Our view

Researchupdate

Covid-19 market impact

26 February 2020

Overview

- From late December 2019 a new virus outbreak, officially called Covid-19 (a.k.a. "coronavirus"), emerged out of Wuhan, China.
- To date this outbreak was focused on China which accounted for 96.7% of 80,423 confirmed cases and 98.4% of 2,708 reported deaths (as at February 26)
- However, in recent weeks we have seen notable growth in cases particularly in South Korea and Italy as well as Japan, Iran and elsewhere in Europe.

Why did the outbreak affect markets?

- Investors fear that the outbreak will further weaken the global economy not just China.
- Fears of spreading elsewhere into Europe would further weaken an already weakly growing European economy.
- There are now substantiated fears that this may upset global supply chains with companies such as Apple calling out revenue misses and potential difficulty in getting iPhones to market given factory shutdowns in China.
- Markets had arguably been rallying in recent weeks despite virus concerns on the assumption that it would be contained. This had seen share market valuations become stretched which heightened the damage we have seen in the last week when investor sentiment weakened.

Implications for your portfolio

- Defensive assets like bonds and defensive subsectors such as property have benefitted.
- Our portfolios as of the most recent SAA review are less than 50% hedged for most risk profiles. These exposures have benefitted from the recent falls in the Australian dollar.
- We take a long-term approach to investing in emerging markets with their weight in portfolios reflecting their higher expected risk. Clients are not exposed to undue loss as a result.
- You **will** see more alarmist headlines such as "global markets lose $x trillion" or "the ASX falls $y billion"
    - These headlines are literally true but are unhelpful and misleading. By triggering fear, they help news websites generate traffic and ad sales.
    - However, **negative** daily or even weekly returns in markets can happen often.
    - Taking a longer-term perspective is key. Holding for longer periods of time substantially improves the likelihood of a positive return as the below shows for the Australian share market over the longer term.

All Ordinaries total returns (1980 to 2020)

Time period	Positive return	Negative return
Daily	54.0%	46.0%
Weekly	57.7%	42.3%
Monthly	63.7%	36.3%
Quarterly	69.4%	30.6%
Yearly	72.5%	27.5%
Rolling 10 years	**100%**	**0%**

Ongoing Monitoring and action

Our base case was for the outbreak to be gradually contained in the near term with its impact on the economy limited to weakness in the March quarter and potentially the June quarter of this year.

Authorities also stand ready to commit to further stimulus with announcements of new Chinese fiscal stimulus being flagged while the US Federal Reserve has announced its willingness to be proactive should the US economy soften.

As a possibility we raised in our previous update, news on the virus did contribute to higher market volatility. The scale of the economic shutdown is also likely to see poor economic data with early warning signs in “flash” Composite PMIs for the US (reflecting the weakness in trade and production as activity has softened).

Currently Australian equity market volatility is at 12.6% (annualised) while portfolio composite proxies (using market index benchmarks) are also low. Periods of heightened volatility tend to coincide with share market corrections. Today’s levels are below SAA thresholds and longer-term historical averages. All else being equal this would suggest leaving portfolios unchanged.

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