

China's recovery

Global Matters Weekly

30 March 2020

– Stephen Nguyen, CFA

We are living in unprecedented times, with much of the world under lockdown due to COVID-19. There are a multitude of potential outcomes resulting from the increasingly extreme global measures being taken to prevent its spread and of course many unanswered questions regarding the lockdown exit strategy or how it all ends. While we are yet to change our portfolios allocations materially, we are making evolutionary changes to the underlying holdings to emphasise balance sheet strength. It doesn't presently seem appropriate to add significantly to portfolio risk: we stick to our unwavering belief that a well-constructed diversified portfolio is the most efficient way to achieve longer term outcomes. Nevertheless, it is instructive to sketch positive scenarios into our outlook and where better to look for inspiration for a positive spin on events than China, which was the first country to go into full lockdown at the end of January. What can we learn and more importantly what can we expect?

The draconian measures taken by the Chinese authorities in late January have shown promising results in tackling the spread of the virus. While the rate of infections has been accelerating globally, China has seemingly managed to keep it contained, with only a few cases reported in the last week, almost all of which were people entering the country from overseas. Shanghai has had no reported cases for fourteen consecutive days. This is a highly encouraging result and one from which western countries can draw great hope, although there's always a degree of scepticism about the accuracy of statistics released by China. The extent to which citizens in the west comply with similar measures will have a major impact on slowing the spread of the virus and determine how long it takes for normal activity to resume.

China is beginning to lift restrictions and activity levels have materially recovered. Anecdotal evidence points towards higher footfall on the streets of Shanghai and other major cities plus rising traffic levels: traffic flow on both highways and business districts is widely reported to be reaching 70% to 80% of its pre lockdown level. It is reasonable to expect China, the original epicentre of the COVID-19 crisis, to be

ahead of the curve in dealing with the outbreak and that it will likely lead the way in the economic recovery once the storm passes.

Around the globe, governments have aggressively implemented lockdowns while offering unprecedented levels of stimulus from central banks (President Trump has just signed the largest stimulus package in US history worth \$2 trillion) to support economies and keep financial markets operating effectively. As a result, we have strong reasons to believe the massive but temporary economic shock will be overcome.

Financial markets tend to reflect changes in the outlook for economies and corporate earnings well ahead of fundamentals and this should mean that most of the negative news is largely 'priced in' today. Barring a significant worsening of the virus' impact such as an uncontrollable wave of second and third round infections, markets have the potential to recover strongly from current levels.

The Chinese equity market has been a perfect example of this. The market bottomed at the beginning of February around the time the spread of the virus peaked there. It subsequently fell further in the following weeks due to the weaker outlook for growth outside of China, but as of today it is still by far the best performing major market globally year to date.

We are not epidemiologists and have no edge in forecasting how the pandemic will play out, but what we can say and are observing is that market participants have moved to discount a Global Financial Crisis (GFC) style outcome for many risky assets. But this is not 2008; we do not have a financial crisis today (and the powers that be are doing their best to prevent one), and we are optimistic that with continued preventative measures in place, the outbreak will be brought under control. A recovery is a matter of when and not if, and while it is futile trying to pick the exact turning point, we know that markets are likely to move higher in advance of any economic and humanitarian recovery.

The Marketplace

- US equities rebounded by record amounts early in the week
- The US agreed upon a \$2.2 trillion fiscal stimulus package late Tuesday
- Brent crude fell 7.6%, ending the week at \$24.9 a barrel
- Gold rose 8.6% ending the week at \$1628.2 an ounce

Market Focus

US

- The Dow Jones Industrial Average had its best day since 1933 early last week and the S&P 500 saw its largest rally since the Global Financial Crisis. These rises saw US equities gain 10.3% over the past week.
- The US overtook China in the total number of reported cases for COVID-19, making it the new epicentre of the virus.
- US President Trump announced that the social distancing measures in the US would last until the end of April.
- The US printed 3.28 million weekly jobless claims, an unprecedented number and a strong multiple greater than the prior week's 282,000 reading.
- US Treasuries returned 1.7% over the week, with their investment grade counterparts returning 6.1% over the same period.

Europe

- Germany announced a €750 bn package and the suspension of its constitutional debt brake.

- European equities gained along with most major equity indices, returning 5.7% over the week.
- More severe lockdowns were imposed across Europe as virus infection rates rose and deaths resulting from the virus surged.
- Euro government bonds returned 1.0% over the past week and the investment grade and high yield indices showed varied gains, returning 0.3% and 4.0%, respectively.

UK

- Pound Sterling reached record lows against a basket of its major trading partners currencies, falling as low as \$1.14 from \$1.31 at the start of March.
- UK Prime Minister Boris Johnson is the first reported world leader to contract the coronavirus.
- UK equity markets gained 6.2% over the week.
- UK gilts returned 1.9% over the past week, with investment grade bonds returning 1.8%.

Asia/Rest of The World

- Oil declined for the fifth consecutive week as the economic slowdown and price war indicated little to no sign of slowing.
- The Reserve Bank of India cut its rates by 75 basis points to 4.4%, along with reducing its reserve repo rate to incentivise lending by banks.
- China is reporting to be mostly back to work as the number of new local coronavirus cases has slowed significantly, resulting in lockdowns being removed.

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Asset Class/Region	Currency	Currency returns			
		Week ending 27 Mar. 2020	Month to date	YTD 2020	12 months
Developed Market Equities					
United States	USD	10.3%	-13.9%	-21.1%	-8.1%
United Kingdom	GBP	6.2%	-15.9%	-26.1%	-20.4%
Continental Europe	EUR	5.7%	-16.1%	-23.0%	-12.4%
Japan	JPY	13.7%	-3.4%	-15.2%	-8.0%
Asia Pacific (ex Japan)	USD	5.0%	-15.0%	-21.6%	-15.2%
Australia	AUD	0.6%	-24.3%	-26.7%	-17.8%
Global	USD	10.7%	-14.5%	-22.2%	-11.1%
Emerging markets equities					
Emerging Europe	USD	3.5%	-25.6%	-38.7%	-25.1%
Emerging Asia	USD	5.1%	-12.3%	-18.6%	-11.7%
Emerging Latin America	USD	5.6%	-34.5%	-45.6%	-38.6%
BRICs	USD	3.9%	-15.2%	-21.7%	-13.9%
China	USD	4.7%	-7.7%	-11.3%	-5.3%
MENA countries	USD	1.4%	-18.5%	-24.8%	-24.4%
South Africa	USD	6.9%	-25.9%	-41.2%	-36.6%
India	USD	-0.5%	-25.3%	-32.4%	-29.6%
Global emerging markets	USD	4.9%	-16.1%	-24.2%	-17.2%
Bonds					
US Treasuries	USD	1.7%	3.1%	8.8%	13.9%
US Treasuries (inflation protected)	USD	3.9%	-1.2%	2.5%	8.0%
US Corporate (investment grade)	USD	6.1%	-8.5%	-5.1%	3.3%
US High Yield	USD	5.1%	-12.8%	-14.0%	-8.1%
UK Gilts	GBP	1.9%	2.6%	8.1%	11.7%
UK Corporate (investment grade)	GBP	1.8%	-7.8%	-5.7%	0.1%
Euro Government Bonds	EUR	1.0%	-1.9%	1.1%	5.0%
Euro Corporate (investment grade)	EUR	0.3%	-7.0%	-6.3%	-3.5%
Euro High Yield	EUR	4.0%	-13.9%	-15.4%	-10.4%
Japanese Government	JPY	0.4%	-1.8%	-0.4%	0.3%
Australian Government	AUD	1.1%	-1.0%	3.4%	7.5%
Global Government Bonds	USD	3.1%	0.4%	3.5%	7.4%
Global Bonds	USD	3.4%	-1.7%	0.4%	4.8%
Global Convertible Bonds	USD	3.5%	-9.2%	-9.3%	-3.8%
Emerging Market Bonds	USD	6.1%	-10.1%	-8.8%	-3.0%

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Property					
US Property Securities	USD	18.1%	-21.1%	-26.6%	-20.9%
Australian Property Securities	AUD	-3.0%	-39.3%	-38.8%	-39.1%
Asia Property Securities	USD	12.8%	-14.0%	-21.7%	-21.7%
Global Property Securities	USD	14.2%	-21.6%	-27.7%	-22.0%
Currencies					
Euro	USD	4.0%	0.9%	-1.2%	-1.4%
UK Pound Sterling	USD	6.8%	-2.7%	-6.4%	-6.1%
Japanese Yen	USD	2.7%	0.2%	0.5%	2.3%
Australian Dollar	USD	5.9%	-4.8%	-12.0%	-12.8%
South African Rand	USD	-0.5%	-10.4%	-20.5%	-17.1%
Swiss Franc	USD	3.5%	1.5%	1.3%	4.3%
Chinese Yuan	USD	0.0%	-1.5%	-1.9%	-5.2%
Commodities & Alternatives					
Commodities	USD	1.6%	-19.7%	-31.0%	-29.7%
Agricultural Commodities	USD	1.5%	-5.2%	-12.1%	-11.9%
Oil	USD	-7.6%	-50.7%	-62.2%	-63.2%
Gold	USD	8.6%	2.7%	6.9%	24.3%
Hedge funds	USD	2.2%	-6.3%	-7.3%	-2.0%

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