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concentric

CORONAVIRUS COMMENTARY

Portfolios & Economist Update

WORLD MARKETS

Not only are we in the grip of a fast spreading aggressive virus, but world markets are falling at unprecedented speed, circuit breakers are triggering in US markets and media reports frequently make comparisons with 1987 or other severe market shocks. Amongst this there are dramatic positive days too, as volatility is generated by government action (or inaction), virus news and sentiment. The opinions of a noted economist, Anatole Kaletsky, and his helicopter money views are included in this update for your reference, whilst we are bombarded with information and opinion we think his viewpoint is worth reading.

To provide some perspective on current markets our March bulletin opens with an interesting distribution chart showing the the annual returns of the US S&P500 index of companies since 1927.

THE HANDFUL OF 'WORST YEARS' SINCE 1927 ARE PICKED OUT IN RED, AND IN BLUE YOU CAN SEE THE FOLLOWING YEARS.

						2016				
						2014				
						2012	2017			
						2010	2009	2019		
					2015	2006	2003	2013		
					2011	2004	1999	1997		
				2018	2007	1993	1998	1995		
				2000	2005	1988	1996	1991		
				1990	1994	1986	1983	1989		
				1981	1992	1979	1982	1985		
				1977	1987	1972	1976	1980		
			2001	1969	1984	1971	1967	1975		
			1973	1962	1978	1968	1963	1955		
			1966	1953	1970	1965	1961	1950		
			1957	1946	1960	1964	1951	1945		
		2002	1941	1940	1956	1959	1949	1938	1958	
	2008	1974	1932	1939	1948	1952	1943	1936	1935	
1931	1937	1930	1929	1934	1947	1944	1942	1928	1933	1954
-50 to -40	-40 to -30	-30 to -20	-20 to -10	-10 to 0	0 to 10	10 to 20	20 to 30	30 to 40	40 to 50	40 to 50
Nominal Percentage Total Return										

Source: Bloomberg

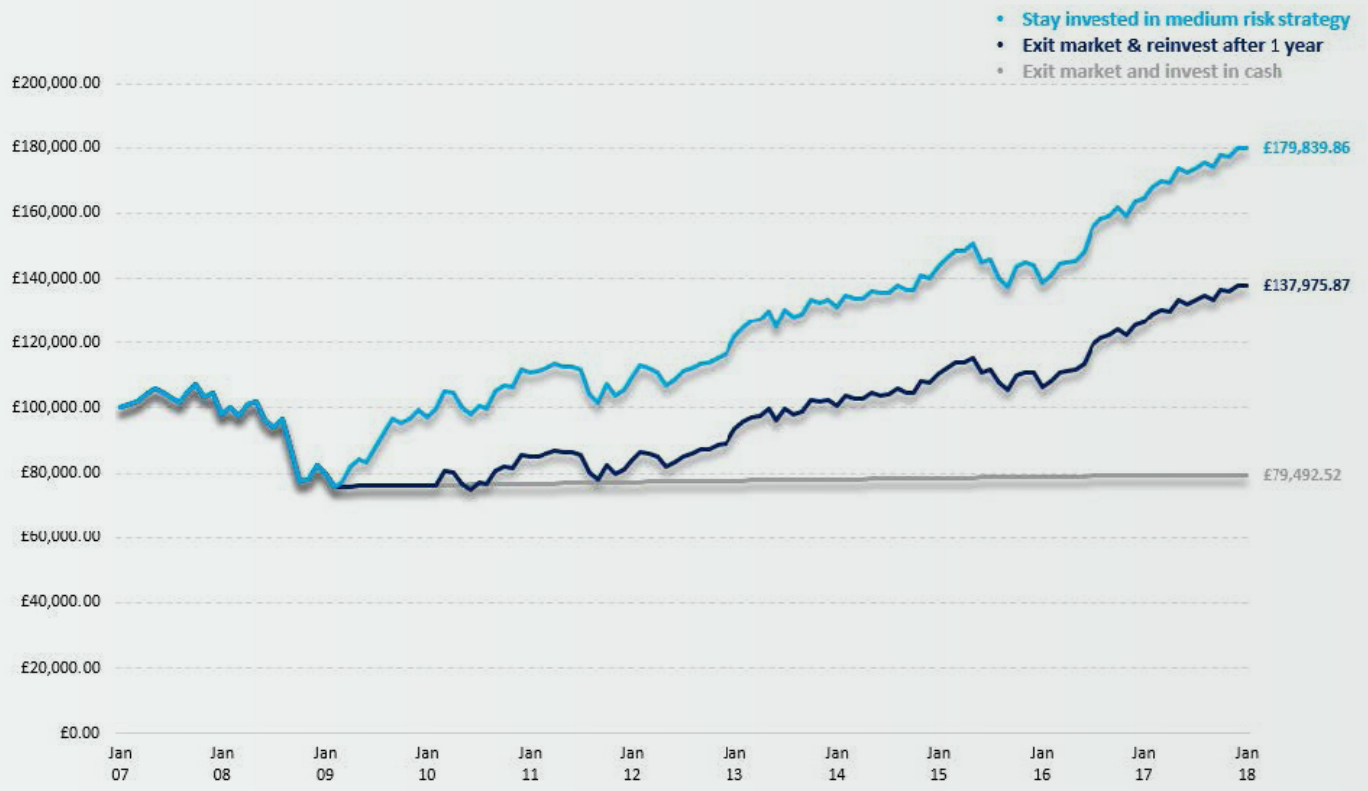
The Depression of the 30s dominates the negative returns, with recent crises 2008 and 2002 also represented.

What is interesting from this analysis is the blue years. With the exception of 1931/1932 (both of which we have highlighted in red), all the years following the worst years were some of the highest return positive markets. Note that 1933 was one of the best years on record, so the very worst produced one of the very best two years later.

The second chart below, shows the impact on a medium risk portfolio of disinvesting during troubled markets and going back into investment when things have settled – thus crystallising the loss during the market downturn and missing much of the upside of the recovery, so very necessary to generate long term returns.

So, our message to investors is to keep calm, batten down the hatches and hold on for a very bumpy ride.

THE CHART BELOW, DEMONSTRATES THE IMPACT ON A MEDIUM RISK PORTFOLIO OF DISINVESTING DURING TROUBLED MARKETS AND GOING BACK INTO INVESTMENT WHEN THINGS HAVE SETTLED.



Source: Morningstar

ECONOMIST UPDATE

ANATOLE KALETSKY — WE NEED A MASSIVE HELICOPTER DROP OF QE TO SAVE ECONOMY

Anatole Kaletsky is a financial journalist and the founder and cochairman of Gavekal Ltd, an economic consulting and asset management group headquartered in Hong Kong.

Since 1976 Kaletsky has written for The Economist, The Financial Times and The Times of London before joining Reuters and The International Herald Tribune in 2012. He has been named Newspaper Commentator of the Year in the BBC's What the Papers Say awards, and has twice received the British Press Award for Specialist Writer of the Year.

Contrary to initial expectations, the spread of the Coronavirus around the world is not following what now turns out to have been the relatively benign trajectories experienced in China outside of Hubei, and in Korea, Singapore and the rest of Asia. Instead, across Europe – and very likely in the US too – the spread of the disease increasingly resembles the path it took in Hubei. This threatens both medical and economic disasters.

But while it may now be too late for policymakers to avert a public health crisis, it is still possible to implement the combined fiscal and monetary measures needed to prevent an economic catastrophe – but they will need to go much further than the monetary steps announced by the US Federal Reserve on Sunday evening.

Initially, I expected that the number of cases in European countries would converge towards the 10 to 100 patients per million seen in Asia outside Wuhan, and that the US might follow a roughly similar pattern once testing began in earnest. The fact is, however, that Italy, France, Spain and other EU countries are not experiencing the slowdown in the rate of change of acceleration, seen in Wuhan and the rest of China by this stage in the epidemic.

One possible explanation is that even Italy's lockdown measures are much less rigorous than those in Asia, and that health care systems are less prepared. For example, patients are not removed from their families as quickly, and so infect others. If so, then the acceleration in the US and the UK will be even more rapid than in continental Europe, because of the piecemeal, and plain misguided, public health policy responses from Washington and London.

The possibility now is that the asymptotic outcome for countries in Europe and America will be more like Wuhan's 1,000 cases per million, and not the 10 to 100 cases per million seen so far in much of the rest of Asia, for example in Singapore.

UNLIMITED REASSURANCE

The only good news in this dreadful situation is that, unlike the medical effects of the virus, the economic impact is quite easy to predict and overcome. There is one possible policy response that could prevent the epidemic, even in the relatively virulent form as experienced in Hubei, turning into a complete economic catastrophe that would be worse than 2008. Governments in every major economy must guarantee unlimited fiscal compensation for lost revenues and wages to all businesses and workers affected by quarantines and lockdowns – if not the full 100%, then maybe 80% or 90%.

Ideally this compensation would come through outright grants and fiscal transfers, but another option for larger businesses might be long-term, zero interest loans or loan guarantees. Luckily, this response is now feasible because of the way the global financial crisis of 2008 transformed the world economy and financial markets—offering governments unlimited financing with zero interest rates, low inflation and a tolerance for previously unthinkable monetary and fiscal experimentation.

To be clear, in the current situation monetary policy won't do anything to stimulate economic activity. Nor do policymakers want it to; right now more economic activity will only aggravate the public health crisis. But zero rates and huge liquidity injections are still necessary as a palliative to prevent financial systems from collapsing. Fiscal measures designed to support recovery should wait until the virus is under control.

QE OF UP TO 25% OF GDP

What governments can and should do now is to reassure their citizens and businesses that they can stay at home and not worry about lost incomes – because the government will make up for the losses once the public health crisis is over. By comparison with China, the fiscal cost of such comprehensive compensation for income lost in lockdowns could easily come to 10% of annual GDP. And if the epidemic turned out to be worse than in China, which is now looking quite likely, the fiscal cost could be as much as 25% of GDP.

These may seem mind-boggling numbers, but they could easily be financed in one or more of three ways:

1 | Every G20 country, with the possible exception of Italy, could easily increase its government debt-to-GDP ratio by 25 percentage points without raising any serious questions about solvency. And debt service costs would hardly rise at all if central banks committed to keeping short rates at zero for at least two years or so, and investors were forced by regulation and financial repression to match liabilities with long maturities.

There is all the difference in the world between a one-off fiscal transfer, however large, and fiscal stimulus through tax cuts or spending commitments that permanently increase annual deficits. A one-off transfer of 25% of GDP does less damage to long-term fiscal solvency than a tax cut of 1% or 2% of GDP or long-term spending commitments that change the fiscal structure for decades ahead.

2 | Central banks could increase their quantitative easing (QE) programmes to absorb the entire additional debt issuance. In short, they could simply expand the monetary base in every G7 economy by 25% of GDP.

3 | The compensation for businesses and workers could come directly from central banks through targeted helicopter money. In practice some combination of these three policies could be employed, although for credibility purposes it would be better if governments and central banks around the world could agree on a single method.

HIGHER INFLATION FOR NOW

There are two objections to such a policy of full government compensation.

- It would ultimately prove inflationary.
- It would be unprecedented for governments to bail-out and subsidise businesses in this way.

In my view these are weak objections.

Today, everyone wants to see higher inflation. And while this might eventually turn out to be a mistake – maybe by the second half of the decade – there will be plenty of time to switch to anti-inflationary policies between now and then.

Also full compensation is far from unprecedented in emergency conditions. Farmers are regularly compensated for agricultural disasters, such as mad cow disease, or even for plunging farm prices and trade wars. Regions and households suffering from floods, earthquakes, or wildfires are normally compensated through disaster relief or subsidised insurance.

And since 2008, banks, insurance companies and financial markets have received effective fiscal transfers in many countries amounting to far more than 25% of GDP. The only difference in this case is that the disaster affects the whole of society and the economy. In principle this makes the case for compensation stronger. The only reason why governments all over the world are still thinking in terms of loans and credit guarantees, instead of straight fiscal compensation, is that there is no special interest lobby such as farmers or bankers demanding targeted relief.

Source: Citywire