ON-SCREEN TEXT: Paul Christopher, Head of Global Market Strategy Wells Fargo Investment Institute, Discusses coronavirus related market volatility. March 2, 2020

ON-SCREEN TEXT: In what way will the coronavirus affect the world economy? What parts will be most affected?

>>Christopher: Well, initially, in the U.S. the markets had focused on the constraints to supply chains from China, but by late February the concern extended to whether infections would become worse in the U.S. and Europe. Right now, manufacturing, tourism, travel, and luxury goods are the most affected industries. Spending by U.S. consumers could be at risk, if the disease spreads widely in this country.

ON-SCREEN TEXT: What kinds of investments become more risky because of the coronavirus outbreak?

>>Chistopher: Well, international investment leads that list. Europe, Asia, and Latin America depend more on trade than the U.S. And tourism could dry up in Europe. We prefer the U.S. over international markets. At the moment, commodity prices also have been hit hard, since China is the world's most important buyer of many raw materials, and their economy is severely slowed. A third area, in equities, would be those companies tied to tourism, travel, industrials, pharmaceuticals because many drug companies import component chemicals from China, and manufacturing. Information Technology could be adversely affected by supply chain disruptions, if the disease spread cannot be slowed.

ON-SCREEN TEXT: Will this trigger a recession?

>>Christopher: We do not foresee a recession in the next year. The best way, we think, to think about a recession is the virus-induced slowdown in the global economy puts stress on businesses and households that were already experiencing some financial strain from debt that has accumulated over the 10-year expansion. We do not yet know the full extent of the stress that the slowdown is creating, but we are monitoring the pillars of this economic expansion – consumer spending, job and wage growth, low inflation, and low interest rates. These have allowed the U.S. economy – especially services – to drive this economy's economic growth during the past 10 years. If people stop participating in the economy for fear of infection with the virus, then we could begin to see cracks in those pillars. So, again, at this point we do not expect a recession in the next 12 months.

ON-SCREEN TEXT: What are the least affected parts of the economy?

>>Christopher: Well so far, the main impact on the U.S. economy has been the concern about supply chains from China breaking down, as China's economy stops working. Now China is starting to plan for a restart. But there is still some stress on travel, tourism, luxury goods, and some manufacturers. We'll see how long it takes China to resume work. For now, the U.S. economy faces headwinds through supply chains from China. If the virus spreads broadly in the U.S., the adverse impact should be much more serious. But that is not our base case, at this point.

ON-SCREEN TEXT: What sectors should investors look at for signs of trouble?

>>Christopher: Over the coming 4-8 weeks, the key sectors to watch are Industrials, travel and tourism, and the Materials sectors. We also would watch the market for bonds that are below investment grade – the so-called high-yield debt. If these yields spike higher, that is also a sign of stress. And if the stresses on companies and households are going to surprise us, and raise the risk of recession by more than we currently expect, then those are some of the sectors most likely to give a warning.

ON-SCREEN TEXT: How does the coronavirus news cause more volatility?

>>Christopher: Volatility means that market participants sell holdings when the future feels dangerous. No one knows yet how far or fast that coronavirus may spread, or what its ultimate economic impact may be. In addition, the S&P 500 Index was at a rich valuation – that means that prices were high relative to the earnings growth that fundamentally drives equity values. Valuations somewhat above historical levels may help magnify the market impact of the uncertainty.

ON-SCREEN TEXT: How long do you expect the economy can sustain or absorb the impacts of this market volatility – weeks, months, or more?

>>Christopher: The short answer is "months." Again, much depends upon how long and how far the virus spreads, and how extensive quarantines are.

ON-SCREEN TEXT: What lessons can we glean from periods of market volatility similar to what's happening now?

>>Christopher: Well, perspective is one of the first things that we human beings tend to lose in a crisis. As a matter of fact, equity prices suffered sharp declines from prior all-time highs in 2011, that was roughly 19%; in late 2015 and early '16, that was 14%; and again in 2018, and that was nearly 20%. In each case, the market recovered to new highs. This matches with the historical tendency of the S&P 500 Index, which is to recover from sharp selloffs, as long as the economy doesn't enter recession. Again, that recession risk is a little higher now, because of coronavirus, but still seems unlikely.

ON-SCREEN TEXT: What can we expect if/when the situation is escalated to an actual pandemic? What imacts will we feel first and how will they manifest over time?

>>Christopher: The term "pandemic" is the worldwide spread of a disease. From an investor's perspective, we see the disease spreading in Europe, Asia and the U.S., less so in Latin America and Africa. These are the main investable regions of the world, and markets have responded. The first impact is fear. Financial markets also are reacting with fear, because no one really knows the extent of the risk. The main tools that we believe investors need right now are patience, to be more proactive about managing risk in 401(k) and investment portfolios all the time.

ON-SCREEN TEXT: What should investors be doing now?

>>Christopher: Well in an environment that is really full of fear, as a matter of fact, the S and P 500 index has never gone down by 10% quite so sharply, quite so quickly as it has in the last 7 days. And so, that tells us that there's a lot of fear in this market right now. The best way to combat fear is to stay diversified and to be patient. We think that investors can benefit from following both of those pieces of advice as we look forward. And so, we've been conservative for some time in portfolios, we're going to remain so. We think investors should favor that same approach and let me give some specific examples of what I mean by that. I mentioned earlier that we think U.S. markets will survive better than foreign markets in this environment, and so we recently moved some money from emerging markets into the U.S. Because we saw U.S. large caps as a little bit expensive, we decided to favor U.S. midcaps instead. Another piece of advice that we favor is to look for quality. When putting some cash to work, look for quality companies and quality sectors. Quality has lots of definitions. For our purposes, let's think of it as: a quality company is one with good cash flow, good cash-to-debt ratios and good earnings prospects. Based on that definition, we like three sectors right now: information technology, consumer discretionary and communications services. There's a fourth sector we like, but that's more from a valuation perspective, and that would be financials. So again, the four we like: information technology, consumer discretionary, communications services and financials. Where would we get the cash to move into those? We favor underweighting. That is, taking money away from materials and energy right now. Those are cyclically oriented companies. They don't have the quality characteristics and both are exposed to China's seizure of its economy during the last quarter. So we think that that's a good place to pull money from right now at the moment. So if investors can be patient here and wait a little bit, we think this crisis will resolve itself and we think there will be no recession. In practice, patience can be thought of as, from an investment standpoint, dollar cost averaging in. That is to say, if one has cash at the moment, best approach is to not try to put it all to work now with the markets low, because they might go a little lower. The best approach, we think, is to put a little bit in at a time over the next six months to a year. We think the economy is safe from a recession during that time. Even better would be to make a plan with one's financial professional in order to take the emotion out of when to put that money to work. Make that plan, stay disciplined to it and put a little bit to work each month or each quarter, depending upon what's right for you based on your conversation with your investment professional. So, combination of sticking with quality and being patient here and remembering that one has long term goals, the best way to reach those long term goals is with that patience and that commitment to managing risk proactively in the portfolio. I find myself it makes me feel better to feel like I have some control over my portfolio by managing the risk and the return in it myself in combination with my investment professional.