# My Thoughts about the Coronavirus

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I will repeat my overarching perspective, which is that I don’t like to take bets on things that I don’t feel I have a big edge on, I don’t like to make any one bet really big, and I’d rather seek how to neutralize myself against big unknowns than how to bet on them. That applies to the coronavirus.  Still, there’s no getting around having to figure out what this situation is likely to mean and how we should deal with it, so here are my thoughts for you to take or leave. In reading them please realize that I’m a “dumb shit” when it comes to viruses, though I do get to triangulate with some of the world’s best experts. So, for the little that they’re worth, here are my thoughts.

**Three Perspectives**

As I see it there are three different things going on that are related yet are very different and shouldn’t be confused: 1) the virus, 2) the economic impact of reactions to the virus, and 3) the market action.  They all will be affected by highly emotional reactions. Individually and together they lend themselves to a giant whipsaw with big mispricing’s, with the off chance that it will trigger the downturn that I have been worried would happen with both the big wealth/political gap and the end of the big debt cycle (when debts are high and central banks are impotent in trying to stimulate).

1) The Virus

The virus itself will almost certainly a) come and go and b) have a big emotional impact, which will most likely produce a big whipsaw. It will most likely lead to an uncontained global health crisis that could have high human and economic costs, though how it is handled and what the consequences will be will vary a lot by location (which will also affect how their markets behave). Containing the virus (i.e., minimizing its spreading) will occur best where there are 1) capable leaders who are able to make executive decisions well and quickly, 2) a population that follows orders, 3) a capable bureaucracy to enforce and administer the plans, and 4) a capable health system to identify and treat the virus well and quickly. It will require the leaders to turn on “social distancing” quickly and effectively ahead of the virus accelerating and to withdraw it quickly as it declines.  I believe that China will excel at this, major developed economies will be less good but OK, and those who are weaker than them in these respects will be dangerously worse. For this reason, I am told that it’s likely that it will spread fast in these other countries and roughly in proportion to those four factors I just mentioned, and likely as a function of the weather (e.g., the hot weather in the Southern Hemisphere is thought to be an inhibitor). Because it is spreading fast to many countries and the reported cases and deaths are likely to increase rapidly, the news is likely to rapidly increase panicky reactions. Also, in the US there will be much more testing happening over the next couple of weeks, which will dramatically increase the numbers of reported infected people, which will also probably lead to more severe reactions and greater social distancing controls.  I am told that the stresses on hospitals could become very large, which will make handling the cases of all patients more difficult. In short, I am told that we should expect much more serious problems ahead.

2) The Economic Impact

Reactions to the virus (e.g., “social distancing”) will probably cause a big short-term economic decline followed by a rebound, which probably will not leave a big sustained economic impact. The fact of the matter is that history has shown that even big death tolls have been much bigger emotional affairs than sustained economic and market affairs. My look into the Spanish flu case, which I’m treating as our worst-case scenario, conveys this view; so do the other cases.

While I don’t think this will have a longer-term economic impact, I can’t say for sure that it won’t because, as you know, I believe that history has shown us that when a) there is a large wealth/political gap and there is a battle against populists of the left and populists of the right and b) there is an economic downturn, there are likely to be greater and more dysfunctional conflicts between the sides that undermine the effectiveness of decision making, and this is made worse when c) there are large debts and ineffective monetary policies and d) there are rising powers challenging the existing world powers.  The last time that happened was during the 1930s leading up to World War II, and the time before that was in the period leading up to World War I. Certainly, the wealth gap and political conflict leading to possible policy changes will be top of mind along with the coronavirus on this Super Tuesday.

3) The Market Impact

The world is now leveraged long with a lot of cash still on the sidelines—i.e., most investors are long equities and other risky assets and the amount of leveraging that has taken place to support these positions has been large because low interest rates relative to expected returns on equities and the need to leverage up low returns to make them larger have led to this. The actions taken to curtail business activities will certainly cut revenues until the virus and business activity reverse which will lead to a rebound in revenue. That should (but won’t certainly) lead to V- or U-shaped financials for most companies.  However, during the drop, the market impact on leveraged companies in the most severely affected economies will probably be significant. We will show you what that looks like shortly. My guess is that the markets will probably not distinguish well between those which can and cannot withstand well the temporary shock and will focus more on their temporary hit to revenues than they should and underweight the credit impact—e.g., a company with plenty of cash and a big temporary economic hit will probably be exaggeratedly hit relative to one that is less economically hit but has a lot of short-term debt.

Additionally, it seems to me that this is one of those once in 100 years catastrophic events that annihilates those who provide insurance against it and those who don’t take insurance to protect themselves against it because they treat it as the exposed bet that they can take because it virtually never happens.  These folks come in all sorts of forms, such as insurance companies who insured against the consequences that we are about to experience, those who sold deep-out-of-the-money options planning to earn the premiums and cover their exposures through dynamic hedging if and when the prices get near in the money, etc. The markets are being, and will continue to be, affected by these sorts of market players getting squeezed and forced to make market moves because of cash-flow issues rather than because of thoughtful fundamental analysis.  We are seeing this in very unusual and fundamentally unwarranted market action. Also, what’s interesting is how attractive some companies with good cash yields have become, especially as many market players have been shaken out.

As far as central bank policies are concerned, interest-rate cuts and increased liquidity won’t lead to any material pickup in buying and activity from people who don’t want to go out and buy, though they can goose risky asset prices a bit at the cost of bringing rates closer to hitting ground zero. That’s true in the US. In Europe and Japan, monetary policy is virtually out of gas so it’s difficult to imagine how pure monetary policy will work. In Europe, it will be interesting to see if fiscal policy stimulations can pick up in this political environment.  Also, in all countries, don’t expect much more stimulation coming from rate cuts because most of the rate cuts have already happened via the declines in bond and note yields which is what equities and most other assets are priced off of. So, it seems to me that containing the economic damage requires coordinated monetary and fiscal policy targeted more at specific cases of debt/liquidity-constrained entities rather than more blanket cuts in rates and broad increases in liquidity.

The most important assets that you need to take good care of are you and your family. As with investing, I hope that you will imagine the worst-case scenario and protect yourself against it.