

The Outlook: Jan. 27, 2020

Wuhan Virus: the next Nightmare arrives.

As 2019 ended a few weeks ago, at Outlook we remarked that “The market will have to find a new Nightmare in 2020.” The “Trade War” had filled that role for 18 months. The Phase One Deal simply meant “cease-fire,” for the time being; not “trade peace.” But the market had done its best to squeeze every drop of fear out of the Trade War Nightmare since mid-2018 . . . and found out, as 2019 rolled on, that “Trade War Fear” kept losing strength. On Main Street, whose reality always wins out over Wall Street’s nightmares eventually, the 18 months of “trade war” had shown us just what we would expect: U.S. companies and their people *making adjustments*. They were gradual adjustments, naturally, but they were unmistakable: production shifts out of China, gathering steam as the 18 months marched on; pressure by American buyers on Chinese factories to lower prices to offset part (sometimes all) of the U.S. tariffs; shifting U.S. exports to non-Chinese buyers to offset China’s retaliatory tariffs (with soybeans being a very good example); and countless others.

The market’s changing “Nightmares” work very well, for a little while, when they show up as a surprise; and when they are *unfamiliar* problems, so that it seems harder for Main Street to get its arms around the nature of the problem and make the adjustments which end up curing it—or at least blocking its worst effects. For a good 6 months, the Trade War looked like that kind of surprise, until it became clear that U.S. companies and consumers were adjusting their behavior to block much of the pain, as people always do in free-market economies.

So the “Trade War Nightmare” faded away. But we didn’t get much of a breather, did we?

“Wuhan Virus!” is Nightmare Number One today, for the market. It qualifies in spades. It was a surprise; it’s unfamiliar, even downright mysterious; so it’s very easy indeed for the market (and the whole world) to wonder, fearfully, just how terrible a global epidemic it might become. Exactly as with the “Trade War Nightmare,” the damage from Wuhan Virus is not the least bit imaginary. It is as real as death, unfortunately. The Chinese economy is certainly taking hammer blows as we speak. They’ll get worse before they get better. Still, we’re somewhere in the darkest part of the Nightmare right now . . . because we have the smallest amount of real facts and real knowledge about the epidemic. That lack of knowledge will change in the future, and the change will go in only one direction: for the better. But while we’re waiting, it’s a certainty that Main Street China is suffering greatly, with widespread factory and general business shutdowns. When travel is shut down and cities are quarantined, the economic ripple effects move like tidal waves, and do a lot of damage. And while China is not the only engine which makes the world economy run, it is one of them—so those damaging ripple effects through China will reach the rest of the world.

That’s “the picture” in the market’s focus today. Is it the whole picture?

Outlook clients and friends know the answer: “Of course not.” Market nightmares at their peak blackness, so to speak, are never anything close to “the whole picture.”

The brightest part of “the rest of the picture” is a kind of paradox: “The more frightening the media makes the Wuhan Virus story appear, right now, the sooner the virus epidemic itself is likely to lose its power and speed.” It is a contagious disease, spread by normal human contacts and behaviors which will be changed faster, the more frightened people become. “Wash a lot, and keep your distance” sums

up the most effective prevention for every contagious disease from the common cold to the flue and much worse. But most people don't force themselves to adopt such preventative behavior—even in hospitals, we are learning—until they're really alarmed . . . then they do, and that widespread behavior change eventually brings the epidemic to a halt. In Wuhan itself, we'd guess the percentage of people who've changed their behavior is very high.

So our “Wuhan Virus Nightmare” sprang from a genuine problem for the Chinese economy, which will spill over into the world economy. The spillover damage for the world will be weaker than in China . . . and could turn out to fall anywhere between “fairly trivial” and “fairly painful.” But the economic damage will not be permanent anywhere. And in China, we might find ourselves fairly surprised, when we look back in a year or two, at the good that just might come out of it. Though we're now firmly in the realm of speculation, China's dictator, Mr. Xi, has very badly needed a face-saving excuse to reverse the shocking blunders he's been making for the past 18 months. As Outlook has noted more than once, he has chosen to shake an iron fist in the world's face in many different ways, from the trade war to military intimidation. His policy has done nothing but hurt China's economic growth: both current and future. Wuhan Virus might give him the excuse he needs to make friends with China's economic partners around the world—for the sake of China's virus-damaged economy.

We mustn't count on that kind of thing. But we can count on a peak and then fading away of this current nightmare, like all the market's bad dreams. At Outlook we will not try to guess the timing of those future events. It's enough to know they'll happen. We'll stay invested.

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