Client Alert

March 2020

Coronavirus: What Bankers Should Consider

The final week of February featured a significant stock market rout driven by growing fear over the global spread of the “Coronavirus,” or more specifically a new strain of Coronavirus named COVID-19. The Dow Jones Industrial Average declined 13.3% during the week, a truly historic drop that represented the 5th worst weekly performance in the history of the index. Given the dire historical circumstances that fueled similar market selloffs, it is important to understand the potential economic impact from the ongoing growth of this new illness, the benefit of taking a measured approach to economic consequences and to investments and opportunities.

Date	% Weekly decline in the Dow Jones Industrial Average	Cause for Market Sell-Off
10/10/2008	-18.15%	Global Credit Crisis
7/21/1933	-15.55%	Great Depression
9/21/2001	-14.26%	Dot.com Bubble
5/17/1940	-14.21%	Nazi invasion of Western Europe
2/28/2020	-13.32%	COVID-19 Coronavirus

Source: Bloomberg

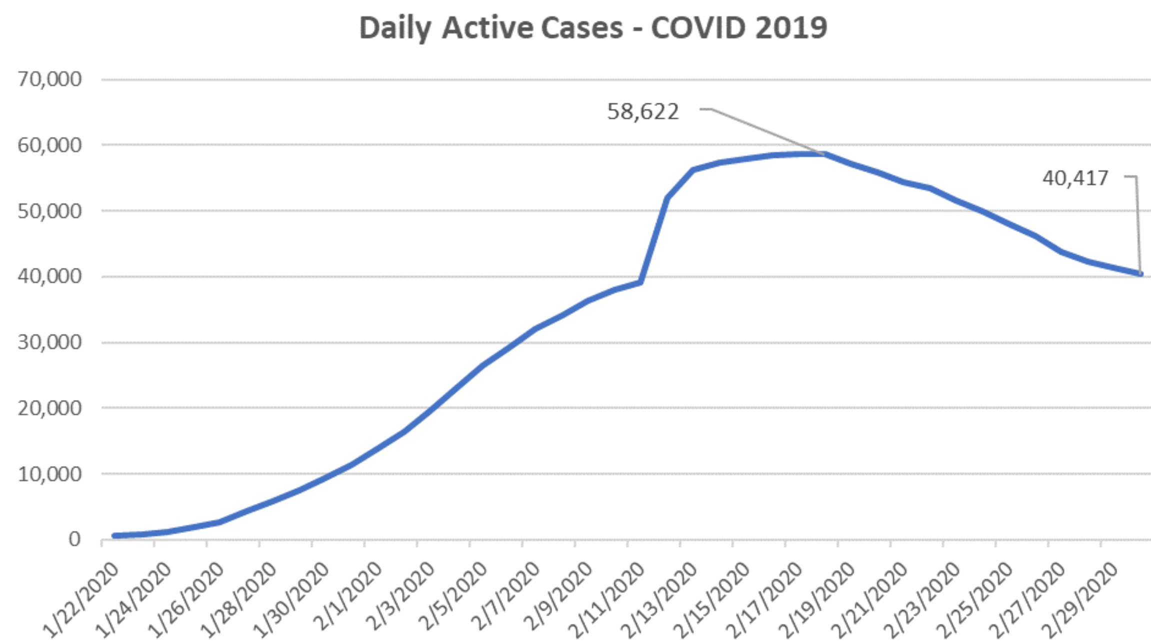
The media coverage of this new strain of Coronavirus has been intense and often contradictory so it is important to understand the true nature of this potential health crisis. Per the World Health Organization, Coronaviruses are:

“A large family of viruses that cause illness ranging from the common cold to more severe diseases such as Middle East Respiratory Syndrome (MERS-CoV) and Severe Acute Respiratory Syndrome (SARS-CoV). A novel coronavirus (nCoV) is a new strain that has not been previously identified in humans.”
Source: https://www.who.int/health-topics/coronavirus

The emergence of a novel coronavirus such as COVID-19 is not an unprecedented market event. The relatively quick spread of the SARS illness in 2003 also resulted in significant stock market volatility, but with only a temporary and insignificant impact on the real economy. Global health experts have so far concluded that COVID-19 is more contagious than prior outbreaks and deadlier than traditional seasonal illnesses like flu or common cold.

Several groups have attempted to track and analyze the spread of the illness. Johns Hopkins hosts an interactive web portal with the latest updates. Information aggregator Worldometers has also become a go-to source for the latest status of the virus.

As of March 2nd, both sites indicate a peak of active infections on February 18th. Nearly 90% of the approximately 90,000 detected cases have been in China and active cases there are declining daily. The virus continues to spread internationally and has been growing in (albeit in minor numbers so far) in the U.S., especially in Washington and on the west coast. The potential peak global scope of the virus remains unclear. Governments around the world are attempting to contain its growth through a variety of measures. The Chinese government has gone to extraordinary lengths in reaction including the quarantine of nearly 45 Million people. European countries have closed borders and curtailed travel. Other countries have also scaled back activities to prevent the spread of the disease.



Source: https://www.worldometers.info/coronavirus/#countries

These containment measures had a quick economic impact. Global supply chains that are heavily dependent on Chinese production have seen significant turbulence. Technology leaders all issued profit warnings due to the abrupt shutdown of key manufacturing partners. Commodity markets, heavily dependent on Chinese purchasing, encountered a sudden and sharp drop in demand. Airlines and cruise companies also saw noticeable declines in customer demand.

Future economic outcomes are all dependent on the future path of the virus's growth. As the COVID-19 news initially broke, most predications centered on a "V-shaped" decline and recovery. This was the precedent set by the SARS virus, which translated to a noticeable but short decline in global economic activity that was followed by a sharp rebound in growth. As the virus has spread internationally, there is now a forecast for a "U-shaped" recovery which will take longer but eventually result in a return to growth by summer. All forecasts rest on the assumption that this virus will follow the pattern of most others that came before it, fading into one of the many manageable illnesses (although it may reoccur next winter, hopefully on a manageable basis) and allowing for a resumption of normal economic cycles.

Economists and market strategists have just begun to project the virus's potential impact to overall corporate performance. U.S. corporate earnings were expected to advance nearly 8% prior to the COVID-19 outbreak. Several prominent market strategists recently switched their prediction to zero earnings growth, or a repeat for the S&P 500 of its $164 per share in earnings realized during 2019. Global GDP was expected to post accelerating growth in 2020. Economists now expect at least one quarter of declining GDP growth and maybe more but no recession.

Turtle Creek Management does not expect market valuations to contract noticeably due to an ongoing plunge in bond yields. If the S&P 500 maintains its P/E multiple and posts flat earnings growth for the year, the February 28, 2020 closing price of $2,950 may be realistic. Should economic fallout be greater than expected and extreme risk aversion lower market multiples (similar to trading behavior in the 2008 credit crisis), losses could be greater throughout the year. If the virus should taper off quickly and profits still grow during the year, stocks could rebound quickly.

Variation in 2020 Projected Earnings

		-10%	-5%	0%	5%	10%
		$ 155.69	$ 164.34	$ 172.99	$ 181.64	$ 190.29
	14.36	2,235	2,360	2,484	2,608	2,732
Forward	15.36	2,391	2,524	2,657	2,790	2,922
P/E	16.36	2,547	2,688	2,830	2,971	3,113
Multiple	17.36	2,702	2,853	3,003	3,153	3,303
	18.36	2,858	3,017	3,176	3,335	3,493
	19.36	3,014	3,181	3,349	3,516	3,684
	20.36	3,170	3,346	3,522	3,698	3,874

In banking, the numbers have been similarly grim:

Historical Performance

	2/28 Close	% Change One Week	MTD	QTD	YTD	One Year	Three Year	P/E (x)
SNL Banking Indexes								
SNL Bank and Thrift	513.20	(14.88)	(12.48)	(18.83)	(18.83)	(6.50)	(3.73)	10.85
SNL Bank	537.88	(15.00)	(12.58)	(18.98)	(18.98)	(6.46)	(3.41)	10.57
SNL Thrift	815.39	(9.42)	(7.72)	(11.44)	(11.44)	(8.10)	(13.87)	23.88
SNL Western Bank	1,121.98	(14.50)	(12.67)	(21.85)	(21.85)	(16.72)	(24.90)	11.03
SNL Western Thrift	131.21	(11.05)	(11.48)	(18.09)	(18.09)	(18.50)	(14.48)	10.95
SNL Thrift MHCs	6,450.91	(7.88)	(2.40)	(0.55)	(0.55)	10.83	8.60	56.72
Broad Market Indexes								
DJIA	25,409.36	(12.36)	(10.07)	(10.96)	(10.96)	(1.95)	22.09	18.18
S&P 500	2,954.22	(11.49)	(8.41)	(8.56)	(8.56)	6.10	24.99	19.42
NASDAQ	8,567.37	(10.54)	(6.38)	(4.52)	(4.52)	13.74	47.07	20.89
Russell 3000	1,730.31	(11.61)	(8.35)	(8.56)	(8.56)	4.92	23.34	20.91

Source: S&P Global

But is the market getting ahead of itself? Looking beyond the next few quarters, the COVID-19 virus may recede to a transitory shock to the economic system that hopefully will not impair the longer-term growth.

So what should bankers do now? Our non-exhaustive list includes the following:

1. Adopt a Coronavirus action plan. In the event that an individual in the bank becomes sick, or there is exposure to customers with potential infection, how will the bank react? This should be planned out now. Please consider the attached regulatory guidance. Note that these documents are old, but still very relevant at the moment:

- FFIEC Interagency Statement on Pandemic Planning – December 2007
- Interagency Advisory on Influenza Pandemic Preparedness – March 2006

2. Banks are reassuring customers that:

    - Their cleaning personnel continues to use high-level antiviral cleaning agents to properly disinfect the entire facility on a daily basis.
    - They are reviewing their daily cleaning and sanitation protocol for all program areas and will modify and enhance daily procedures where necessary and appropriate.
    - Their staff are being reminded and retrained on procedures for sanitizing high-use surfaces and equipment/supplies.

3. Banks that are considering closing an office or operation need to be aware of requirements to notify their regulators. Certain states, such as California and Texas, may require explicit approval from the commissioner to close offices for more than 48 hours for emergency bank closings. Please contact us if you have questions about notice requirements in your particular state or any state where you have offices or operations that may be affected by the Coronavirus.

4. Consider the bank and customer's business interruption insurance. We have been hearing that insurers have started adding exclusions that read like the following: "Losses arising from or related to any business interruption or other business downturn solely to the extent such interruption or downturn arises out of novel Coronavirus (including any resulting COVID-19 sickness) or any other government or regulatory sanction or response thereto are excluded." Consider if such an exclusion is being added to the bank's policy, then push back on such efforts. Alert your customers to do likewise.

5. Evaluate your own customers to see if they have dependency on industries most likely to be impacted by a significant stress to the economy, such as transportation, commodities, including energy, aviation and travel. Reach out to those customers in order to determine whether more frequent monitoring of financial information would be appropriate. Expect your regulators to start to ask about the protocols you have in place as well as customer exposure to virus risk.

6. Consider steps you can take to work with your consumer customers that are directly affected by COVID-19. For example, consider waiving ATM fees, increasing ATM daily cash withdrawal limits, waiving overdraft and NSF fees, offering short-term or small dollar loans, waiving late fees for credit card and other loan balances, waiving penalties for early withdrawal of savings or offering payment accommodations, such as allowing loan customers to defer or skip some payments or extending the payment due dates, which would avoid delinquencies and negative credit agency reporting caused by Coronavirus -related disruptions. These are similar types of steps that banks have considered in response to natural disasters.

7. For public companies or those considering securities offerings, consider Risk Factor disclosure. In M&A transactions, evaluate whether to carve out COVID-19 from the "Material Adverse Effect" definition.

8. Consider taking advantage of the sharp drop in interest rates to issue subordinated debt or senior unsecured debt. Jacque Kruppa presented a webinar on this topic that we would be happy to send to anyone with an interest.

Americans have always been great at pulling together at times of stress. We expect the reaction to this novel virus to be no different. Nonetheless, the continuing drumbeat of news and focus may cause some people to overreact. Hopefully we will be able to look back at the Coronavirus the way we consider Y2K readiness. In the meantime, we will pass along other ideas to the extent we think they will be helpful.

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