UPDATE ON THE GLOBAL CRISIS

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momentum

Events unleashed by the coronavirus crisis are evolving at an extraordinarily rapid pace and our comments in our latest Viewpoint, written in early March, require updating.

Since then, the virus has spread globally at lightening pace and has been officially declared a pandemic. There are now more cases outside China, the original source, than in it, and Europe has become the epicentre but with the US following closely behind. The trajectory of escalation is exponential in many countries, just as it was in Wuhan soon after its outbreak. The numbers affected will be much higher very soon, with no peak in sight outside Asia.

Below we set out ten key points for investors at this juncture of a crisis now of epic proportions and which still carries deep uncertainties as to its duration, impact and damage:

1. Above all, this is a humanitarian crisis, on a scale which few if any of us have experienced. It has reached 160 countries compared with 58 on 1st March, and few will escape it. Cases outside China exceed 110,000 and deaths 4,576, compared with 7,169 and 104 respectively on 1st March. No further explanation is necessary for the fear and panic which is now gripping Europe, the US and increasingly the rest of the World. Those of us working in financial services are accustomed to bouts of investor fear but community wide fear triggered by a real and present danger to life is altogether more menacing and tougher for authorities to combat.

2. This, together with actions taken by authorities to try to control the pandemic's spread and rate of transmission, have delivered an unprecedented shock to economies, impacting both supply and demand. The pace of the spread and its immediate and broad impact are making it very difficult for authorities to control it effectively; markets have responded negatively to date to all policy measures introduced.

3. The economic shock delivered as a result has become much bigger, deeper and longer than initially anticipated. Without warning, all the major economies across the World are now in the midst of an extraordinarily sharp contraction of historic proportions, on an altogether bigger scale than that imparted by the global financial crisis. The few figures released to date since the crisis erupted and empirical evidence of the shutdown of spending and swathes of economic activity point to contractions well into double digits. Perhaps the greatest economic fear is that the crisis will no longer be very short and sharp but likely to extend for many months. This has become an immediate threat to jobs, confidence and the very survival of a wide range of companies, large and small. Insolvency risk has soared.

4. As a result, with fears of economic depression escalating and financial markets collapsing (Wall Street has now fallen by 30% since its peak on February 19th) this has rapidly turned into a liquidity and credit event. Spreads on high yield bonds have ballooned to over 900bps, on investment grade to 300bps, and liquidity has become paramount.

5. Adding fuel to the extreme fear pervading markets has been the collapse in the oil price, initially caused by an abrupt drop in demand then fuelled by a price war triggered by Saudi Arabia and Russia. Oil at $25 per barrel undermines much of the shale industry in the US and heightens fears of bankruptcies.

6. Volatility is now extreme across all asset classes as investors struggle to reprice these unprecedented risks. Once again, US Treasuries proved to be the best safe haven as the crisis evolved but even these have sold off dramatically in recent days as the fiscal response from governments is stepped up and deficits and debt levels balloon. Over the past week the yield on 10 year Treasuries has risen a full 1% from lows of 0.3%. For the moment, cash is proving to be king.

7. It has become imperative for central banks to provide liquidity support; cuts in interest rates have had little impact although they will help as we come through the crisis. All the major central banks have now restarted asset purchase programmes, including the US Federal Reserve (Fed) and, belatedly, the ECB, which yesterday announced a package of €750bn of asset purchases through 2020. As in the financial crisis a decade ago, the Fed has stepped in to provide liquidity support to money market funds and so-called ‘helicopter money’, in the form of government payments that go directly to consumers, is on its way. In the same way, governments have reacted with increasingly dramatic policies, most importantly, from an economic perspective, in providing essential support to companies and individuals to ensure that a short, sharp and deep economic contraction does not destroy basic economic infrastructure and turn this into a depression type scenario with reduced recovery potential. Fiscal support packages of unprecedented size have been announced (that in the UK announced a few days ago is equivalent to 15% of GDP with assurances of ‘doing whatever it takes’).

8. Although markets to date have been spooked by the scale of the policy moves, heightening the deep sense of uncertainty, they do provide an ultimate guarantee that the scars of this crisis will be less deep and long lasting, and should ensure that the recovery, when it finally comes, will be robust and sustainable. Whilst perspective is difficult when the fear factor is all-embracing and the ultimate duration and depth of the crisis, and extent of the damage caused, remain highly uncertain, it remains the case that this is a temporary shock. We believe that the actions taken by authorities will prevent the doomsday scenarios now being predicted by some. As the crisis reaches its peak in terms of spread and humanitarian damage in coming weeks we expect the fear factor to diminish; light at the end of a dark tunnel will reappear. As we have seen in Asia, the virus can be brought under control and although secondary rounds of infection are possible as economies gradually move out of the current lockdown, some degree of immunity will be built up and the pace at which vaccinations are being brought to testing stage is astonishing. Fears of a repeat of the Spanish flu 100 years ago, which came in three devastating waves, are unduly pessimistic given the huge advances since then in knowledge, preventative measures and medical science. We appear to be heading towards the peak of the wave of distress selling, deleveraging and flight to safety in markets and calm heads are required to see through this period. We do not underestimate the severe economic impact of the crisis and recognise that its financial effects could deteriorate further but markets will eventually begin to anticipate the recovery to come and will probably do so before the end of the humanitarian crisis.

9. We also recognise that there will be longer term implications of the crisis. It will take a long time to recover fully, and confidence of both consumers and businesses will be impaired. The importance of liquidity has been sharply emphasised and is unlikely to be forgotten quickly. Monetary policy will remain extremely loose for many years ahead. Governments will be saddled with much higher fiscal deficits and debt; weaker economies and those already with high debt levels have the biggest challenges ahead. Italy and its southern European neighbours spring to mind as do a number of developing countries. Globalisation might well have taken another knock as companies and governments prioritise security of supply over cost. The structural fragility of the EU has again been thrown into the spotlight and the real test ahead is whether a single fiscal and monetary union can be formed or whether the current nationalistic approach will prevail, thereby storing up problems for the future.

10. But recovery will come; we do not know when but when it does the carnage suffered to date has left valuations of equity markets using normalised earnings at more attractive levels than for many years. Risk free assets are more expensive than ever and provide no protection whatsoever if the current massive fiscal injections result in time in higher inflation. This is not a time for great risk taking given the uncertainties surrounding the eventual outcome of the pandemic and liquidity remains critical but the sell-off to date is discounting huge damage already and central banks the World over are taking the action right now to ensure adequate liquidity is available to the financial system. Now is not the time for panic but for ensuring portfolios are built on sound foundations, properly diversified, in high quality managers and stocks, and ready to take advantage of the extraordinary opportunities arising to capitalise on the recovery to come.

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