FLASH MARKET COMMENT

Markets are currently extremely volatile as the Coronavirus continues to spread around the world. We take a look at what exactly is happening, what markets are focusing on, where we go from here and how we at FWU Invest are reacting.

EXECUTIVE SUMMARY

Markets are experiencing major volatility currently and have fallen significantly – driven by the ongoing outbreak of the Coronavirus and an unfolding oil price war. Investors should brace for more turbulence in the coming weeks, as the virus will continue spreading and generate further economic dislocation. We at FWU Invest are preparing for this turbulence by keeping volatility under control, which means investing in defensive areas of the market, where we find companies with steady business models. Moreover, in order to weather this storm, safe-haven assets are also needed, meaning we are also allocating more towards government bonds as well as cash. Crucially, however, we are staying invested. Ultimately, things will calm down again once new cases peak outside of China, while if a recession materialises it will likely prove short. Monetary policy is very stimulative in this environment and markets can rip higher very quickly – a move that investors should not miss. In summary, be prepared for turbulence in the coming weeks, but note that we are preparing for it, while we should not lose sight of long-term goals, which are best met by staying invested.

MARKETS SELL OFF – A Q&A

February and early March saw intense selling pressure across stock markets all around the world. The culprits: Covid-19 – the Coronavirus – as well as an oil shock. In this brief Q&A, we take a look at the key questions investors should keep in mind and how we at FWU Invest have been reacting.

Q: WHAT'S GOING ON IN THE MARKETS?

A: As you can see on figure 1 (as seen on page 2), equity markets are severely down over the past two weeks, with all major markets now in correction territory. Driving markets lower has been first and foremost fears around the Coronavirus, which has started to spread beyond China and worryingly for investors into Europe, primarily Italy. Having Chinese economic activity adversely affected was bad enough for investors, but now with activity hit in another central zone for the global economy it is even worse and has pushed many to sell.

Indeed, a large part of the reason why equity markets were able to hold up since the outbreak of the virus was first known, was the assumption that it could be contained within China, where quarantines could bring it under control relatively quickly. This idea has now been shaken and investors are taking the possibility of a global pandemic seriously, with new cases in the United States set to rise in the coming weeks.

Q: WHAT DOES OIL HAVE TO DO WITH THIS?

A: Adding insult to injury, we have now also seen an oil price war unfold between Russia and Saudi Arabia. Oil prices have collapsed as a result, hurting the Energy sector in the process, while also forcing yields lower as inflation expectation take a hit. This, in turn, hurts industries such as the Banks, which earn less the lower rates go.

We should bear in mind, however, that the fall in oil is related to the virus outbreak. At the same time, while the fall is a shock, it is not all negative, as it represents a significant drop in costs for consumers and large sectors of the economy. Thus, while it is important to keep an eye on, the real problem here is the virus.

Q: WHAT HAPPENS NEXT TO THE VIRUS? TIME TO PANIC?

A: No, when it comes to investing – no matter what the context – we should never give in to panic. It usually proves costly.

This does not mean investors should not be prepared and take into consideration all types of scenarios. To be frank, a global devastating pandemic scenario cannot be ruled out, but it still looks unlikely.

While the rest of the world cannot hope to be as effective as China, it does appear possible to contain the virus, without having to rely on the drastic, hard-handed tactics Beijing employed. South Korea, Hong Kong and Singapore are stand-out examples that show how targeted and sensible measures can impede the outbreak without having to resort to mass quarantine. This entails cancelling mass events, wearing face masks, frequent handwashing and working from home.

A recession is a possibility, but the good news is that if we do see one materialise, it will likely prove relatively short and easy to get out of. In contrast to a recession driven by the inner workings of the economy itself – as was the case in the wake of 2008 – external, shock-induced recessions tend to subside once the shock is over.

In this case, once the virus has either been contained or has taken its natural course, we will likely see a steep recovery. This is because there aren't major sources of instability affecting our economies now that would impair a recovery. In addition, we need to bear in mind that the virus is not occurring in a policy vacuum – governments all around the world are likely to increasingly step up and provide monetary and fiscal relief.

Q: HOW ARE YOU ACTING ON ALL OF THIS? WHAT ARE THE QUANT FUNDS DOING?

A: As we saw, the short-term outlook is certainly difficult – with a further surge in new cases likely – meaning precautions should be taken with our portfolios, while some of the central features of the Quant approach are showing their benefits.
Since the start of the year and the outbreak of the virus in China, we have seen volatility starting to rise. In this environment, the positioning in our funds has started to change, to lessen any potential drawdowns.

Within our equity allocations – the portfolio has been tilted towards lower volatility areas of the market to keep volatility under control. This in practice means we have a high allocation to defensive sectors, such as Utilities and Consumer Staples. Companies in these sectors tend to have less cyclical business models and thus tend to perform in environments where economic fear is rising. To put this another way, even if the economy starts turning sour, people will still need electricity and toothpaste, meaning the companies selling these products/commodities will fare relatively better than everyone else.

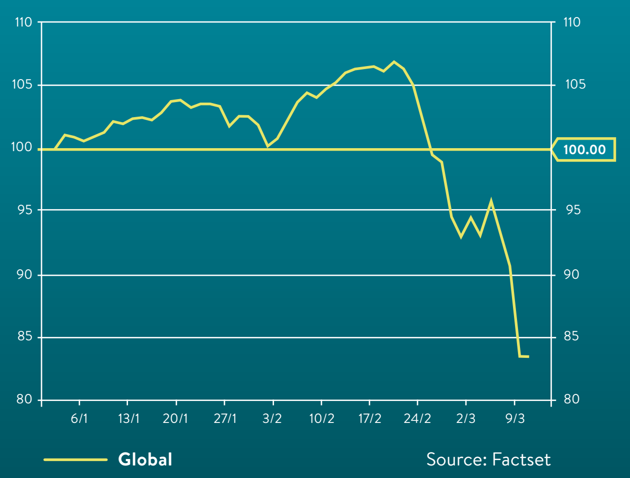

Fig. 1: Large sell-off in global stock markets

Meanwhile, in our balanced products, we have moved towards a larger position in fixed income. Having bonds in the portfolio will tend to cushion any future hit on the equity side of the portfolio, as rates will likely come down again in this type of scenario. This is good for bond prices and hence for the bond portion in the balanced product.

Q: ANY FINAL THOUGHTS ON STRATEGY?

A: Yes. Further selling pressure is not unlikely and we are positioning for it, but being completely out of the market is not the way to go, as some may suggest.
Monetary policy is extremely loose, implying ample liquidity, while, as we saw, fiscal policy is also loosening. In this environment, the probability of a very strong upward move is high. If these moves are entirely missed, it will turn out to be extremely expensive and will have negative repercussions for the long-term.

Thus, although it can be hard and we will have to brace for turbulence, investors should stay focused on their long-term goals, which markets are still able to deliver. We will get through this. **Forward You!**