Concentric Financial Services Limited
Coronavirus Commentary – Markets and Investment Managers

28th February 2020

As February comes to a close equity markets have fallen very sharply, reaching double-digit drops for many markets. This is principally (but not exclusively) due to fears of a COVID-19 pandemic as infections spread to different countries. The market reaction is determined by what authorities tell us. The overreaction (arguably) of authorities in certain countries; locking down two northern provinces in Italy, closing schools in Japan and Hong Kong, and declaring a state of emergency in the Japanese island of Hokkaido, is feeding a market panic sentiment.

Ravenscroft

We expected global economic activity to stabilise this year after slowing during 2019 but the spread of the coronavirus from China (its source) into Asia, Europe and beyond has the potential to significantly weaken the growth outlook and raise the risk of recession through the impact on consumption, investment, supply chain disruption, confidence and overly-leveraged companies.

It is clearly too early to make any high conviction predictions about the full impact of the virus on either economic activity or financial markets - partly because it is still spreading and we do not have any clarity on how long it will last. However, a number of companies have already highlighted that their prospects have been negatively affected by the virus, including Apple - who relies on China to supply components for its products - and LVMH, which generates significant sales from China and Asia. We are now starting to see these warnings spread to other stocks including Diageo, Unilever, Nike, Disney and Visa.

Global stock markets have reacted negatively to this news as they attempt to price in expectations for future downgrades to revenue and profit forecasts. Government bonds, on the other hand, have risen strongly in anticipation of central banks embarking on further interest rate reductions and additional quantitative easing in order to counter slowing growth. The oil price has also fallen significantly on the back of reduced demand whilst the gold price has risen materially as a perceived “safe haven”.

Quilter Cheviot

As a result of the spread of the disease and its impact, a number of clients have contacted us about their portfolios, questioning whether they should sell investments. We would caution against a knee jerk reaction to move to cash. While the emergence of clusters outside of China is an unwelcome development, the Chinese authorities and international community have mounted an aggressive response to the disease. Coronavirus will depress global economic growth in 2020, but it is impossible to say whether markets are currently too optimistic or pessimistic about its progress.

We are currently waiting to see whether the World Health Organisation (WHO) declares coronavirus as a Phase 5 pandemic, which would mean the disease was spreading from human to human in more than one country of one WHO region.

Global economic growth is still expected to be between 2-2.5% this year, with the potential for a rebound towards the end of 2020. For investors who are mindful of selling their investments now, there is a clear risk of selling at the bottom and having to buy back into the market once stocks have rebounded. There are prudent steps investors can take, such as limiting their exposure to the travel and tourism sector, but this could also be a good opportunity to increase investments to high quality companies which reliably grow their earnings over time.

From a more general perspective, we would encourage clients to 'wait out' the impact of the coronavirus. Any decision to move to cash/sell down shares needs two things to happen for the decision to pay off: 1) markets must continue to fall and 2) a decision must then be taken to reinvest before share prices recover.

It is not so much about timing the market, but time in the market, with long-term investors benefiting from steadily compounding returns over the years, as any chart of historic market performance will show.

Tilney

Over the last few weeks, we have seen market sentiment hit in particular by concerns around the Covid-19 virus, which has pushed equity market valuations down and impacted short-term economic expectations, potentially delaying the rebound in economic growth that was anticipated at the start of the year. This comes after an extended strong run in 2018, principally driven by multiple expansion.

However, whilst we do not know what the future holds around Covid-19, we think over-trading around the current uncertainty is unlikely to be a winning strategy. Whilst we agree it could indeed escalate further, any decision to decrease equity exposure in portfolios should be the result of two factors: what do we already own and would we be comfortable to own this if there was a shock to economic growth? Secondly, do we believe we could be able to time your entry back into the market after taking the decision to sell? Experience has shown us that no investor can time markets consistently through time and that providing we own high quality companies that are able to compound cash flows at a consistent rate,

we should be rewarded for enduring periods of volatility.

So far this year (to last night's close) our 100% equity portfolios have returned -2.7%, after registering a positive return in January. In comparison the UK and global equity markets are down -9.1% and -4.8% over the same time frame. Whilst it is never pleasant to see drawdown in clients' portfolios it is good to see the capital preservation characteristics of our underlying funds.

Whilst we don't know what the future holds around Covid-19, we can look at market reactions during other virus emergencies – which provides us with an element of comfort over the longevity of these corrections:

Virus	Date Range	Trading Days	% Change
SARS	Jan 03 – Mar 03	38	-12.8%
Avian Influenza	Jan 04 – Aug 04	141	-6.9%
MERS	Sep 12 – Nov 12	43	-7.3%
Ebola	Dec 13 – Feb 14	23	-5.8%
Zika	Nov 15 – Feb 16	66	-12.9%

Source: CitiResearch, US equity (S&P 500)

Whilst there are some signs that the spread of the virus is being brought under control at the current epicentre in Hubei province in China, outbreaks in other parts of the world are now to be expected which is likely to add to volatility in the near-term. A supply side shock to labour will likely lead to further quarantines, closed borders, lower capacity and output, and disrupted supply chains. On the supply side there is little that governments can do to remedy a fall in output, and potential disruption in China's economy is significant as their share of world GDP has climbed to 19.3%. However, investors should not ignore the flip side of authorities successfully bringing the infection under control, nor the potential to provide additional stimulus to reduce the impact of a demand shock to support markets and kick-start economic recovery. China has indeed already announced earlier this month that they are injecting $174 billion of liquidity into the markets via reverse repo operations.

Investment research provider BCA notes that initial estimates suggest Chinese GDP will struggle to reach 3.5% on an annualised basis in Q1 compared to the initial 6% estimate. However, under a baseline scenario, growth will recover in the second quarter, leaving the level of global GDP down 0.5 percentage points for the year as a whole compared to what would have transpired if the virus had never emerged. This of course is assuming that output across the rest of the world isn't materially disrupted (which is impossible to claim at this point).

We remain very comfortable with our current position – and to date, do not believe that the corrections have provided us with an attractive entry point to justify a significant change in asset allocation. If there is an immediate need for capital however, we always believe in ring-fencing funds in cash or lower risk assets for short term spending or liability requirements.

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