MARKET MATTERS

9 MARCH – 13 MARCH 2020

THE FIVE CORONAVIRUS SHOCKS

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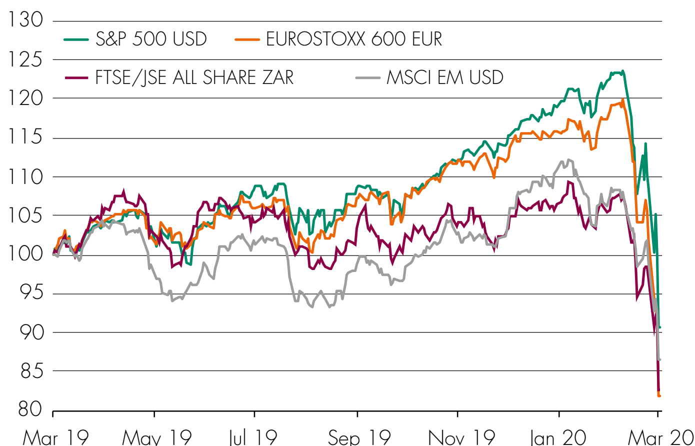
The global economy has been hit by five shocks as the coronavirus spread rapidly. This could not have been predicted, though with hindsight the market was initially much too complacent.

The situation is so uncertain now that a strategy based on trying to predict the future is bound to get it wrong. So what to do now after the severe market declines of the past two weeks? Remember the following:

- If you don't need to sell, you still own the same number of shares and bonds in your portfolio as before. They are worth much less now, but they can recover. This is not the first bear market, and won't be the last.
- Also remember that the indiscriminate selling will have pushed some investments well below their intrinsic value, creating opportunities for patient investors.
- It is too late to hedge equity exposure, since the extreme volatility means the cost of hedging is enormous.
- A natural response would be to want to get out of the market now. However, when markets snap back, they do so quickly and without warning. By the time the panic subsides and conditions on the ground improve, it might be too late to get back in. All that is achieved then is selling low and buying high.
- The next steps investors should take will depend on their individual needs and how much time they have on their side. With appropriate financial planning, this aspect should've been taken care of.
- Our strategy funds are diversified and we would not advise switching unless your personal circumstances have changed.

Chart 1: Equity indices over the past year, rebased to 100



Source: Refinitiv Datastream

THE SUPPLY SHOCK

As China locked down the city of Wuhan, followed by several others, it caused major supply disruptions across the world. China is after all the world's factory, supplying inputs for firms across the globe. It appears as if China is slowly getting back to work as the rate of new infections is declining, but it will take some time for its factories to clear the backlogs.

Meanwhile, producers in other parts of the world are now shutting down as the virus spreads further. Supply should bounce back eventually once the virus passes and workers return to their posts to start tackling the massive back-orders. The risk of course is that their clients might have gone out of business for a lack of stock to sell, or a lack of customers to sell to.

THE DEMAND SHOCK

The demand shock was also initially concentrated in China. People who are forced to stay at home spend less. This is especially true if they are wage workers whose incomes have fallen substantially. Outside of China, the tourism and travel industry felt it first, as millions of Chinese visitors stayed put. With flights across the world now cancelled, hotels and restaurants are empty and workers in these industries are losing wages, tips, and worse, their jobs. Italy and Spain took the drastic action last week of closing all but the most essential shops. Major sporting events are taking place behind closed doors, or are just outright cancelled. The summer Olympic Games must surely be at risk too, for the first time since the Second World War.

THE OIL PRICE SHOCK

As the coronavirus continued its worldwide spread, it became clear that global growth would be much slower in 2020 than initially thought. As a result, demand for oil would also be lower than thought. The widespread expectation was therefore that Russia and the OPEC countries, led by Saudi Arabia. would agree to output cuts to prop up the oil price.

When no deal could be reached, Saudi Arabia launched a price war against Russia, and also particularly against the high-cost US shale producers. Coming completely out of the blue in an already fragile environment, the oil price slumped by a third last Monday morning. This caused a violent response in other financial markets. Oil extraction and refining are extremely capital intensive, and therefore debt and equity capital markets have substantial exposure to oil. Banks have also lent heavily to oil companies, and US bank shares suffered deep losses.

Chart 2: Brent crude oil, $ per barrel

Source: Refinitiv Datastream

On balance, lower oil prices are good for the world economy, since consumers tend to spend more of every dollar saved than oil producers spend on every dollar earned. But as we saw in 2015, when a similar price war erupted, the market stress is immediate and concentrated, while the benefits to consumers are diffuse and take time to materialise.

Locally, we got a taste of this with Sasol. It was already under pressure, having borrowed heavily to fund its megaproject ethanol cracker in Lake Charles, Louisiana. Much like Eskom's Kusile and Medupi, the Lake Charles plant is years behind schedule and billions over budget. Oil below $40 per barrel puts enormous strain on Sasol's ability to service this debt, never mind turn a profit. Its share price has fallen 85% this year, pricing in a rights issue. Sasol is (was) a big share on the JSE and a cornerstone in many local investment portfolios.

THE CONFIDENCE SHOCK

Unlike previous episodes of market turmoil or economic stress, this is incredibly scary on a personal level. While most people infected with the virus experience only mild symptoms, and the vast majority make a full recovery if they receive good healthcare, the fact remains that it is deadly for a small percentage of its victims. Images of crowded hospitals and doctors in hazmat suits instil a deep fear. The dread of waiting while the virus comes our way has a medieval feel to it.

The US consumer has long been the engine of global growth, but the outbreak, the measures taken to stem its spread and the sentiment shock is about to seriously challenge that role. Apart from this, investors around the world have seen declines in their financial net worth as markets plummeted. This is bound to have a negative impact on the willingness and ability of consumers to spend (known as a negative wealth effect) and for businesses to invest. Low interest rates don't help much if there is no appetite to borrow.

We will get important early clues from China as to how consumers respond now that the worst there is seemingly over. Is there an explosion of pent-up demand for goods and services? Or do they remain deeply cautious and keep their wallets closed? Will they dare to go out to restaurants and movie theatres, board planes and trains and be out and about? Or will the fear of a secondary outbreak keep them rooted at home? The answers to these questions will be very important in determining how quickly the global economy can bounce back once the outbreak subsides.

THE FINANCIAL SHOCK

In this highly uncertain environment, markets slumped further last week as the realisation of the seriousness of the situation grew. Major equity indices are now in bear market territory, typically defined as a 20% peak to trough loss. The 20% fall is a bit of an arbitrary cut-off. A more useful way of classifying a bear market is perhaps a deep decline in equity values that takes a more than a year or two to recover, and is associated with an economic recession. In other words, while most investors can sit out a short, sharp correction, a long, drawn-out decline can cause real financial damage as well as psychological stress. It is obviously too early to tell.

Fortunately, despite panicked selling, the basic plumbing of the financial system – liquidity, payments, settlements, trading, lending and so on – has functioned relatively smoothly thus far. The major banks are in a much stronger position and can absorb some of the stress of their borrowers, rather than add to it. This is a major difference compared to the 2008 Global Financial Crisis and will be very important in supporting the economic recovery when the viral outbreak subsides.

FEEDBACK LOOPS

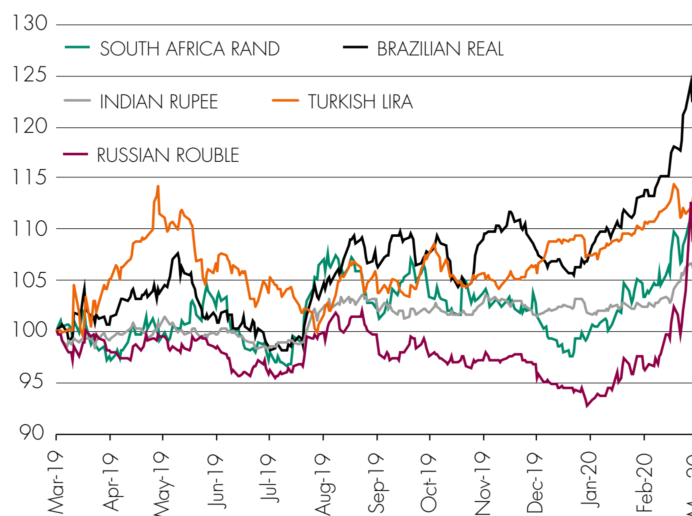
The biggest risks to markets and the world economy now is the possibility of feedback loops between these five shocks, where the one amplifies the others in unpredictable ways. A forceful policy response is needed to avoid this from happening. Policymakers have not been sitting still, but markets have been unimpressed so far. Led by the US Federal Reserve (the Fed), major central banks have already cut rates, with more to come. The Fed announced liquidity injections potentially amounting to $1.5 trillion over the next several months to ensure the continued smooth functioning of the financial system. Over the weekend it cut rates to near zero in another emergency meeting, and revived several of its 2008 crisis-fighting tools.

The European Central Bank's policy interest rate is already negative with little room to cut further. Instead it ramped up monthly bond buying and launched a new round of cheap loans to banks to encourage them to keep credit flowing to smaller businesses. However, the announcement lacked the "whatever it takes" stance that the market was looking for.

In the UK, authorities announced an unprecedented combined fiscal and monetary response, the Bank of England cutting rates back to 325-year lows, while the Chancellor revealed a £30 billion fiscal package. The UK and other countries have introduced targeted measures to help business and households weather a temporary cash crunch. Examples include temporary tax credits, mortgage payment holidays, unemployment benefits and extended sick leave on full pay.

Unfortunately, the one country that has so far bungled its response is also the most important. Instead of announcing a substantial and targeted stimulus package in a televised speech on Wednesday, US President Donald Trump introduced a travel ban on arrivals from Europe. Apart from being ineffective - the virus is already passing between Americans on home soil - it amplifies the disruptions to the global economy and hurts sentiment further. Equity markets around the world nosedived after the speech, with Thursday's losses rivalling the worst daily declines in modern times. In an election year, it might be difficult for America's deeply divided political class to agree to a set of policy responses to address the economic impact of the virus, never mind the outbreak itself. On Friday, Trump finally declared a national emergency, while Congress voted on a support package over the weekend. How effective this is will be crucial for all of us.

Chart 3: Emerging market currencies against the US dollar, rebased to 100



Source: Refinitiv Datastream. Higher values indicate a stronger dollar

BACK HOME

There is a sliver of good news for South Africans already reeling from an Eskom-induced recession. Apart from the Sasol debacle, South Africa should benefit from the much lower oil price. Though the rand has predictably weakened in line with other emerging markets, it has fallen by a lot less than oil. The rand price of oil is down 40% from the start of the year. Lower prices should help the economy in four principal ways: it reduces the import bill, makes it cheaper for Eskom to run diesel generators and will leave more money for consumers and businesses to spend elsewhere. Importantly, a lower inflation outlook gives the SA Reserve Bank scope to follow other central banks in cutting rates meaningfully this week.

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OLD MUTUAL MULTI-MANAGERS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	1 882.0	-12.42%	-12.10%	-20.19%	-10.21%
United States	S&P 500	US$	2 711.0	-8.78%	-8.23%	-16.09%	-3.56%
Europe	MSCI Europe	US$	1 261.0	-20.29%	-19.83%	-29.32%	-22.73%
Britain	FTSE 100	US$	6 590.0	-21.85%	-21.88%	-34.11%	-30.98%
Germany	DAX	US$	961.0	-21.29%	1.54%	-29.66%	-22.06%
Japan	Nikkei 225	US$	192.1	-2.46%	-12.21%	-11.73%	0.27%
Emerging Markets	MSCI Emerging Markets	US$	891.0	-11.96%	-11.43%	-20.09%	-15.14%
Brazil	MSCI Brazil	US$	1 434.0	-18.20%	-24.49%	-39.57%	-34.70%
China	MSCI China	US$	77.0	-7.75%	-5.85%	-9.52%	-5.78%
India	MSCI India	US$	472.0	-10.20%	-13.24%	-20.28%	-19.05%
South Africa	MSCI South Africa	US$	321.0	-18.32%	-15.30%	-32.85%	-29.91%

EQUITIES - SOUTH AFRICA (TR UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	44 178.0	-15.15%	-13.44%	-22.61%	-20.87%
All Share	All Share (Total Return)	Rand	6 748.0	-14.93%	-12.92%	-22.09%	-18.01%
TOP 40/Large Caps	Top 40	Rand	6 004.0	-15.37%	-13.35%	-21.79%	-17.62%
Mid Caps	Mid Cap	Rand	13 311.0	-15.67%	-10.94%	-24.85%	-16.09%
Small Companies	Small Cap	Rand	13 336.0	-11.82%	-10.06%	-22.55%	-24.30%
Resources	Resource 20	Rand	2 258.1	-23.94%	-21.51%	-33.08%	-25.88%
Industrials	Industrial 25	Rand	11 958.0	-12.29%	-9.16%	-13.23%	-9.85%
Financials	Financial 15	Rand	7 249.0	-9.48%	-10.74%	-22.83%	-21.96%
Listed Property	SA Listed Property	Rand	1 362.0	-13.43%	-11.21%	-27.44%	-28.80%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	514.1	-3.83%	-1.45%	0.47%	5.96%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	670.8	-5.19%	-5.03%	-3.97%	2.73%
Government Bonds	BESA GOVI	Rand	663.0	-5.23%	-5.06%	-4.03%	2.54%
Corporate Bonds	SB JSE Credit Indices	Rand	53.8	-1.93%	-1.18%		
Inflation Linked Bonds	BESA CILI	Rand	250.6	-3.95%	-4.07%	-3.61%	-2.24%
Cash	STEFI Composite	Rand	446.8	0.13%	0.26%	1.36%	7.24%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	33.9	-25.23%	-32.30%	-48.71%	-50.22%
Gold	Gold Spot	US$	1 592.0	-5.13%	-2.75%	4.46%	22.09%
Platinum	Platinum Spot	US$	814.0	-6.54%	-7.71%	-16.17%	-2.51%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	16.26	-3.61%	-3.71%	-13.88%	-11.30%
ZAR/Pound	ZAR/GBP	Rand	20.02	2.15%	0.25%	-7.29%	-3.90%
ZAR/Euro	ZAR/EUR	Rand	18.00	-1.71%	-4.04%	-12.82%	-9.27%
Dollar/Euro	USD/EUR	US$	1.11	1.80%	-0.63%	0.99%	1.80%
Dollar/Pound	USD/GBP	US$	1.23	6.25%	4.23%	8.30%	8.30%
Dollar/Yen	USD/JPY	US$	0.01	2.52%	-0.09%	-0.63%	-2.80%

Source: I-Net, figures as at 13 March 2020

OLD**MUTUAL**

THE WEEK AHEAD

SOUTH AFRICA

- Inflation
- Retail sales
- Reserve Bank interest rate decision

US

- Federal Reserve interest rate decision
- Retail sales
- Industrial production
- Housing starts and building permits

EUROPE

- Germany ZEW Economic Sentiment Index

CHINA

- Retail sales
- Fixed investment
- Industrial production

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