BERGOS BERENBERG

MARKET COMMENTARY

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CORONAVIRUS, ITS IMPACT ON MARKETS AND OUR POSITIONING

SITUATION EXTREMELY DIFFICULT TO ASSESS

The Coronavirus (COVID-19) is dominating the news and increasingly having an impact on global economies. Millions of people are quarantined (the vast majority of them in mainland China) and the number of deaths is tragically increasing day by day. According to WorldOMeter, at least 82'221 infections have been reported worldwide (78'514 in China, 1'595 in South Korea and 407 in Italy) and 2'807 individuals already died as of today (2'747 in China, 13 in South Korea and 12 in Italy). The numbers have been steadily climbing for weeks, with cases confirmed in 50 countries and have also surged in Europe, especially in Italy, over the last couple of days. Having said that, the epidemic is undeniably a bigger issue as previously expected. The risk has increased that authorities around the world may have to take even more drastic measures such as broader travel restrictions and lockdowns to contain the spread of the virus. The actual economic consequences are extremely difficult to predict and market participants fear that the coronavirus will expand from an epidemic to a pandemic.

IMPLICATIONS ON THE ECONOMY BECOME SLOWLY VISIBLE

While we cannot really anticipate the potential spread and duration of the coronavirus, the impact on the overall economy becomes ever more visible. Due to the contagion risks in shopping centres and restaurants, there is currently a demand-side shock and the closure of entire production sites is causing a supply-side shock at the same time. A lot of western companies have production sites in China and with supply chains interrupted, companies such as Apple were forced to cut its sales expectations for the quarter, citing the coronavirus's impact on factories and stores. Other household names like Mastercard, Danone and Microsoft followed recently and also adjusted their guidance downwards. The expected growth stabilization thanks to the lower political uncertainty under the phase 1 agreement between China and the US and the monetary support from central banks is expected to shift further into the future and could be smaller than initially assumed. Also the anticipated modest upturn in global trade and manufacturing output will most certainly be delayed. Our economists have lowered their GDP growth forecast for China to 4.5% from 5.9% for 2020. And our equity team no longer projects that western companies will generate solid earnings growth in 2020.

FURTHER SETBACKS POSSIBLE BUT WE ALSO SEE OPPORTUNITIES

The global selloff of risk assets reflects the uncertainty about how the situation will develop and what its economic consequences will be. The sharp equity correction has reversed a large part of the 'risk on' move since Q4 last year. Global equity markets now stand at the same level as early December. But with increased risk of an economic downturn, central banks and government could take monetary and fiscal policy measures to support the economy. In China, first steps have already been taken and in the US more central bank easing is also expected. But one has to keep in mind that while monetary and fiscal policies can offset a sudden drop in demand, they can do little to offset negative supply-side shocks. On the other hand, the relative attractiveness of stocks versus bonds has increased further due to the recent selloff. With global bond yields approaching all-time lows, it seems that there is no real alternative to equities in the medium term in a liquid portfolio. As of this moment, global equities show the same level of attractiveness compared to bonds as seen after the 2018 selloff and during the trade stress in May/June 2019. E.g. the gap between the S&P 500 earnings yield and the 10-year US Treasury yield equals 440 bps, far above the long-term average of 230 bps (since 1976). Until year-end, we expect the yield gap to narrow.

OUR CURRENT POSITIONING

Of course, we cannot forecast how the coronavirus will develop and we certainly have to brace ourselves for some further bad news but so far, we do not see the epidemic as a reason to fundamentally change our view. Although the risks of a more severe disruption to economic activity have increased, our economists believe that the impact, albeit significant, will be mostly temporary. The current correction could therefore create opportunities to add risk eventually as we do not expect a deep bear market or recession, especially in the US. Our overall equity allocation remains at neutral. We continue to overweight US equities vs. the rest of the world mainly due to a higher earnings base and a better technical picture. There is also the fact, that the US seems to be less affected by the outbreak so far. Our current cross-asset positioning should be fairly suitable to weather the current phase of increased volatility, particularly due to our overweight in gold and our high exposure to USD - both perceived as safe-haven assets rather resistant to a deteriorating market environment. In the current environment and with steady demand for fixed income and more central bank easing expected, we just increased the overall duration for USD investments.

TILL CHRISTIAN BUDELMANN

As capital market strategist of the private bank Bergos Berenberg, Till Christian Budelmann regularly comments on events on the international capital markets and examines them in the context of economic and political trends. Since 2004, Budelmann has been responsible for various investment strategies and sits on the bank's Investment Committee. He has been Managing Director since 2013.

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