Demand

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Scott Wren
Senior Global Market Strategist

Last Week's S&P 500 Index:
-1.0%

Key takeaways

- *We are closely monitoring the latest coronavirus, but historically the stock market has only been negatively affected for short periods of time by previous virus outbreaks.*
- *We continue to see upside in the stock market by year-end and will be looking for opportunities to put money to work.*

At the time of this writing on January 27, the S&P 500 is down more than 1% on the day and has fallen a bit more than 2% from its all-time record high set less than two weeks ago. Uncertainties surrounding the coronavirus outbreak in China that has now spread to a number of different countries, including the U.S., is being blamed for what has up until now been a minor selloff. While we are keeping a close eye on this particular virus outbreak, if history is any indication, we believe the equity market is unlikely to suffer a major correction as a result. As a reference point, according to the Centers for Disease Control (CDC), an average of 36,000 people die from the common flu every year in the U.S. Thus far, according to official Chinese reports, less than 125 people have died and approximately 4,500 have been infected. The 2020 coronavirus is spreading more quickly but appears less severe than SARS, according to medical experts.

We know that the U.S. consumer has been the driver of economic growth during this expansion. Consumers in other parts of the world, like emerging markets, have also been meaningful drivers of economic activity. In the end, we believe this consumer angle is the one that stock investors should be focused on when trying to evaluate the coronavirus fallout. The potential increased headwinds for global economic growth appear to be sparking some investors to move money off the equity table. Consumers who are quarantined in their homes/cities or afraid to go out and spend money because they don't want to be exposed to the virus could put a dent in growth over the near-to-intermediate term. That is the fear.

The expectations that we have used to make our equity target and earnings projections are based on a continuation of this modest-growth/modest-inflation environment where major central banks around the world are providing liquidity. In addition, firming global growth and easing trade tensions have also led to more positive sentiment. We believe these factors should allow for somewhat higher valuations.

The recent outbreak of the coronavirus, at this point, has not affected our outlook for equities. We continue to favor domestic large-cap (S&P 500) equites over U.S. small caps and over developed international and emerging market stocks. We currently carry an unfavorable rating on U.S. small-cap equities. In terms of sectors, we favor Information Technology, Consumer Discretionary, and Financials. We believe all of these sectors should benefit from the macro environment we look for in 2020.

Also, you may want to keep in mind other drivers of the current pullback in addition to coronavirus concerns. Stocks gained nearly 12% from early October though the end of last year with barely a stumble along the way. One could argue at least a minor pullback was overdue. We also sensed some chasing over that time frame as underinvested market participants looked to put sidelined funds to work. Many of these participants who recently jumped in could be considered "weak hands" who were quick to jump back out on negative headlines. We would argue that after an extended run higher traders were looking for a reason to lock in some gains and the virus headlines provided that opportunity. There are a lot of moving parts driving stocks right now, but broken down to its basic component, we believe investors are concerned that the coronavirus will negatively impact consumer demand.

Risk Considerations

Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. The prices of **small-cap** company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market.

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