Coronavirus and Markets update: 20 – 24 March 2020

- The major development of course since the last update is that Coronavirus has gone global; previously the declining infection and death rates in China were seen as a positive and the hope was that the virus would be largely contained to greater China, Korea and Japan, where the authorities appeared to be gaining the upper hand in the containment war. That didn't happen for reasons set out below; in terms of the virus globalising, it is widely speculated that the Milan Fashion Week from around 20-28 February may have been a principal factor involved – 100,000+ visitors from around the world attending the show at a time when the outbreak in China was well under way and being transported to Northern Italy by tourists and show attendees alike. Without wishing to sound controversial, the fashionistas attending the show probably didn't evidence much of what we now know as social distancing and the regrettable fact of the disease is it is primarily spread by close contact between people. Italy is currently being overwhelmed by the disease and it seems a coincidence that Milan is the epicentre of the European outbreak, and it seems also the global outbreak as those circa 100,000 people all headed home to the four corners of the planet following the show. Doubtless the epidemiologists will tell us the paths the virus took in due course, but in the meantime Europe is well and truly ground zero for the disease now, although it has of course spread to some 143 countries, including the USA where all 51 States see some measure of outbreak. To put the current crisis in perspective, the current daily rate of new infections of Coronavirus is now comfortably more than double the total number of people that ever contracted SARS, while the current daily death rate from Coronavirus easily exceeds the total death rate from the entre SARS outbreak, so the world indeed faces an epic problem

- Did the initial denial and cover-up of the outbreak by Chinese officials cost the world valuable time in dealing with this? Almost certainly yes: whistle-blower doctors raising the alarm last December were hauled in by local police and told to stop spreading 'false rumours', or else. Ai Fen, a director at Wuhan Central Hospital was a case in point, on 27 December alerting authorities to the threat and lethality of the hitherto unknown form of coronavirus, similar to flu and cold, but of a different strain of then unknown origins. Fen was then silenced by said authorities. Another Wuhan doctor Li Wenliang having been unable to persuade officials of the emerging crisis, resorted to sharing data publicly on WeChat on December 30 and had been silenced by 1 January, the same day a further 8 doctors highlighting the dangers of the virus were brought in for questioning by the Wuhan Public Security Bureau. Wenliang subsequently died of the virus.

- On that same day 1 Jan an official at the Hubei Provincial Health Commission orders all samples of the virus to be destroyed and further testing and research to be stopped, and for there to be no further publicity around the outbreak. That same commission had already been informed prior to this that the new virus was similar to SARS, probably originated as a zoonotic animal to human disease transfer, and hence posed a clear and present danger to the public. The virus genome was mapped by 2 January, and Xi Jinping becomes involved by 7 January. On January 14 Chinese authorities state to the WHO that there is no evidence of human to human transmission despite knowing that SARS was transmitted in this manner and that the new disease was almost certainly from the same disease category as SARS. January 18 saw a large gathering of tens of thousands for the annual Wuhan Lunar New Year Banquet. On January 20 a top Chinese doctor confirms the virus is transmitted between people. January 21 sees the authorities mandate that any evidence of the disease must now not be covered up. Jan 23 sees Wuhan and three other Hubei cities put on lockdown – immediately an estimated 5 million people leave (this is normal for the Lunar New Year holiday, but workers from outside the immediate region probably left quickly to spend the New Year holiday at home, fearing the city-wide lockdown); those people leaving underwent no health checks on doing so. From 24-30 Jan hundreds of millions of workers are in transit around the country visiting relatives for the New Year holiday. Only on Jan 24 does China extend the lockdown to cover 36 million people and strict country-wide measures start to be implemented to control the outbreak

- In the US, top Republican House Foreign Affairs Committee member Michael McCaul states 18 March that China has carried out one of 'the worst cover-ups in human history and inflicted a pandemic and economic catastrophe on the world'. In the meantime the Chinese disinformation machine is already in overdrive, expelling several US journalists from China and stating the US military had deliberately introduced the disease into the country, proving that when a totalitarian regime lies, it lies BIG - the problem being of course the regime controls what Chinese citizens hear. So it seems something between 3 and 6 weeks were wasted by the Chinese authorities, during which period free movement of affected people was permitted both inside and out of China, resulting in the disease globalising and affecting countries which had little warning of what was descending on them

- So one casualty of the above will be the future of Sino / US relations, when in fact we had hoped for a resumption of talks leading to a Phase 2 trade agreement some time in 2020 or 2021 – that seems in doubt now, with Trump Administration officials only too keen to talk of Coronavirus as the 'China Disease' or the 'Hunan disease'. That China stands accused of exactly the same level of cover-up over the SARS outbreak indicates that they did not learn the lesson from that event, with far worse consequences this time

- But the main casualty of course is normal human social and economic activity – that the disease is transmitted by person to person contact is beyond doubt, therefore to stop the virus one has to prevent normal human contact, and the only way to do that is by shutting down most forms and forums of that contact, schools, workplaces, factories, bars, restaurants, and so on, thereby depriving businesses of their lifeblood, customers and cashflow. Effectively the shutdowns involve governments around the world pressing the pause button on the global economy, and in reality going onto a war footing – and the war analogy is not misplaced; Adolf Hitler did not close Britain's pubs in 6 years of World War II, something the current crisis has succeeded in doing in under six weeks – little wonder then that the current pandemic is being termed 'World War C', with former ECB head Jean-Claude Trichet calling the Covid-19 pandemic the worst crisis facing the world since the 1939-45 global conflict

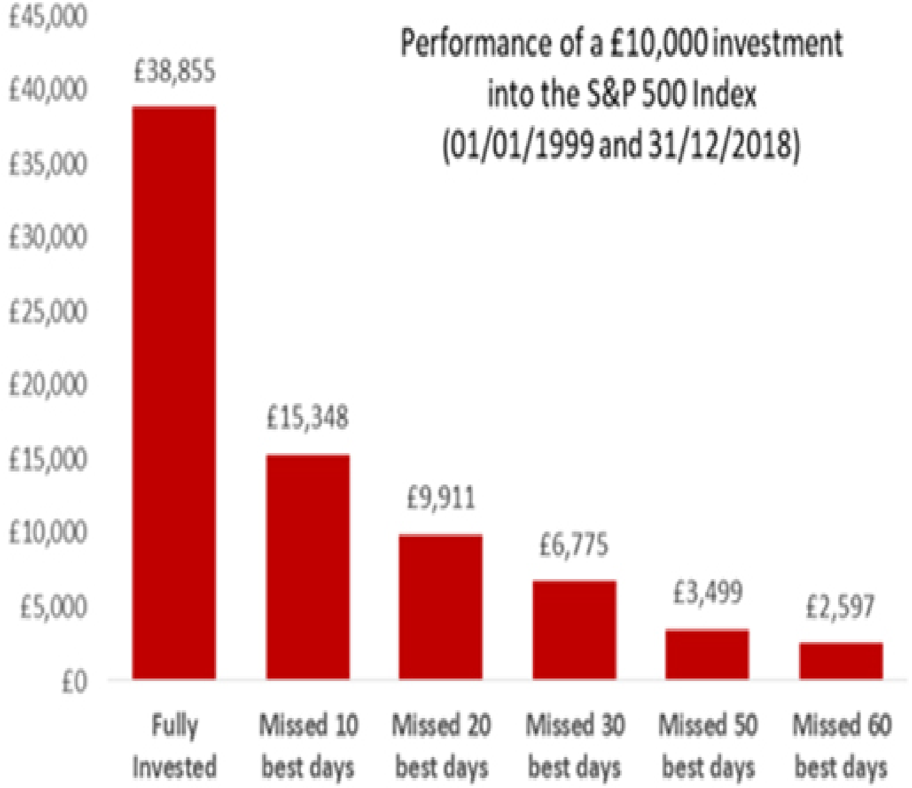
- Investment markets crave certainty like no other commodity in existence, and what the virus outbreak has done is to introduce unprecedented levels of uncertainty, with markets unable to calculate how long the economic shutdown has to last. However, the minute some real visibility on the path of the European and US phases of the disease becomes apparent, markets can start to look through the crisis and reprice for the re-opening of the wider economy in X weeks; one hopes X in this case is around a further 6-7 weeks in Europe and perhaps a little longer in the US, which is further behind Europe in the disease's progress around the world. We could consider the disease as progressing in 3 phases, first Asia, then Europe and the Middle East, and finally the US and the Americas generally. Phase 1 in Asia appears under control with previous disease ground zero states of China, South Korea and Japan recording just 103 new cases combined on Sunday 22 March, although in the rest of the region the picture is more mixed but not yet serious. Europe is clearly the new ground zero and the US is now heading in that direction. The latest evidence from Italy however indicates the death rate may have peaked Saturday 21 March, with the Monday March 23 death rate some 24.09% lower than that of the 21st, although it's probably unwise to extrapolate too much from that just yet

- Warren Buffet has pointed out that the 2008-10 Great Financial Crisis (GFC) was far more dangerous and more scary than the current situation, no matter how unpleasant the virus outbreak might seem to us at the moment. And in that is the key issue, the GFC was a financial crisis of biblical proportions, with systemic and severe underlying causes with very uncertain outcomes, potentially taking years to rectify, and with both political and financial administrations initially unclear as to how to deal with it. This time it is not a financial crisis, rather it's a health crisis, an exogenous shock of admittedly global proportions, but which can be defeated and possibly so over a far shorter time frame than the GFC, provided the right containment measures are taken and stimulus packages signed into law. China did at least show how to contain the outbreak once they had finally acknowledged its existence, and thus have shown the way forward. The global monetary and governmental authorities meanwhile are drawing on the GFC experience as to how to calm and underpin markets when crisis hits

- If this sounds complacent, it is not intended to – the means of defeating the crisis is to temporarily halt all usual human social and economic activity in about 20% of the world, in turn shutting down much of the developed world's economy - thus governments are effectively mandating a recession by insisting on societal compliance with these extreme measures in order to limit the time taken to bring the virus under control, and hence the downtime for the wider economy. The good news here is that the virus was initially noticed as serious in China around late December 2019, and by the third week of March 2020 some 80% of Chinese workers are back at their posts, an estimated 70% of productive capacity there has resumed and things are getting back to normal – even after having been mismanaged (aka covered-up) along the way. Doubtless the global situation at present is still worsening with infection and death rates climbing fast, Italy already having overtaken China in terms of both infection and death rates
- But be in no doubt the big monetary and fiscal bazookas are now being fired – The US Fed has just announced March 23 that it will purchase Treasury Bills (US government stocks) and mortgage-backed securities in 'whatever measure is required'….this is in effect unlimited or infinite QE, something pioneered after the GFC and now being redeployed as a tool to get the US through the current crisis. Before that the Fed dropped rates to zero, allowed for massive windows of liquidity to markets in order to maintain order, $ flows, and to allow companies to keep functioning. And in its first ever such move, it will buy corporate bond ETFs, basically in a 'Whatever It Takes' mentality; we need to get used to that phrase going forward
- That's the Fed or monetary response, and this is by no means an exhaustive list of its armoury. What of the governmental or fiscal response? The US fiscus intends to provide so-called 'helicopter money' in the form of cheques to US citizens in a bid to boost spending, there is $150bn available to distressed companies, $50bn available to help the distressed aviation sector, $300bn available for small business loans, 2 more tranches of $500bn each via state and City authorities, and so it goes on. Trump is pushing for a further injection of $1trillion, all this comprising the 'Mainstreet' program to keep small America functioning. The Senate is currently wrangling over a total Phase 3 package probably totalling upwards of $2trillion, which is not far short the size of the entire UK economy. The total amount of liquidity of all types that is currently being discussed and is heading for the emergency pipeline in the US in the form of loans, aid and grants and liquidity must now be in the region of $5 trillion, or twice the UK economy. The UK, ECB, Hong Kong, Singapore, Japan, China, Canada, Australia, the list goes on, have all responded with highly significant stimulus packages of their own and aimed at offsetting the effects of the crisis and ensuring as far as possible some economic continuity. The overall US stimulus will be a quantum advance over what was done in 2008-9 in the GFC - the currently planned stimulus will do about double in the next two weeks what QE did in 7 months in the GFC….Yet as I write this, the Senate is split along partisan lines with Democrats largely voting against the relief bill until changes are made, some reportedly to do with climate change – they may be overplaying their hand in the eyes of the electorate and while this may seem like the Democrats fiddling while Rome burns, a deal to get the package through the Upper House is highly likely to be struck by Friday 27 March
- Thus the intended policy response is absolutely unprecedented - one positive flowing from the GFC experience is an understanding that rapid, decisive and co-ordinated action is required to prevent the crisis expanding into the bond markets and thereby triggering a major market recession. Note that this will still not prevent higher unemployment coming about regardless – we expect the next US jobless claims figure to rise from the current circa 220,000 to a figure about 8-10 times that at the next reading – this is unavoidable in the circumstances
- A major part of the policy response is loans will be *rapidly* made to large and small businesses to help them survive the shutdown period – fair enough given these have been ordered to close. Part of the intended deal is that the low interest loans will be written off entirely if said small businesses keep their staff on the payroll over the coming 2-3 months - clearly the big recession risk from here is if millions of workers get quickly laid

off, in which case the economy will suffer serious stress and the recovery period will be much extended. The US and many other governments are determined to get funds into small business accounts to ensure the employment status quo is maintained as far as possible by allowing these businesses 'to make payroll', and thereby ensure businesses are both financially stable and retain their workforces to restart operations once victory over the crisis is declared. So everything is being done to keep small businesses – by a country mile the largest employment sector in America and elsewhere – functional and able to resume normal commercial activity in a few weeks. Government recognises that the US cannot function without airlines, airports, hotels, restaurants and the myriad small enterprises which largely comprise the US economy. The situation is similar in the UK where Rishi Sunak has promised around £350bn in aid to small businesses, this as a starter

- Developing nations with weaker health systems and weak fiscuses are more prone to long term problems, but the major economies can survive 2-3 months of lockdown, after which the outlook becomes more uncertain – hence the effort to get citizens to comply with lockdown rules to shorten the pandemic period, and why it is entirely possible both the USA and the UK end up in Milanese or Madrid- style shut-ins
- Assuming the above measures are sufficient and allow the economy to resume activity in a few weeks or perhaps 2-3 months, what will the post-crisis global economy look like? Things will be different certainly, Q1 GDP will be unattractive, but Q2 GDP will be just ugly – estimates vary but a quarterly real reduction of around 2-3% is entirely possible for Q2. Unemployment will be higher across the world, strained US / China relations have been mentioned and are inevitable, putting into some doubt the Phase 2 Trade Deal. Unemployment will be one hopes only a short term problem, and consumer demand – provided the payrolls maintenance efforts pay off – should remain high given consumers will have cash in their pockets and will be experiencing an element of cabin fever and be willing to go out and spend again; we consider consumer demand as having been deferred rather than cancelled. In the meantime lower fuel prices will serve as an effective tax cut and spending boost, millions of mortgages are being refinanced at lower long term rates and borrowing costs overall will be lower – all this bodes well for the US and global consumers provided they don't perceive their personal balance sheets as having been badly damaged. Maintaining people on payrolls allows bills and mortgages to be paid and should prevent any collapse in the housing market, for most consumers their major measure of accumulated wealth. Nevertheless the recovery may be slower than some optimists are hoping for, but Q3 and Q4 should see a reasonably rapid resumption of consumption, and in the final analysis the current pandemic is unlikely to be anywhere near as bad the US 1957-58 flu outbreak
- Joe Biden will almost certainly be the Democratic Presidential candidate although given limitations on rallying and campaigning in the short term it seems doubtful he can build momentum with the public, unlike Trump who is in the limelight every few hours. Trump should also be careful what he wishes for – in talking down share buybacks he is potentially removing one key pillar on which recent equity market gains have been based, and for someone who favours stock market performance he seems to be talking down his favourite measure of success. In the UK meanwhile we must be thankful for the outcome of the last general election, as a Labour government's policies could have severely weakened the UK economy prior to the outbreak reaching its current levels, thereby limiting the ability of the Bank of England and Chancellor to carry out the necessary steps to contain the crisis
- Finally, consider the following charts - the first shows the importance of not panicking out of bear markets; it depicts several different paths of £10,000 invested in markets. Left fully invested over an 18 year period, the funds clearly outperform instances where much market timing has been attempted and the investor has missed certain of the best performing days in markets over that period; left invested the funds recorded growth exceeding 100%, while market-mis-timed to miss the best 60 days or just 3 days per year, the investment barely matches 18 years of inflation



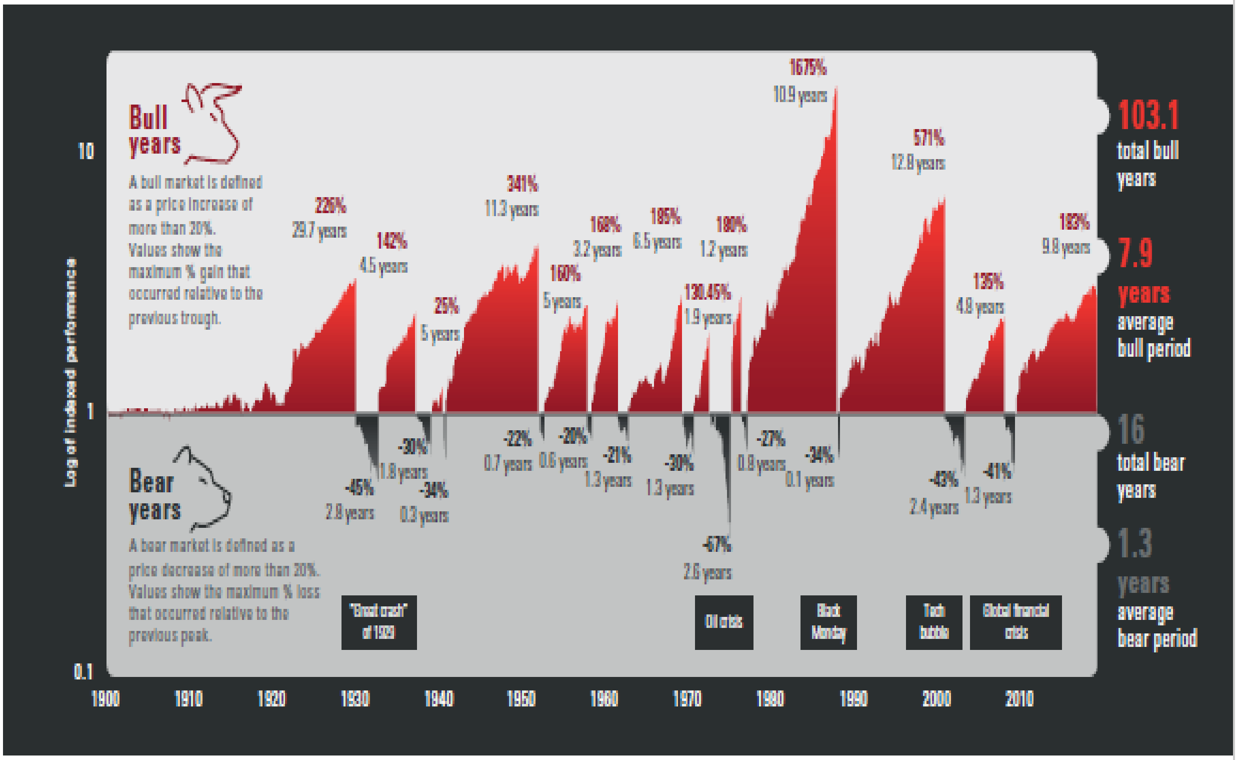
Source: Bloomberg. All analysis is before fees.

Having said that the portfolios are sitting on cash which will be redeployed as and when we believe indices have stabilised and the legions of leveraged players (those that 'invest' with borrowed cash) have been fully squeezed out of the markets

The second chart depicts the relative nature of bull and bear markets, and shows that markets usually bounce back over time no matter what systemic or exogenous shock has beset them…as already highlighted, this is not a systemic shock, but it is now up to the fiscal and monetary authorities to put sufficient back-stops in place to prevent this exogenous health shock turning into a full-blown financial recession, with all the negative consequences that would bring. In the meantime one can count on less than the fingers of one hand the number of times markets have been this over-sold, namely 1929-32, 1987, and the GFC 2007-10, and today.

Vanguard

Bull and Bear Markets



Notes: Calculations are based on FTSE All Share (GBP Total Return). A bear market is defined as a price decrease of more than 20%. A bull market is defined as a price increase of more than 20%. The plotted areas depict the losses/gains ranging from the minimum following a 20% loss to the respective maximum following a 20% appreciation in the underlying index. Time period: 31 January 1900 to 31 December 2018. Calculations based on monthly data. Logarithmic scale on y axis.
Source: Global Financial Data.
Past performance is not a reliable indicator of future results. The value of investments, and the income from them may fall or rise and investors may get back less than they invested.

So, as brutal as the current setback appears, it is not likely to be worse and will likely be more short-lived than some of the above bear events, and so far at least the rapidly gathering global policy response is likely to see the affected economies through the crisis. Another update will follow shortly.

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In regard to the current situation with Covid-19, MPL Wealth Management Ltd are now working remotely from 45 Doughty Street, however there will be no change to the normal methods of contact including postal communications.