Market Update - Coronavirus (COVID-19)

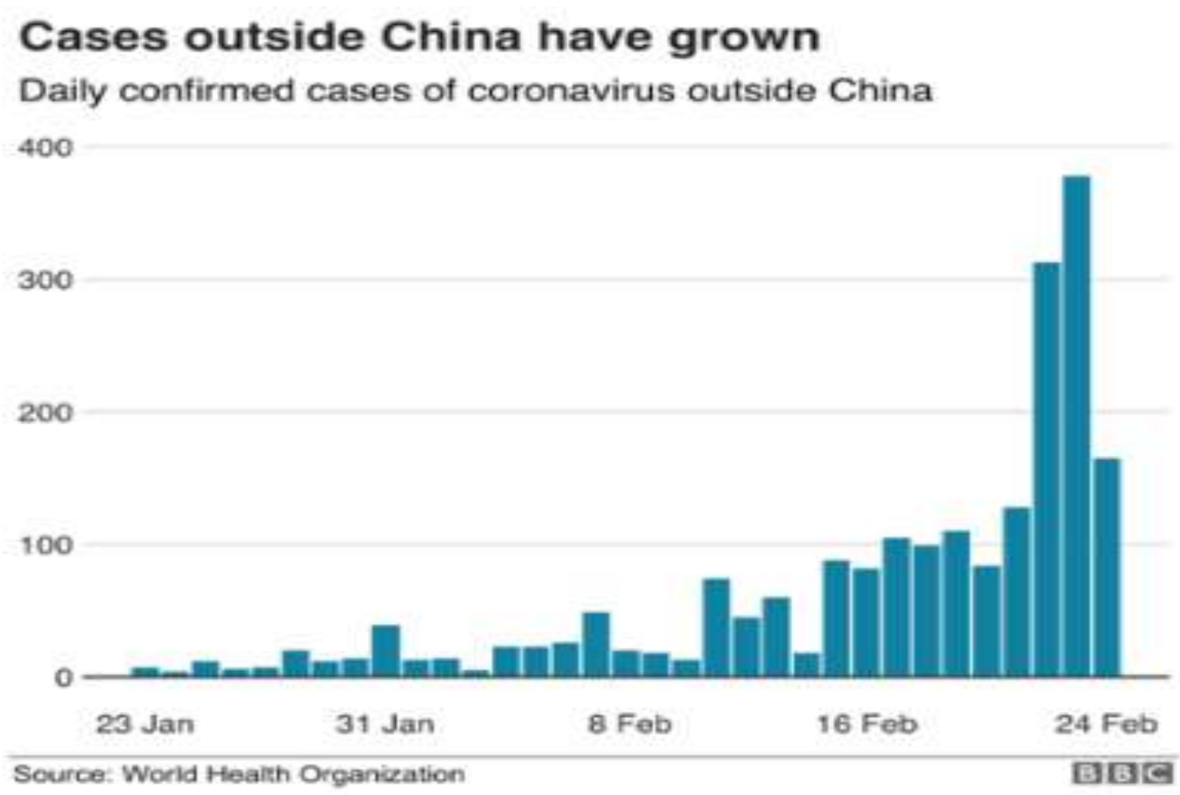
29th February 2020

BACKGROUND

Equity markets and growth assets generally, have fallen sharply in the past week due to the rising concern surrounding the spread of the Coronavirus to previously less affected countries such as Iran, Italy and South Korea. This has seen safe haven assets such bond yields drop to a multi-year lows and gold rise to a multi-year high. The sharp drop has erased gains for growth assets this year, and even further depending on which asset class.

The reason for the sharp fall now and not earlier was that markets made the assumption that the virus would be contained within China, and that the number of newly reported cases of the virus would continue to decline. While the overall number of new cases has continued to decline, the sharp rise in reported cases outside of China, including in Europe, suggests containment has not been, and may not be, effective. This now makes it a global problem rather than a problem just for China!

The fact that some carriers are asymptomatic and that the incubation period is long and variable (typically 2 – 14 days) is complicating containment efforts of national and international authorities. Below are some charts that show the number of daily confirmed cases of the virus outside of China and the fatality rate for the various age groups within China.



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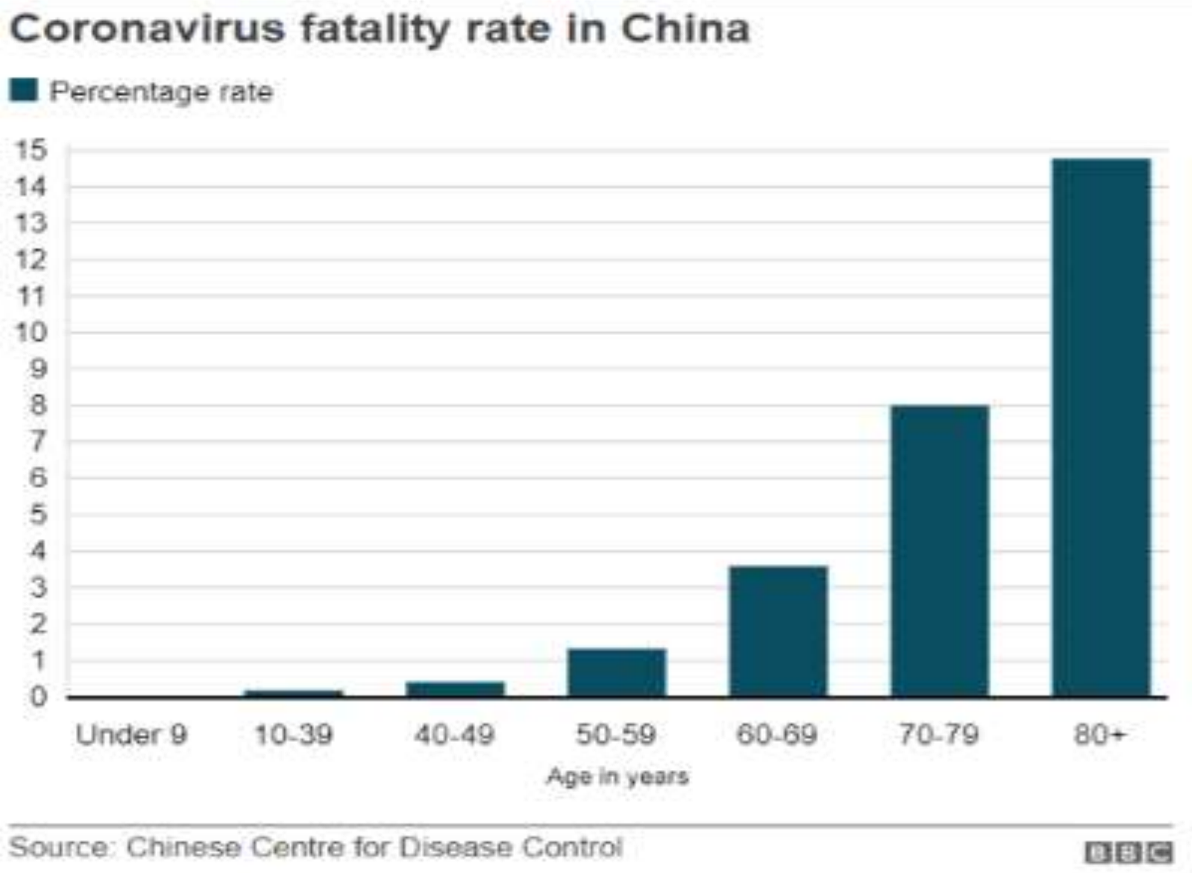

IMPACT OF THE VIRUS ON MARKETS

The Coronavirus and its spread to other countries outside of China have created fear, disruption and uncertainty, with investors unsure of the economic impact. Given the strength of the market in 2019, and the continuation of this strength into the start of 2020, there was a sense that the market was due for a sell-off. Arguably, the coronavirus has affected investor and business sentiment to an extent that it has encouraged this sell-off.

However, in past instances of virus outbreaks, be it SARS, H1N1 influenza, swine flu or Ebola, once a clear pattern emerged of declining new cases, markets recovered, typically within 3-6 weeks. The chart below of previous world epidemics shows that within 3 months from the peak of an epidemic, global equity markets mostly had recovered earlier losses.

Immune: world epidemics and global stock market performance

	Market Returns		
Epidemic	1-month	3-month	6-month
HIV/AIDS	-0.46%	-4.64%	-3.25%
Pneumonic Plague	-2.79%	-4.67%	-4.30%
SARS	8.64%	16.36%	21.51%
Avian Flu (H5N1)	-0.18%	2.77%	10.05%
Dengue Fever	1.07%	7.09%	9.68%
Swine Flu (H1N1)	10.90%	19.73%	39.96%
Cholera Outbreak	-2.35%	7.02%	13.61%
MERS	-0.29%	2.15%	8.58%
Ebola	-0.09%	2.37%	4.37%
Measles/Rubeola	-1.71%	1.92%	2.29%
Zika	-6.05%	-0.88%	-0.57%
Ebola	-7.42%	-13.74%	-3.49%
Measles	6.46%	4.51%	12.02%
Average	**0.44%**	**3.08%**	**8.50%**

The MSCI World Index captures large and mid cap representation across 23 Developed Markets countries. With 1,646 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. **Past performance is no guarantee of future results.**

However, each epidemic is different and past outcomes are no guarantee of future outcomes. Therefore, the situation is being very closely monitored and as more information becomes available we will begin to see what government and central banks responses are going to be to restore economic growth. At this stage it is anticipated that major governments and central banks responses will be coordinated and aggressive to rebuild their economies.

SOME DIFFERENT SCENARIOS FOR THE IMPACT OF THE VIRUS

In a bull case scenario, due to heightened global vigilance and a global effort to avoid infection, the number of new cases outside of China also begins to decline, leading to the end of what have been in some cases draconian containment measures that have been severely economically disruptive, especially in China.

In a bear case scenario, the number of cases globally accelerates, and authorities would also ease up on containment efforts and focus instead on the effective treatment of severe COVID-19 cases.

In the positive scenario, it is expected a V-shaped recovery in global economies as deferred economic activity creates pent-up demand and travel returns.

In a negative scenario, given that the containment measures and not the virus itself have caused the disruptions to the economy, it is expected that a modest and more protracted rebound in economic activity would occur (U-shaped recovery). In this scenario it is anticipated that we would see depressed levels of consumer activity and confidence that could have a lingering impact to economic growth.

CURRENT POSITION

We are currently holding our position to see what government and central banks responses are going to be to restore economic growth and are taking the more optimistic view, for now, that the number of new cases outside of China will begin to decline as authorities increase their efforts to contain the spread of the virus.

Client portfolios are well diversified with capital spread across the different asset classes. Within asset classes there is also a blend of differing investment styles, which should help reduce the level of downside investors' experience. In periods of uncertainty the AUD tends to fall, providing additional protection for international assets that are unhedged. Retaining some exposure to equities will also benefit most once the longer-term impacts of COVID-19 are absorbed by markets.

However, while the disruptive impact of containment measures globally will have a meaningful impact to short-term economic growth, it is expected these measures are gradually eased even if containment is unsuccessful. The trajectory of economic recovery, and therefore that of earnings is path dependent and may be modest to slow in a negative scenario.