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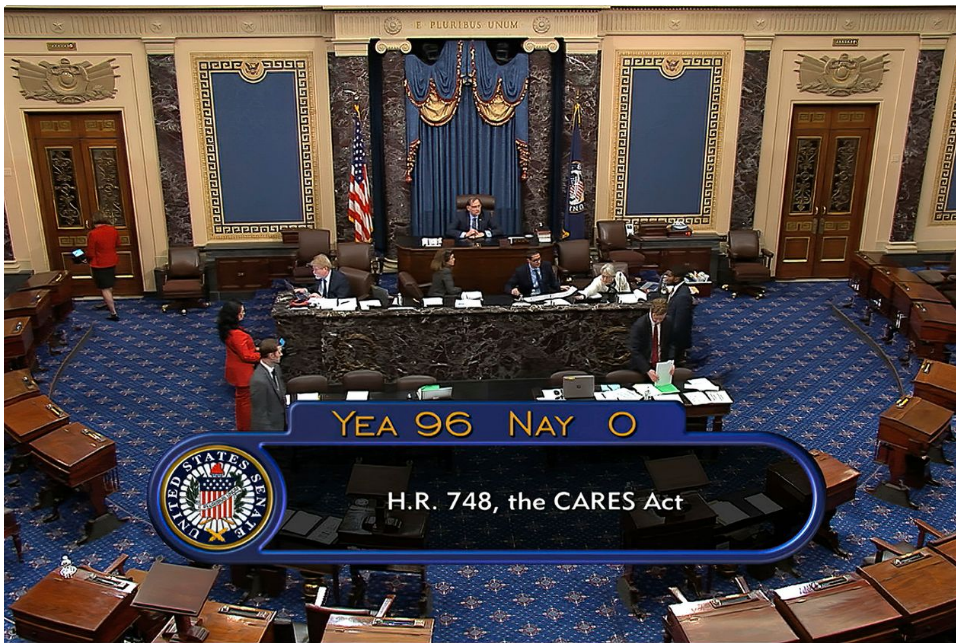
The Dow Ignored the Spread of Coronavirus Last Week. It Won't Be Able to Anymore.

By Ben Levisohn   March 27, 2020



In this image from video, the final vote of 96-0 shows passage of the $2.2 trillion economic rescue package in response to coronavirus pandemic, passed by the Senate at the U.S. Capitol in Washington, Wednesday, March 25, 2020.
Photograph by Senate Television/AP

Hope springs eternal—but false hope can be costly.

For more than two months now, the world has moved to the drumbeat of increasingly bad news about the coronavirus crisis. As the disease has spread, fears about the possible death toll and the extent of the economic disaster roiled global financial markets. The fever of panic broke at least briefly this past week, thanks to a healthy dose of monetary and fiscal policy, and hope that the market carnage has a floor beneath it. The Dow Jones Industrial Average rallied more than 20% off its low, putting it in a bull market, at least by some definitions, though it remains down 24.2% on the year.

The wild card is the coronavirus itself. It is far from contained, and Covid-19, the respiratory disease caused by the virus, continues to spread. There are now more than 550,000 cases world-wide, touching nearly every country.

The U.S. is now No. 1 in confirmed cases, passing China, where it all started. Even where the disease's spread has been slowed and quarantines lifted, life hasn't returned to full speed as people remain reluctant to interact and conduct commerce as usual. The financial stimulus and rescue measures signed into law Friday will bring people financial relief, but it isn't clear that they will be enough for the economy to bridge the gap of a near-shutdown or prevent another stock market swoon—one that almost surely is coming.

In other words, this isn't over yet.

There are reasons to be hopeful, however. With their robust action to shore up financial markets and give American businesses a lifeline, the Federal Reserve and Congress have likely kept the U.S. economy from sinking into a prolonged recession or even another Depression. The Fed, for its part, acted with unprecedented speed once it realized the scope of the problem. Beyond cutting short-term interest rates to near zero and launching bond-buying programs known as quantitative easing, its quick decision to backstop money-market funds, pump cash into the short-term funding markets, and make dollars available to foreign central banks has helped unclog the pipes of the financial system so that cash can get where it is needed.

This isn't 2008, when both the Fed and lawmakers dithered as the financial system crumbled and the economy slumped. "The Fed took the kitchen sink and threw it at the market" says Wells Fargo Securities strategist Christopher Harvey. "Then it took another kitchen sink and threw it at the market."

The fiscal response, too, has been unprecedented. In 2008, it took a market crash to get the legislative branch to take the financial crisis seriously. This time, while it took longer than some might have liked, the Senate took about a week to pass a $2 trillion rescue package. Even when roadblocks sprang up, it was clear by midweek that a bill would pass, and that it would be big. The final document included payments to individuals and families; $500 billion for corporate aid; and an extension of unemployment benefits that could cost $260 billion.

The stock market liked what it saw. Even with Friday's decline, the Dow Jones Industrial Average soared 12.8% this past week, its biggest one week gain since June 1938. And well it should. Between the Fed and the government, two big issues facing the market have been addressed, at least for now. The financial markets are functioning, if still fragile, while the Cares Act provides enough funding to get even some of the hardest-hit industries through the next two months.

Airlines stocks got a lift from the $58 billion earmarked to help them through an unprecedented shutdown in travel, while credit-card companies such as Discover Financial Services (ticker: DFS) and Capital One Financial (COF) got a boost from the consumer assistance provided by the bill.

Markets, however, are forward looking and may soon be looking for more. "The success of central bankers puts the spotlight on the more important aspects [of] this fight—the one against the spread and devastation of the virus, and the one against the economic blight that comes with it," writes Société Générale strategist Kit Juckes.

And that is where the situation gets more complicated. While the fiscal rescue package, in combination with the Fed's monetary stimulus, was enough to rally the market, it remains to be seen whether it is enough to plug the gaping hole in the economy that is just around the corner. More than three million Americans filed for first-time claims for unemployment insurance in the week ended March 21, and economists say the numbers will get far worse in coming weeks.

Stocks could still head south toward their recent lows, or even tumble further. "Every time we see those numbers, the market will act like it's a surprise and go down," says Peter Andersen of Andersen Capital Management.

What's more, the financial stimulus and corporate rescue measures might not bear fruit commensurate with the trillions of dollars that will be spent to survive this crisis. Wolfe Research strategist Chris Senyek says it would be "shockingly good" if each dollar spent translated into 50 cents of GDP growth. "This package will help improve consumer, business, and, especially, investor sentiment," he says. "However, we're not that optimistic about the fiscal program's ability to boost GDP growth."

Then there's the virus itself. No one knows how the disease will progress around the world or in the U.S. So far, 100,000 people have been infected in the U.S., while 1,544 died as of Thursday.

In Italy, the mortality rate is around 10% of reported cases; in China, where the disease appears to have been brought under control, the mortality rate is 4% of reported cases. The fact that just $180 billion, or 8.2% of the $2.2 trillion stimulus package goes to health-related spending is a sign that America is worried more about the economy than Covid-19 itself.

Even if the spread can be controlled soon, new questions will have to be answered. No one knows if someone who has had Covid-19 can get it again, or if they still carry the virus and can infect people who haven't had it. If those

who have had it can infect others, the government will have to decide to keep the two groups separated. “Locking up people without exposure, while the exposed go on their merry way won’t go over well,” writes Evercore ISI analyst Josh Schimmer.

For now, the hope that economic damage can be contained—regardless of whether the virus can—is what’s causing the market consternation. This past Thursday, even as the U.S. saw its largest daily increase in Covid-19 cases, the Dow gained 6.4%. No one should expect that to continue. The economic numbers are expected to be horrific, but the number of people who get infected is likely to get worse than many expected—and rattle the markets. “The market could easily go back and test the low,” writes Stuart Kaye, portfolio manager at Matarin Capital Management. “It will depend on the progression of the disease and its cost to society.”

That would square with the historical record. Bear markets rarely end without retesting the low. In 2008, the passage of the financial-system bailout package and other measures helped the market soar off its low. Attention then turned to the real economy and corporate earnings. The initial estimates were off—way off—and it wasn’t until analysts got a grip on the profit path that the S&P 500 found a bottom on March 9, 2009, says RBC strategist Lori Calvasina.

Analysts today are busy cutting their forecasts for earnings—but likely not fast enough. According to Refinitiv, S&P 500 corporations will see their earnings drop 0.2% in 2020. They had been predicting high-single digits heading into the year. Wall Street’s strategists, though, are warning of a much bigger drop. Calvasina calls for S&P 500 companies to report earnings of $139 a share in 2020, down 16% from $165 in 2019. But she acknowledges that it’s anyone’s guess right now.

“When we have these selloffs, it’s a process,” she says. “Bottoms take time.” And for $2 trillion, we’ve certainly bought ourselves that.

Write to Ben Levisohn at Ben.Levisohn@barrons.com