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Does 2019-nCoV matter for markets?

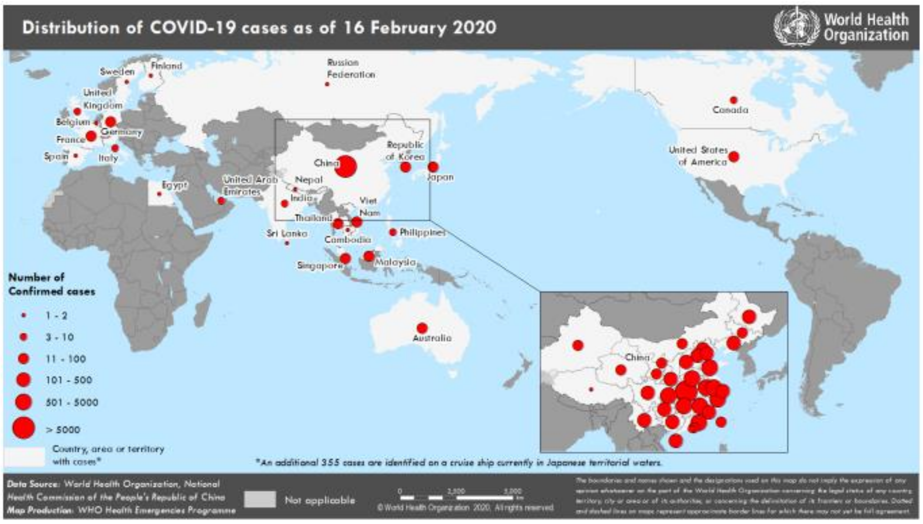
The coronavirus has added uncertainty to an otherwise low-volatility market environment. Recent developments suggest that the spread of the virus can be contained.

Global financial markets have reacted strongly to rising concerns over the spread of a novel coronavirus. After starting the year on a positive note, most risky assets took a dive at the end of January when the outbreak intensified, though most of this correction has now been recovered. In the near term, we expect more volatility as a result, but ultimately, we see this as a temporary phenomenon that should only marginally affect global economic growth and markets.

The 2019-nCoV has introduced new uncertainty to a market that has been spoiled by positive economic momentum, accommodative central banks and the forging of a trade truce between the US and China. It has affected a growing list of companies by sapping consumer demand in key regions and disrupting supply chains. Chinese stocks, the travel sector and energy companies have also been hit among other things. The key question is whether this will continue, in which case the impact might be more damaging, or whether this is just an overreaction to an otherwise temporary phenomenon.

Background

The Coronavirus was first reported on 31 December 2019 in Wuhan, China and has since spread rapidly. According to the latest report from the FT, as of February 16th 2020, there are 71,709 confirmed cases and 1,775 deaths, the vast majority of which occurred in China (see distribution map from the WHO).



Source: World Health Organization

The situation appears to be under control as the speed of contagion is decelerating thanks to efforts undertaken by Chinese and international authorities as well as an increase in cure rates. That said, the situation remains highly malleable, and hence it is too early to make definitive conclusions.

While seasonal flu infects and kills far more people each year than the newly discovered coronavirus, the unknown nature of this virus has created fears of an uncontrollable global pandemic. This in itself can cause market participants, governments and businesses to take severe measures and actions, causing significant collateral damage to the economy.

Macroeconomic impact

Although it is currently difficult to assess and quantify this outbreak's impact on economies and markets, in the near term we expect a relatively deep hit to China's first quarter economic growth and a mild impact on yearly growth, which most analysts are already revising lower. However, longer-term, the impact on the economy should remain fairly limited as the structural shift to consumption in China remains intact and the People's Bank of China has plenty of room to stimulate the economy even after injecting USD 170bn of liquidity to calm markets. Moreover, recent positive developments on the trade front should also be supportive for growth.

Implications for markets

Most investors are looking to the 2003 SARS outbreak as a precedent to the coronavirus and for guidance to what will happen next in markets. Although this can provide useful insights, there are differences between the two periods to consider. China is a much bigger part of the global economy than it was 17 years ago. China's share of global trade rose from 5% in 2003 to 11% in 2019 based on World Bank statistics, while its share of global GDP grew from 4% in 2003 to 16% today. As a result, it is not surprising to see that the market impact on various sectors is more pronounced today than it was back in 2003.

Authors

Federico Chiastra
Senior Investment Analyst
+41 44 444 16 31
federico.chiastra@kieger.com

Kieger Multi Asset Group

Brendan Robertson
Head Portfolio Solutions
+41 44 444 18 26
brendan.robertson@kieger.com

Pascal Meier
Head Wealth Management
+41 44 444 18 55
pascal.meier@kieger.com

Sandro Olivero
Director Wealth Management
+41 44 444 16 32
sandro.olivero@kieger.com

Peter Maag
Senior Investment Analyst
+41 44 444 18 28
peter.maag@kieger.com

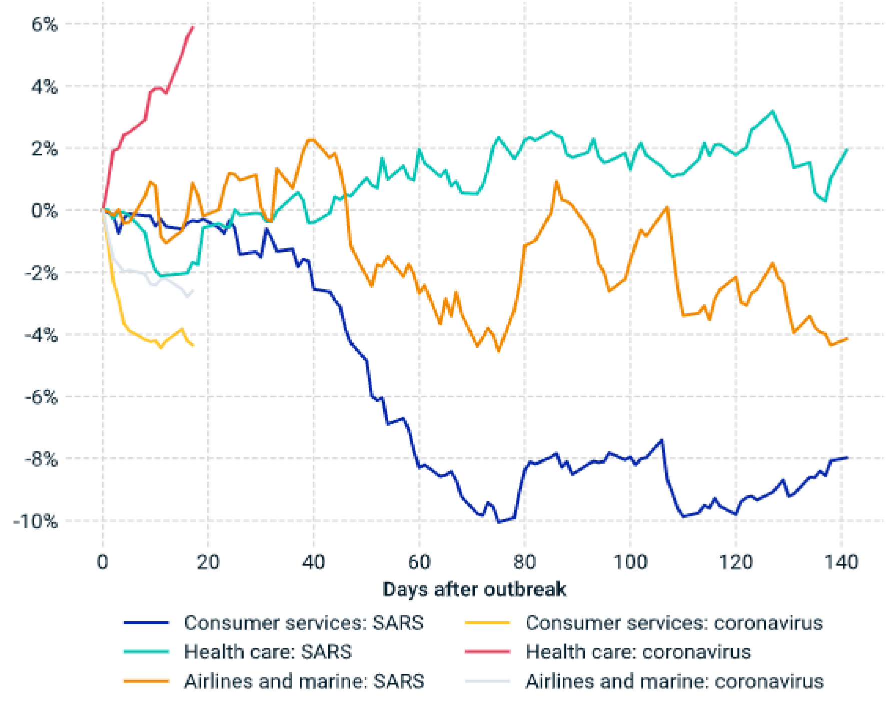
Evan Carmean
Portfolio Analyst
+41 44 444 18 51
evan.carmean@kieger.com

Federico Chiastra
Senior Investment Analyst
+41 44 444 16 31
federico.chiastra@kieger.com

Kieger AG

+41 44 444 1844
info@kieger.com
www.kieger.com

Asia ex-Japan's cumulative return for the coronavirus vs. SARS outbreaks



Data from Jan. 20 to Feb. 5, 2020, for coronavirus, and from February 2003 to June 2003 for SARS.

Source: MSCI

In particular, from January 20th to February 5th, airlines, marine, consumer services, media and retailing were five of the industries with the largest losses, while health care was among the largest gainers. This pattern was relatively consistent across regions. However, as can be seen on the chart above, it was particularly pronounced in Asia ex-Japan.

Bottom line

Overall, we maintain a modestly positive outlook for markets, but we expect increased volatility in the short-term as a result of this outbreak. Moreover, we expect the intra-sector and industry return dispersion to persist in the near future. Despite the heavy toll on human lives and the business disruption stemming from this kind of rare event, on a more positive note, it has to be remembered that the economic effects of infectious outbreaks tend to show a V-shaped pattern. This means that once health issues are under control and regulation eased, markets generally tend to recover quite quickly.