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The “black swan” virus

One month ago, markets finally took note of COVID-19 and its critical impact on the global economy. Our Healthcare Investment Team recently published a “Thoughts from the street” piece that provides more details about SARS-CoV-2 treatment developments.

Intense R&D efforts will help us manage and eventually treat the virus. In the meantime, assessing the impact of government containment measures and stimulus packages on the global economy continues to be challenging.

Multi Asset portfolios generated extraordinary performance in 2019. Mid-year, the US yield curve inversion and an unprecedented period of economic growth raised concerns of a looming recession. However, a normalisation of the yield curve towards the end of the year, stable global GDP growth, healthy company earnings and little sign of excesses in the markets led all major asset classes to continue to rise and recession expectations to abate.

But once again the yield curve has proved to be prophetic: 2020 will be the latest validation that a recession follows a yield curve inversion.

Stalling global growth

With the global economy in quasi-shutdown mode for at least a few weeks if not much longer, 2020 GDP growth expectations will be downgraded further. The key variable in estimating the length and severity of the recession is how strict and drawn-out the containment measures will be in each country and how companies will manage the move back to business-as-usual. We do not yet have reliable information on the impact on company earnings, therefore we must turn to historical crises for comparison. Historically, earnings revisions have often been very much in line with equity market price corrections. Global equity markets declined 38% whereas EPS dropped by 34.3% on average since the 70s according to Citi Research.

The monetary and fiscal policy "helicopters" have arrived

Policy makers have gained a lot of experience in implementing quantitative easing programs since the Great Financial Crisis. Aggressive and fast action should provide the economy with desperately-needed liquidity to bridge the global lockdown period. Central banks moved early and aggressively: with the Fed`s uncapped QE program and its monetary policy at zero bound (0-25 bp range), and with many other central banks taking similar decisions where possible, the monetary policy arsenal has been depleted. A swift fiscal policy response is the next logical step to boost global economies, and on March 25th the US legislators agreed on the largest rescue package in American history, which will infuse USD 2 trillion of emergency funding into the US economy. Many other countries' finance authorities have also implemented unprecedented spending. Whether or not these measures will be sufficient to support the economy has yet to be seen. And longer-term, how the massive sovereign balance sheets will be reduced is another open question. The path back to normal monetary policy might not be straightforward.

Implications for markets

As of March 24th, global equity markets have lost 26.1%, commodities have declined 20.7% (oil -59.8%, gold +5.8%) and corporate bonds are down 7.6%, while government bonds held up best at +3.4% (all performance numbers are in USD, YTD). Peak-to-trough market declines are at this stage in similar ranges to other crises although the losses have occurred much faster, making it difficult for investors to react. The shutdown of the economy has the potential to cause a liquidity squeeze on companies; the hope is this has been countered by corresponding monetary policy measures. Corporate default probabilities are increasing, indicated via substantial corporate bond spreads widening. The absence of bidders in the corporate bond market has led to low levels of liquidity which caused bid/ask spreads to widen significantly.

Bottom line

Just as governments were unprepared to deal with a global pandemic, investors have struggled to deal with the unprecedented speed of this downturn and the magnitude of the impacted regions, sectors and industries. The volume of new information is immense, but almost immediately obsolete, making any forecast for the economy and markets near-impossible. The best preparation for such a crisis is, as always, maintaining a diversified and balanced portfolio with ample liquidity which allows us to stay calm and opportunistically capture interesting investments. A focus on quality companies with strong balance sheets, stable cash flows and margins provides some downside protection. We continue to believe in the growth potential of the Healthcare sector and note that this sector will benefit from a potential treatment against the virus. The current environment also provides interesting investment opportunities with a much higher return expectation for multi asset portfolios over the next 10 years compared to just one month ago.

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