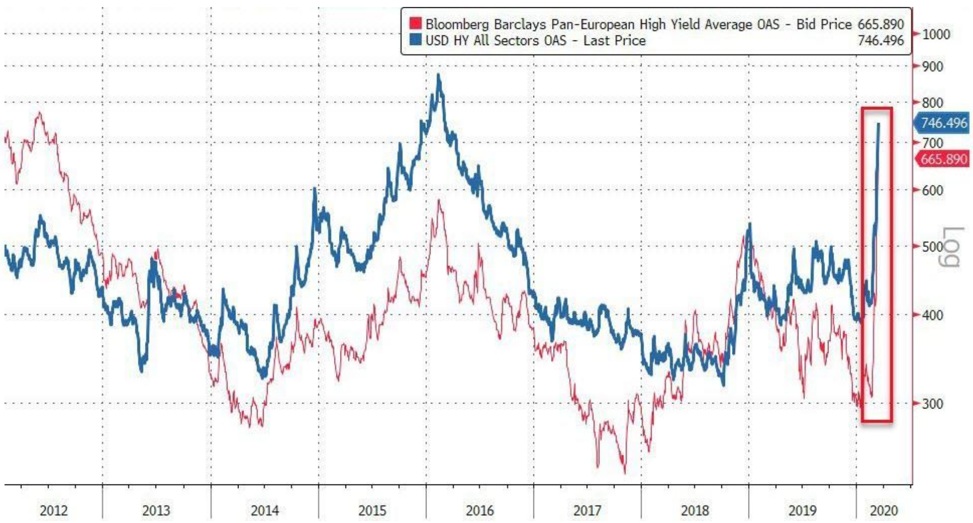
“Coronavirus” COVID-19 – update for Investors. 16th March 2020.

It was Harold Wilson in 1963 who was credited with coining the phrase ‘a week is a long time in politics’. Well it certainly has been an extraordinarily long week in terms of the twists and turns in the markets. Soaring volatility, as collapsing oil prices added another twist to the economic shock already provided by COVID-19, provided the final catalyst to end the US equity bull market after 11 years, prompting a predictable and much needed response from various authorities around the world, in terms of emergency support. Sunday’s extraordinary actions from The US Federal Reserve, cutting the Fed Funds rate 0-0.25%, the banks’ reserve requirement ratios to 0% and the re-launch of Quantitative Easing (QE) with $700bn in asset purchases starting today, being the latest and showing a desire to keep pumping more liquidity into the markets to help stabilise the situation.

As the markets now digest the distinct possibility of a global recession (defined as sub 2% global growth) if, as now seems increasingly likely, the disruption caused by The Coronavirus continues deep into the second quarter, fractures are inevitably showing across all risk assets.

So far, FTSE has lost more than 30% since its most recent peak and US equities, as measured by the S&P500 are down 19%, even after the sharp rally of almost 10% late in the session on Wall Street on Friday (13th), with volatility levels not seen since the 2008 Great Financial Crash. In the high yield market, spreads have exploded over the past week, as the economic reality of a sharp slowdown in activity sinks in, not helped by the oil price collapse and its immediate implications for the energy and related sectors. As previously discussed, high gearing ratios and inadequate interest rate coverage will inevitably push some companies over the edge and provide the next chapter in this saga.

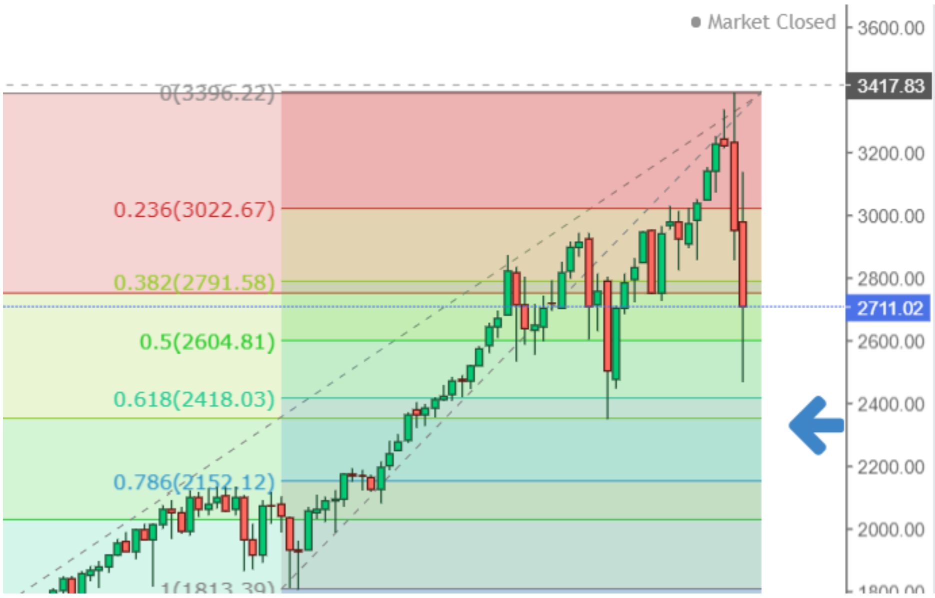


Finally, the contagion has even affected the perceived safe haven of Investment Grade bonds and the pricing of US Treasury Credit Default Swaps. It may seem odd but the cost of all this additional support and QE, on top of the existing $24tr US debt pile, with recurring large fiscal deficits does not paint a rosy picture.

Where to next?

Until the effects of the Coronavirus peak, it's too early to confidently call the bottom on US equities and global equities in general, despite the latest announcements of support. That said, as we test previous support and retracement levels, the fundamentals do start to look a lot more reasonable. We anticipate that the S&P 500 should start to see some form of bottoming out around the 2300-2361 level. Assuming US earrings now decline 10% this year (they started the year at +8%), this would imply a forward PE under 15 and a Cyclically Adjusted PE (CAPE) ratio in low 20s. While the CAPE did briefly touch 15 in the 2009 correction, ultra-low rates, provide us with additional support.

Nevertheless, markets as we all know, do have a tendency to overshoot so until COVID-19 is contained and on the decline, there is always the possibility of another leg down to the 2000 level but as things stand today, we suspect the financial measures being put in place around the globe, should help avoid this.



Of course, all the above is contingent upon the normal functioning of the markets such as repo and interbank. Meanwhile there is a race to find a vaccine and it is hoped that recent trials will help design a better response. Oil, the other exogenous shock, will have to settle at a higher level once the highly leveraged shale companies are priced out and Oil heavyweights start feeling pressure on their own GDP.

As followers of our global multi-asset strategy will know, we focus on systematic risk only and diversification at the systematic risk level ensures we have exposure to different economies hence reducing overall portfolio risk. Those funds with single market exposure and large idiosyncratic risks will have experienced a great deal more volatility and downside through these difficult market times.

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