COVID-19 Recovery: Does the Black Swan’s Flight Path Run Through China?
March 2020

- The COVID-19 crisis has been a catastrophic “Black Swan” event that caused an exogenous shock to global markets.
- The financial pain and human toll has been very real, but we encourage investors to remain calm and patient.
- We’re starting to see improvement in China and it’s not unreasonable to believe that western countries can follow a similar virus-containment path and start to recover economically.

Markets are moving quickly and our perspective may evolve with them.

We often talk about the potential of catastrophic “Black Swan” events that have the power to completely derail financial markets. Sometimes those events are largely contained within financial markets—as was the case in 2008. Other times they are exogenous shocks—as was the case with the 9/11 terrorist attacks. The current COVID-19 crisis certainly counts as an exogenous black swan.

**Financial Pain is Real, But Be Patient**

The pain in financial markets is palpable. We have seen bigger one day declines—“Black Monday” in 1987—and we’ve seen numerous declines exceeding these total current losses. But we’ve never seen declines of this magnitude, over this short a time period. This, of course, engenders strong feelings in investors with many feeling the urge toward “loss aversion.”

While it may seem like a great idea to sell now and avoid further losses, this would create another problem of when to buy again to participate in the gains that have always historically followed these types of losses. If you invest with SEI you know that we always preach against the pitfalls of trying to time the market. In fact, with the losses we’ve suffered during the COVID-19 crisis, we’re probably closer to the bottom then the market top. And the closer we are to the bottom, the closer we are to the possibility of a sustained market rally. As SEI’s own Jim Solloway recently and colorfully put it, “I believe we’re more likely to see a face-ripping rally than another 30% decline.”

Now, it’s fair for investors to wonder how we can be optimistic about a rally when credit markets have all but seized up at the same time oil and equity markets tumbled amid massively volatile price swings. But we’ve seen thorough action on the monetary front from central banks that provides significant support across the range of credit markets, and we’re now starting to see a massive fiscal response in the form of government legislation. Perhaps, though, the most important change...
we are seeing is in the infection rates of the COVID-19 virus (see Exhibit 1) and what comes after those infections start to decline in countries like China.

**The West Begins the Virus Fight**

The Western world, including the U.S. and Europe, are surely in the early stages of combating COVID-19 and will see much higher numbers of infections, and unfortunately higher corresponding death tolls.

However, we can look to China for clues about what may come next. As the epicenter for the disease, China is much further along in this brutal fight. Early indicators have shown Chinese economic activity plunged into recessionary territory (see Exhibit 2) as the country was forced to take draconian actions to stem the infection rate.

Similar situations are beginning to take shape in the West, although quarantines and lockdowns are being imposed less stringently than in China. After taking dramatic action, China has seen its infection rate slow dramatically and economic activity has begun to come back as the situation improved. It seems likely that the West may follow a similar course if appropriate actions are taken, with Italy serving as a cautionary tale.

**China is Recovering**

While growth in much of the developed world is grinding to a halt, China seems to be revving back up. China has been the world’s growth engine for a while now, so it’s not unreasonable to think that a return to growth there can help stave off some of the impacts of tightening conditions elsewhere. It’s difficult to get timely and accurate data on the Chinese economy, but by all accounts the situation seems to be improving. On March 1, about five weeks after massive quarantine efforts started, China reported that over 90% of its state-owned firms were back to business. Smaller firms, albeit, appear to be operating at a lower capacity. On a more anecdotal level, we saw Apple reopen all 42 of its stores in mainland China on March 13, even as it maintained indefinite closures at all its stores outside of China.

**Our View**

To reiterate, this has been painful. The human toll, along with the destruction of value and demand, have all been very real. At least in terms of value destruction, however, we believe that we’re closer to a rally off the bottom than another 30% drop. As always, we encourage investors to review their goals and practice disciplined, globally diversified investing. These words are especially true in times of crisis.

**Exhibit 3: Performance of China versus U.S. Equity Markets**

Source: Bloomberg, SEI. Price only returns in local currency. As measured by S&P 500 Index, U.S. stocks peaked on 2/19/20 and performance is measured through 3/24/20.

**Important Information:**

Information provided by SEI Investments Management Corporation (SIMC), a wholly owned subsidiary of SEI Investments Company (SEI). This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice.

Index returns are for illustrative purposes only and do not represent actual fund performance. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

This is an article published by SEI in the Knowledge Center.

Securities and investment advisory services offered through NEXT Financial Group, Inc. Member FINRA/SIPC. None of the named entities are affiliates of NEXT Financial Group, Inc. Neither NEXT Financial Group nor its Representatives give tax or legal advice.