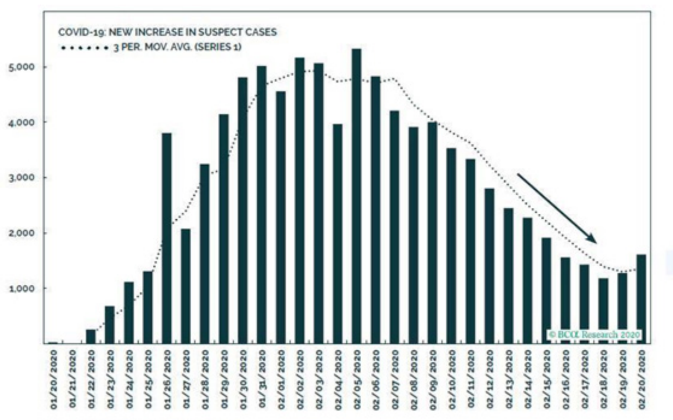
COVID-19: THE IMPACT ON THE MARKETS WORLDWIDE

The coronavirus outbreak is a "tail-risk-event" that is unfolding in real time as we prepared this newsletter, and as markets reacted strongly to the downside in the last week of February. This "real-time-effect" suggests uncertainty across all levels. By "uncertainty at all levels" we mean that, at this particular point in time, our chosen underlying investment managers, ourselves, as well as global policy makers, do not have any definite idea of what the actual impact will be, as well as how portfolios may need to be adjusted in order to reflect this. Thus far, most views have been extracted from comparisons with prior epidemics, and in all cases the impact on the global economy and global capital markets was short-lived.

Following the initial news of the coronavirus outbreak in China, markets reacted negatively, but recovered during the beginning of February as evidence emerged that the coronavirus was contained within China (as can be seen from the graph below), coupled with evidence that China had also engaged in meaningful policy stimulus in order to combat the adverse economic impact. To date, economic activity in China is gradually rising as economic-activity-participants return to work. Starbucks reopened 85% of their 4 290 stores in the country.

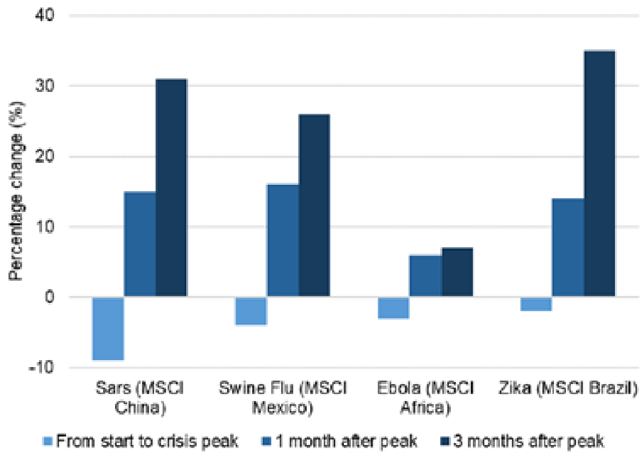


SOURCE: CHINA NATIONAL HEALTH COMMISSION.

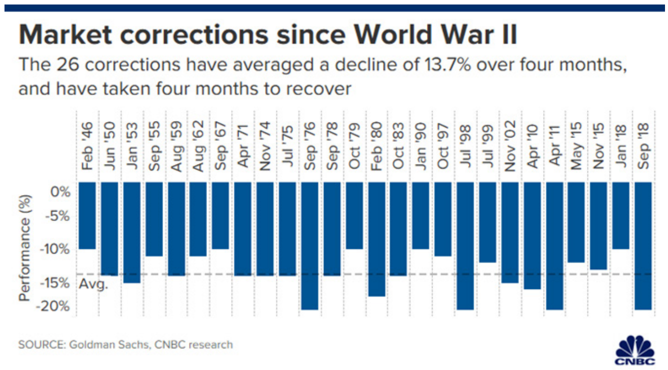
Since 20 February, there have been incidences of the Coronavirus spreading to countries such as Japan, South Korea, Iran and Italy, as illustrated in the chart below.

Markets panicked!

It appears that global investors are not confident that these other countries will be able to contain the virus in the same manner that China was able to. It also suggests that global investors are not confident that these other countries have the same policy-tools to support their underlying economic growth in the same manner that China was able to. At this stage, it is very difficult to assess the extent to which global investors are justified in giving no credit whatsoever to these newly infected countries' abilities to contain the virus, or to defend their economic growth via policy support. It is also very difficult to confidently dismiss the impact of policy responses undertaken by China's policy makers on global economic growth thus far in February as "null and void". BCA, our independent global investment strategy partner, remains of the view that much of the adverse effects of the coronavirus will be contained to the first quarter of 2020, which will lead to a meaningful, strong recovery afterwards, as pent-up demand is released into the economy. They are accordingly upgrading their equity exposure recommendation from neutral to marginally overweight on a three-month view, to capitalise on the current correction in markets. Based on previous virus outbreaks, the markets initially fell but recovered within 1-3 months as indicated in the chart below.



Overall, there have been 26 global market corrections since World War II. The average decline was 13.7% and has taken four months on average to recover. Over this same period, there have been 12 bear markets with an average decline of 32.5%. On average, it has taken 14.5 months to recover from the bottom.



Markets will remain volatile until there is a slowdown in the spread of the coronavirus. News surrounding the virus might paint a gloomier picture for the world economy than should be the case. It is a serious virus, but China was proactive in trying to contain the virus. Bad news sells. As such, the combination of sensationalist reporting and fake news will create an intoxicating narrative which will probably contribute to market volatility. The expectations are that countries will stimulate their economies to jumpstart economic growth. Markets tend to recover quickly after the peak of a virus outbreak

We will continue to monitor the developing situation closely and will not hesitate to communicate with you should the picture change materially for the better or worse in ways that compel us to adjust portfolios.

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