over into credit. At this point we just don't know how much impact the virus will have on the economy. To be sure, there will be an impact. What is particularly frustrating is that this all comes as economic data was accelerating into the new year.

We just had back-to-back months (January & February) of 273,000 gains in employed Americans. Weekly claims remain low and the overall unemployment rate was at 3.5%. We had strong auto and retail sales. All of this occured against the backdrop of a growth friendly policy agenda and an accomodative central bank.

Low interest rates contributed to strong housing starts pacing over 1.5mm for the year at last print. In fact, January-February was the fastest paced two-month period since the housing bubble burst.

Even sentiment surveys were looking good. ISM Manufacturing showed a slowdown in the growth rate, but growth none-the-less. The ISM Non-manufacturing index, which measures a much larger share of the economy, rose to 57.3 in February, a sign of a strengthing service sector. Both of these surveys are likely to plummet when the March readings come out in early April.

All of this contributed to rising GDP estimates just a few short weeks ago. In fact, last week the widely followed Atlanta Fed GDPNow Forecast rose to 3.05%, its highest level of the year.

Slowdowns related to rapidly spreading viruses typically serve to shift GDP from one quarter to another. There will now doubt be a modest slowdown in Q1 with perhaps some acceleration of the slowdown in Q2. Stocks are likely a leading indicator of that phenomenon. We suspect the Coronavirus impact on Q1 GDP will be to pull it down to a 2.0% real rate. With a 0% quarter to follow in Q2. But once the virus impact subsides, companies will need to make up for lost production and we are likely to see a large ramp up in Q3 and Q4 to real rates north of 4%. In the end, the impact to annual GDP may not be as large as some are predicting.

Looking back to the Asian Flu crisis of 1957/1958 which killed more than 65,000 Americans we saw a 3% real GDP growth rate plummet to -4.1% in Q4-1957 and -10.0% in Q1-1958. That was followed by a nearly 8% growth rate for the next five quarters.

Of course its always "*different this time*". Available therapies are much greater today. Medical science is far more advanced than it was a half century ago. Today, the availability of information and misinformation via traditional news, political news and social media have served to create an "infodemic" to go along with the pandemic.

The bottom line seems to be that past large virus outbreaks have lead to quickly reversed slowdowns most of the time. On the occasion where an outbreak led to a recession, recovery was quick.

Herb W. Morgan
Sr. Managing Director
Chief Investment Officer

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