The Advisor

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Coronavirus Impacts the Markets

The markets were rolling along very smoothly, unaffected by recent geopolitical events until a zoonotic-transmitted virus caused Wall Street to stumble.

The outbreak, which is believed to have originated in Wuhan, China, is a strain of virus believed to be transmitted to humans through wild animals. In this case, scientists believe the host animal was a pangolin, which may have been bitten by a bat.

In 2002, the SARS virus killed 800 people worldwide. The SARS virus is also believed to have originated in bats. While the SARS outbreak nearly two decades ago was thought to be worse, in terms of the disease itself, the numbers of fatalities caused by the Coronavirus (COVID-19) have already surpassed it.

The virus has reportedly infected nearly 78,000 people worldwide, with most cases in mainland China.

Although tensions with Iran were not enough to disrupt the markets in the U.S., the markets have taken notice of the Coronavirus which has made some parts of China look like ghost towns and has disrupted commerce in many parts of the world.

The pace of worldwide economic expansion had just hit a ten-month high in January. Then, the numbers of the infected, and those who have died from Coronavirus, became known in late January and began to concern the economic world. The virus, and it's spread at its epicenter, were known by the Chinese government in December.

Economic Impact

China is the second largest economy in the world. Products and components of products for companies worldwide are produced in China. There has been supply chain disruptions as a biproduct of the disruption caused by the virus and its spread.

Oil consumption in China is down considerably and China's growth rate in 2019 had slowed considerably already. China's economy is contracting. This would be the first time since 1976 that the economy had contracted there.

The information about the toll the Coronavirus has taken in China may be controlled by Beijing and prove to be worse than the "official" numbers. Many infectious disease specialists outside of China believe that the number of confirmed cases, as far back as December, was probably much higher than reported.

Apple is one international company that is impacted by the Coronavirus. The company's dependence on China has impacted its global supply chain. This will impact sales and potentially second-quarter revenue guidance.

Nike, ON Semiconductor, Kontoor Brands and Qorvo are other stocks impacted by the outbreak, although some analysts remain optimistic for each company.

The HIS Market's U.S. Composite Output Index hit a 76-month low on February 21. The index measures manufacturing and services business activity. This indicates a contraction in the service sector and manufacturing due to a slow down in orders. The firm says that the slowing can be traced back to the Coronavirus and global uncertainty.

New infections of the Coronavirus are surging in South Korea, Japan, Iran and Italy, where authorities are attempting to contain the spread and there is a travel ban in several locations in northern Italy.

There are concerns that the disease could become a pandemic. On February 23, the Dow plummeted more than 1,000 points, joining other world markets concerned about the spread of the virus outside of China. That was the third worse point drop in Dow history.

George Citroner, "Where Did the New Coronavirus Come From? Potentially a Bat, Snake, or Pangolin," (2020, January 27), Healthline.com, Health News

Video, "Why Coronavirus Estimates Are Higher Than China's Official Tally," (2020, February 19), Wall Street Journal

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Anna Fifield/Simon Denyer/Chico Harlan/Miriam Berger/Marisa Iati, "New developments suggest coronavirus incubation could be longer than 14 days, as global infections rise," (2020, February 22), The Washington Post, Asia & Pacific

Growth Has Outperformed Value in Recent Years

When selecting stocks, different people have different goals and different priorities that make up their choices. Some may just choose a company they like with no consideration of the classification of that company's stock. Whether or not the stock is a growth stock or a value stock may not have occurred to them, although, over the past several years, it should have.

Is the stock outperforming the market or is the stock flying under the radar with good value? Does the stock have a low price-to-book ratio? Many people don't focus on those characteristics because they may just use a company's products or services and want to own a piece of that company. The high-flying stocks describe growth stocks and the low price-to-book ratio stocks fit into the value category.

Many investors who make deliberate decisions about these classifications have a preference for one over the other. Value investors often search for stocks and companies that are out of favor with the market. They may have come up short in an earnings reports, or had a change in management or a product recall. That bad news depressed their stock price.

Growth versus Value

Anything that depresses the stock price below the price that a value-investor believes the stock is worth based on its intrinsic value can qualify as a value stock. Many valuation techniques may go into determining this value such as the price-to-book ratio, the price-to-earnings ratio, free cash flow or a number of other measures.

Growth stock investors invest in companies which offer growth in capital instead of those paying dividends. Investors anticipate that the company and its stock will have a rate of growth that beats the market. The growth stocks often do not have valuations that would appeal to value investors, but since growth investors are looking to potential future capital appreciation, they do not dwell on these variables in the same way.

Over the past five years, the Russell 1000 Growth Index has outperformed the Russell 1000 Value Index by 7.1 percent per year. That is substantial. It means also that growth stocks are more expensive and value stocks are, well, a better value. The difference has not been this stark since the 1990s.

Leading up to the tech bubble, the valuations of many growth stocks were outside the comfort zones of any value investors.

The lead that growth stocks, whether small cap or large cap, had over their value counterparts by the end of January was nearly five percentage points. During 2019, the iShares Russell 1000 Growth ETF returned nearly 36 percent.

One recent reversal that allowed value stock holders to declare victory was during the steep market plunge on February 24. The valuations on the value stocks look much better than their growth brethren, trading at 15 times estimated 2020 earnings versus the growth stocks which are trading at 24 times, based on the Russell 1000 Growth Index compared to the Russell 1000 Value Index.

This steep drop in the market resulted from the Coronavirus spreading outside the borders of China. This may be an example of where value stocks are more buoyant than growth stocks. Also, recently, growth stock valuations have hit an 18-year high.

One geopolitical event may change the strategy, but only time will tell.

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Andrew Bary, "Growth Stocks Are Still Topping Value in 2020. Here's Why," (2020, January 30), Barron's, Growth Investing

Jeff Cox, "The S&P 500 just passed its highest valuation level in almost 18 years," (2020, February 21), CNBC, Markets

About the Author

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