



Portfolios Update

13 March, 2020

The pace of market movements is similar to the stock market crash in 1987. Sparked by concerns that the coronavirus is spreading globally, and culminating with a shocking oil price war by the Saudis, the widely followed S&P 500 index fell 27% from its peak in February.

The pain was felt in other asset classes like credit, commodities and foreign exchange markets. Junk bonds erased all of the year's gains while industrial metals continued to make new lows. High yielding currencies were not spared, with the Australian dollar trading at levels not seen since the Great Financial Crisis of 2008. Even traditional safe havens like US Treasury bonds and gold are also cracking in the midst of panic as investors hoard liquidity.

With the VIX (a.k.a Fear index) trading at 75.5, it was the highest level since 2008 when the global financial system stopped functioning. Clearly, there is a sense of panic in financial markets. Back in 2008, when banks started to collapse one after another, we saw the VIX index rising steadily. It did not stop until Lehman Brothers collapsed and the US government was forced to step in to bailout the banking system. While some may compare the current coronavirus to 2008, where the spread of the COVID-19 virus cripples the global economy with lockdowns, the pace of the rise in the VIX index surpassed what we saw in 2008. Jittery investors are either pricing in something worse or are acting irrationally. Investors should step back to see how the situation is evolving, first in China which is the epicentre, and then to the rest of the world, especially places like South Korea and Italy.



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There has been good progress in terms of containing the coronavirus in China. Transmission is falling and life is slowly getting back to normal. As of 13 Mar, the number of new cases in China has fallen to 8. This is a big improvement, compared to a week ago where new cases came in at 129. While we acknowledge that the draconian measures implemented by China may not be replicable by other countries, looking at the trend in South Korea gives us hope.

The situation in South Korea peaked in late February and the number of new cases has trended lower even as the authorities tested 189,000 people. While the number of new cases may increase, the fact that the trend can come down shows that the virus is containable, so long as everyone plays a part to combat the coronavirus. With Europe and the US just starting to see an increase in the number of cases, we will need to observe when it can peak and start declining, given that Italy has started restricting movements and implemented social distancing.

Another point to note is that China is slowly normalising. While economic data for March will not be out till April, high frequency data like traffic conditions, labour movement and freight indicators all point towards recovery. As we get more news that China is restarting production, this will give investors confidence that the COVID-19 challenge is not insurmountable.

The sharp declines in equity markets reflect the rising odds of economic weakness. Yet, at the same time, governments are planning fiscal response to help businesses and consumers cope with the coronavirus, while central banks are already loosening monetary policy to keep financial conditions easy. These serve as a backstop to how severe the economic weakness can be. In fact, it is highly probable that the full effect from such measures will kick in just as the virus peaks, lockdowns are eased and economic activity rebounds, with pent up demand leading to a turbo-charged recovery in the second half of the year. This is not the time to sell, but to buy into risk assets.

