

The Bear Necessities

– Robert White, CFA

“There are decades where nothing happens; and there are weeks where decades happen”. After the longest bull market on record finally came to an end last week, Lenin’s famous quote concisely sums up the current mood among investors. The S&P 500 officially moved into bear market territory on Thursday after it breached the 20% level in a record 16 sessions of trading. Such price action reflects the tragic reality that the coronavirus has now caused the death of thousands globally, and the focus quite rightly is on limiting its human cost. Amidst the barrage of negative news, it is important for long term investors to act rationally and take account of the situation as it develops.

With Europe now officially at the “epicentre” of the pandemic, Spain and France have followed Italy in announcing emergency restrictions and wide-ranging economic shutdowns in order to limit the spread of the virus. European equities have been among the hardest hit, with the Eurostoxx 50 down 20.0% last week. By sector, Energy was the worst performer globally as the breakdown in talks between Saudi Arabia and Russia led to the oil price dropping to levels last seen in 2016. Banks also sold off which was an additional headwind for markets such as the UK which have greater exposure to Financials and Energy stocks.

The most peculiar aspect of recent days however has been the mixed performance of safe-haven assets which typically provide uncorrelated sources of return to risky assets such as equities and credit. Government bonds dropped 3.5% in price terms last week, with gold and silver also falling 8.6% and 15.1% respectively (although gold and US treasuries are still positive YTD). While asset price correlations can temporarily break down during periods of crisis, the dislocation between bonds and equities last week points to indiscriminate selling in the market.

This can occur for many reasons, such as: (1) systematic risk parity strategies will be cutting positions as volatility and correlations have risen (2) leveraged investors such as hedge funds are finding it harder to access capital (3) asset managers facing redemptions are being forced to raise cash and (4) the sheer uncertainty around the situation is creating high demand for cash as people are becoming more risk-averse. The latter point is best illustrated by the +3.5% outperformance of global “quality” stocks last week, which typically generate higher than average cash flows and are generally better placed to withstand economic downturns.

So, what is the best course for the rational investor right now? The most obvious conclusion is that things are going to be volatile across the board. Part of this will be in reaction to rapidly changing news flow about an unpredictable virus, but the extent of recent price moves (in both directions) suggests that greed and fear will be having an impact too. In that respect, it is noteworthy that hedge funds which attempt to profit from prevailing trends in asset prices are in positive territory YTD, despite the broader selloff.

The biggest risk in times of uncertainty is that it is easy for investors to lose sight of their long term objectives. While cash may seem appealing during a selloff, its value erodes over time in real terms, and the opportunity cost of being out of the market can be at least equally painful. Over the long term, share prices are representative of business fundamentals, and well-run companies will be able to weather the storm and come out stronger on the other side. With equities now looking significantly cheaper than they were a few weeks ago, now does not seem like the time to sell and lock in losses. Trying to time markets in this fashion is a highly risky strategy given current levels of volatility. Instead, the rational approach would be to keep calm, refrain from trading headlines, and remain mindful of your investment objectives.

The Marketplace

- The rapid spread of COVID-19 caused significant portions of Europe to lockdown
- Global markets declined 12.4% over the past week
- Brent crude fell 25.2% ending the week at \$33.9 a barrel
- Gold fell 8.6% ending the week at \$1529.8 an ounce

Market Focus

US

- US equities fell 8.7% over the past week in reaction to the rise in COVID-19 cases in the US.
- This morning the Federal Reserve cut its base rate by 100 basis points to 0.0%-0.25%, as well as launching a \$700bn quantitative easing programme.
- An increasing number of US firms issued profit warnings citing sharp declines in demand, especially within the travel sector, and supply chain disruptions.
- The US banned all travel to and from Europe (ex UK) midweek and extended this ban to the UK by the end of the week.

Europe

- Many European countries are now in a state of emergency. Countries including Germany and Poland have closed their borders.

- European equities fell by 18.3% over the past week, with emerging European equities falling 21.5%.
- Euro government bonds fell 2.8%, with investment grade and high yield indices faring worse, at -3.0% and -7.7%, respectively.
- Both Germany and Italy have announced fiscal packages to aid the economy during the COVID-19 outbreak, in the case of Italy they have suspended mortgage payments and increased their fiscal injection to €10bn.

UK

- UK equities declined 17.1% over the past week, bringing the year to date decline to 28.4%.
- UK Gilts fell 2.7% with their investment grade counterparts falling 5.8%.
- The Bank of England decided to cut the base rate by 50 basis points to 0.25%, as well as a £30bn spending package to weather the COVID-19 outbreak.

Asia/Rest of The World

- The main volatility index reached record highs over the past week.
- The Bank of Japan has loosened monetary policy, stating their desire to continue buying corporate bonds whilst raising their annual ETF purchase target to 12 trillion yen.
- The signs of China's gradual economic recovery continue as the forced one month lockdown is lifted and production lines reopen.

Asset Class/Region	Currency	Currency returns			
		Week ending 13 Mar. 2020	Month to date	YTD 2020	12 months
Developed Market Equities					
United States	USD	-8.7%	-8.2%	-15.8%	-2.2%
United Kingdom	GBP	-17.1%	-18.5%	-28.4%	-22.4%
Continental Europe	EUR	-18.3%	-20.0%	-26.6%	-16.1%
Japan	JPY	-14.3%	-16.5%	-26.7%	-18.7%
Asia Pacific (ex Japan)	USD	-11.1%	-10.1%	-17.1%	-10.1%
Australia	AUD	-10.8%	-13.5%	-16.1%	-6.3%
Global	USD	-12.4%	-12.0%	-20.0%	-8.5%
Emerging markets equities					
Emerging Europe	USD	-21.5%	-22.4%	-36.1%	-21.8%
Emerging Asia	USD	-10.0%	-8.6%	-15.2%	-7.6%
Emerging Latin America	USD	-17.5%	-21.7%	-35.0%	-31.3%
BRICs	USD	-10.2%	-10.4%	-17.3%	-10.4%
MENA countries	USD	-14.7%	-17.2%	-23.6%	-21.1%
South Africa	USD	-18.2%	-15.1%	-32.6%	-28.2%
India	USD	-9.2%	-12.9%	-21.2%	-16.5%
Global emerging markets	USD	-11.9%	-11.3%	-19.9%	-13.0%
Bonds					
US Treasuries	USD	-1.8%	1.2%	6.7%	13.4%
US Treasuries (inflation protected)	USD	-6.2%	-4.1%	-0.5%	6.1%
US Corporate (investment grade)	USD	-7.2%	-5.4%	-1.9%	8.8%
US High Yield	USD	-7.1%	-7.6%	-8.8%	-2.1%
UK Gilts	GBP	-2.7%	0.9%	6.3%	12.8%
UK Corporate (investment grade)	GBP	-5.8%	-4.3%	-2.1%	5.6%
Euro Government Bonds	EUR	-2.8%	-2.1%	0.8%	6.0%
Euro Corporate (investment grade)	EUR	-3.0%	-3.0%	-2.3%	1.4%
Euro High Yield	EUR	-7.7%	-8.6%	-10.1%	-4.3%
Japanese Government	JPY	-1.1%	-1.4%	0.0%	1.1%
Australian Government	AUD	-2.3%	-1.7%	2.6%	8.0%
Global Government Bonds	USD	-3.4%	-0.2%	2.8%	8.0%
Global Bonds	USD	-3.9%	-1.5%	0.6%	6.2%
Global Convertible Bonds	USD	-6.7%	-6.4%	-6.6%	-1.4%
Emerging Market Bonds	USD	-8.9%	-7.0%	-5.7%	1.1%

Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-13.1%	-10.3%	-16.6%	-9.3%
Australian Property Securities	AUD	-13.7%	-13.7%	-13.1%	-11.1%
Asia Property Securities	USD	-13.4%	-11.6%	-19.6%	-16.6%
Global Property Securities	USD	-15.5%	-13.1%	-19.9%	-11.9%
Currencies					
Euro	USD	-2.0%	0.7%	-1.3%	-2.0%
UK Pound Sterling	USD	-5.0%	-3.2%	-6.9%	-6.5%
Japanese Yen	USD	-2.0%	0.5%	0.9%	3.3%
Australian Dollar	USD	-7.0%	-4.9%	-12.1%	-12.9%
South African Rand	USD	-3.7%	-3.3%	-14.2%	-11.4%
Swiss Franc	USD	-1.7%	1.6%	1.4%	5.4%
Chinese Yuan	USD	-1.1%	-0.2%	-0.6%	-4.3%
Commodities & Alternatives					
Commodities	USD	-10.2%	-12.1%	-24.3%	-23.0%
Agricultural Commodities	USD	-4.5%	-4.8%	-11.8%	-10.8%
Oil	USD	-25.2%	-33.0%	-48.7%	-49.9%
Gold	USD	-8.6%	-3.5%	0.5%	16.9%
Hedge funds	USD	-3.0%	-3.3%	-4.3%	1.1%

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