

Unknown unknowns: the coronavirus

Michael Clough

When we talk about risks to our investment outlook, we always warn of the threat of 'unknown unknowns', events that come seemingly out of nowhere that can't be predicted or planned for. All we know is at some point they will arise. As all readers will be aware, two have already arisen in the early stages of 2020, firstly with the tragic incident in Iran when a civilian plane was shot down and secondly with the outbreak of the new coronavirus in China. Understandably, we have received numerous queries from clients, notably on the latter, and this Global Matters Weekly seeks to clarify our current stance on recent events.

As at the time of writing the virus has killed 361 people, with more than 17,000 confirmed cases. Fears have naturally escalated across the globe with cases now confirmed in a host of countries where the patients had not even visited China. Indeed, last Thursday the World Health Organisation deemed the outbreak a global emergency, the sixth time it has made such an announcement since 2009. Fears also stem from the memories of past outbreaks, including SARS (severe acute respiratory syndrome) in 2003 which caused the death of 774 people, Ebola in 2014 which killed over 11,000 people and even the 1918 influenza pandemic which killed an estimated 50 million people. At this stage the current outbreak has not hit the levels of those stated previously and, without meaning to downplay the developments and acknowledging the ever-increasing number of casualties, far fewer people have died compared to the tens of thousands who die each year from seasonal flu. Though the recent developments have of course been frightening, we do think it is important to keep them in a historical context.

Sectors deemed to be most sensitive to this outbreak are luxury retailers, alcohol producers, leisure, airlines and selective commodity producers with these sectors directly impacted by a fall in customers' propensity to consume. We are receiving regular updates from the Chinese equity managers we have met with. One has described the situation in China's largest city: "Shanghai remains quiet with most streets fairly empty. Transport has largely stopped with people staying at home and only going out for food and other necessity shopping." Chinese consumption, economic growth and certain company earnings are certainly going to take a hit in the first quarter of 2020, though this slump is currently only expected to be short lived, as was the case with SARS in 2003. An announcement over the weekend from China's central bank that it has now pumped the equivalent of net \$22bn into the economy confirms the economic significance and safe haven assets have moved to price in a negative outlook. US 10 year real yields are now sub-zero and currently sit at their lowest level since 2013. Gold has also bounced up 4% so far this year and has shown its tail risk hedging qualities. Times like this show why we typically have an allocation to the precious metal, and always to safe haven assets more broadly, in portfolios.

Sharp market moves in the crescendo of such events provide opportunities for those who can be active and nimble. Our current approach, as it has been since the outbreak of these events, has been one to not panic. We have not made any alterations to portfolios as a result. As the situation continues to unfold that of course may change as opportunities are presented. Events such as these will come up again in the future, as they have in the past, and markets will be volatile in the short term. Nonetheless we don't believe they should distract us from our long term objectives for clients. We remain diversified across asset classes so as not to be too affected by large swings in individual companies and sectors.

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Market Focus

- » The UK departed from the European Union on Friday, after more than 47 years of membership
- » Global markets continued to fall as the coronavirus concerns dominated sentiment
- » Brent crude fell 4.2% ending the week at \$58.2 a barrel
- » Gold rose 1.1% ending the week at \$1589.2 an ounce

US

- » US equity benchmarks lost ground over the past week as coronavirus fears weighed on global trade outlook.
- » Despite the broad equity falls, Amazon, Apple and Microsoft all posted positive Q4 earnings and rallied strongly in the week.
- » As expected, the Federal Reserve voted to keep rates unchanged at 1.50-1.75% with their post meeting statement remaining mostly unchanged from December.
- » Over the week, the S&P 500 fell 2.1%, whilst in fixed income markets US Treasuries gained 1.0%.

Europe

- » Europe was also negatively affected by rising coronavirus fears, with the continental European equity index falling 3.0%.
- » Euro-area unemployment fell to its lowest level in over a decade.
- » The European Commission's economic sentiment indicator rose in December to a five-month high, showing higher confidence in the industrial and construction sectors.

UK

- » The Bank of England voted to maintain its base rate at 0.75%, pointing to improved business sentiment and the stabilisation of global growth.
- » Nissan announced that it may abandon EU operations and increase UK operations following Brexit.
- » The UK allowed Huawei a minority participation in the UK's growing 5G industry, despite the potential negative consequences on a US-UK trade deal.
- » UK gilts returned 0.4% over the past week, with equity markets falling 4.0% due to falling global trade sentiment.

Rest of the World/Asia

- » The World Health Organisation declared the coronavirus an international public health emergency.
- » In response to the coronavirus, Chinese equity markets opened over 7.0% lower this morning after the Lunar New Year break (their worst daily fall since 2015). China's central bank, the People's Bank of China, injected net \$22 billion into markets to provide liquidity.

Asset Class / Region	Currency	Cumulative returns			
		Week ending 31 January	Month to date	YTD 2019	12 months
Developed Markets Equities					
United States	USD	-2.1%	-0.1%	-0.1%	21.0%
United Kingdom	GBP	-4.0%	-3.3%	-3.3%	8.5%
Continental Europe	EUR	-3.0%	-0.8%	-0.8%	18.9%
Japan	JPY	-2.7%	-2.1%	-2.1%	10.2%
Asia Pacific (ex Japan)	USD	-4.8%	-3.7%	-3.7%	7.0%
Australia	AUD	-1.0%	5.0%	5.0%	24.7%
Global	USD	-2.2%	-0.6%	-0.6%	17.7%
Emerging Markets Equities					
Emerging Europe	USD	-5.2%	-3.6%	-3.6%	14.4%
Emerging Asia	USD	-5.2%	-4.5%	-4.5%	6.1%
Emerging Latin America	USD	-4.9%	-5.6%	-5.6%	-3.5%
BRICs	USD	-4.7%	-4.4%	-4.4%	6.9%
MENA countries	USD	-1.5%	-0.7%	-0.7%	1.0%
South Africa	USD	-5.9%	-8.8%	-8.8%	-10.6%
India	USD	-2.7%	-2.1%	-2.1%	10.9%
Global emerging markets	USD	-5.1%	-4.7%	-4.7%	3.8%
Bonds					
US Treasuries	USD	1.0%	2.6%	2.6%	9.4%
US Treasuries (inflation protected)	USD	0.9%	2.3%	2.3%	9.7%
US Corporate (investment grade)	USD	0.5%	2.3%	2.3%	14.5%
US High Yield	USD	-0.3%	0.0%	0.0%	9.4%
UK Gilts	GBP	0.4%	3.9%	3.9%	10.4%
UK Corporate (investment grade)	GBP	0.1%	2.9%	2.9%	12.1%
Euro Government Bonds	EUR	1.3%	2.5%	2.5%	8.3%
Euro Corporate (investment grade)	EUR	0.3%	1.2%	1.2%	6.3%
Euro High Yield	EUR	-0.3%	0.2%	0.2%	9.1%
Japanese Government	JPY	0.4%	0.5%	0.5%	2.1%
Australian Government	AUD	1.1%	3.2%	3.2%	10.7%
Global Government Bonds	USD	1.3%	1.8%	1.8%	6.5%
Global Bonds	USD	1.0%	1.4%	1.4%	6.9%
Global Convertible Bonds	USD	-0.7%	1.5%	1.5%	9.2%
Emerging Market Bonds	USD	1.1%	2.2%	2.2%	9.6%

Source: Bloomberg. Past performance is not indicative of future returns.

Asset Class / Region	Currency	Cumulative returns			
		Week ending 31 January	Month to date	YTD 2019	12 months
Property					
US Property Securities	USD	-1.6%	1.1%	1.1%	12.5%
Australian Property Securities	AUD	-0.7%	6.4%	6.4%	14.2%
Asia Property Securities	USD	-2.2%	-4.0%	-4.0%	0.5%
Global Property Securities	USD	-1.7%	-0.4%	-0.4%	10.8%
Currencies					
Euro	USD	0.5%	-1.3%	-1.3%	-3.2%
UK Pound Sterling	USD	0.9%	-0.5%	-0.5%	0.6%
Japanese Yen	USD	0.8%	0.2%	0.2%	0.4%
Australian Dollar	USD	-1.9%	-4.7%	-4.7%	-7.9%
South African Rand	USD	-3.8%	-6.7%	-6.7%	-11.1%
Swiss Franc	USD	0.7%	0.3%	0.3%	3.1%
Chinese Yuan	USD	-0.1%	0.8%	0.8%	-3.0%
Commodities & Alternatives					
Commodities	USD	-3.2%	-7.4%	-7.4%	-3.2%
Agricultural Commodities	USD	-2.3%	-3.1%	-3.1%	-5.2%
Oil	USD	-4.2%	-11.9%	-11.9%	-6.0%
Gold	USD	1.1%	4.4%	4.4%	20.2%
Hedge funds	USD	-0.4%	0.5%	0.5%	6.9%

Source: Bloomberg. Past performance is not indicative of future returns.

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