

Coronavirus Outbreak

26 February 2020

Background

On 31 December 2019, the World Health Organisation China Country Office was informed of several cases of pneumonia detected in Wuhan City, Hubei Province of China. From 31 December 2019 to 3 January 2020, a total of 44 case-patients with pneumonia of unknown causes were reported to the WHO by the national authorities in China. The Chinese authorities identified a new type of coronavirus, which was isolated on 7 January 2020. According to the latest figures published on Wednesday, 80,980 people have been infected since the outbreak began. Most of the cases of the new coronavirus remain in China (78,190) where the virus originated last year, however it has spread across the globe and has now infected people in 38 countries. Nearby South Korea has the most infections outside of China, with more than 1,100 confirmed cases. The total number of deaths from coronavirus is estimated at 2,760 (at the time of writing), with over 2,715 coming from mainland China.

Health officials reported 52 more deaths on Tuesday, which is the lowest daily total in more than three weeks. The number of new infections has been declining in China, and attention has now turned to clusters of cases abroad and the transmission between countries. South Korea has reported 11 deaths and Iran at 16 (the highest outside China), although fears are that this figure is underestimated. Italy is the worst hit European country with over 320 cases confirmed and 11 deaths, and concerns grow that this could increase the speed at which the virus spreads across the continent. The developments in South Korea, Italy and Iran are the reason why people are drifting closer to calling the coronavirus outbreak a pandemic. The WHO Chief Dr Tedros Adhanom Ghebreyesus believes the virus "absolutely" has pandemic potential. Comparisons have been drawn with the SARS outbreak of 2002/03; indeed, initial genome sequencing of the coronavirus has found that it shares 79.5% of the SARS genome-sequence. Between November 2002 and July 2003, a total of 8,098 people in 26 countries were diagnosed with SARS, with 774 dying from the virus.

To put those numbers in context, the Centers for Disease Control and Prevention (CDC) in the US estimates that so far during the 2019-2020 influenza season there have been at least 15 million cases, 140,000 hospitalizations and 8,200 deaths from flu.

Market Reaction

Determining the monetary impact of the breakout is a far harder task. Using SARS as an example, the impact on GDP in China was brief and muted, and on the stock markets it was even more so. Over the entire course of the outbreak, markets actually rose. It is inevitable that coronavirus will be disruptive for economic activity in the short-term. Until the last few days financial markets globally were keen to look through the short-term disruption but the recent virus outbreak in countries outside China has been a source of market concern. On Tuesday the S&P 500 and Dow Jones fell over 3% after making a positive start to the session, with the S&P falling 7.6% from its record high reached last week. Investors have turned to the relative safety of government bonds, with yields on the 10-year US

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Treasury falling to a record low of 1.306% on Tuesday. Gold has also seen heightened interest from market participants.

The situation is highly uncertain but likely to get worse before it improves. Nonetheless, the experience from SARS and the fact the Chinese government has mobilized its resources comprehensively and quickly suggests that the impact to consumption and business confidence will be cyclical rather than structural. We would expect to see earnings come under pressure in the short term, and market volatility to remain elevated. However, it is too difficult at this moment in time to predict how severe and prolonged the impact of coronavirus on financial markets will be. It is worth noting that despite the recent pain suffered by stock markets, the S&P 500 fell from record highs and is flat over 3 months (in dollars). The MSCI China Index is up over 5% from 3 months ago even taking into account the falls in January and February, and the MSCI World is just below flat for the same period.

Our View

The view at NLP Financial Management is that it is far too early to know how serious a threat to global GDP and financial markets coronavirus will be. At the start of the month the decision was made by the investment committee to trim our position in Asian and emerging market equities, which has continued to sell-off since the trade date. Our portfolios have been defensively positioned with positions in government bonds, short-dated bonds, cash and alternative funds. We believe that our positioning should help protect wealth in times of increased market sensitivity and this has been the case thus far this year. Our balanced portfolio is flat for the year (to end of 25 February), with the relative strength of our bond and alternatives allocation (+1.4% and +2.5% respectively) helping defend against the weakness of equity markets. We are liaising with our fund managers daily to garner their views on the coronavirus outbreak and we are watching market movements very closely. Longer term, opportunities may present themselves to reinvest into assets trading at depressed valuations, but we remain highly cautious and vigilant over the short-term.

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