Seeing **Beyond** the Coronavirus Scare

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Risk assets endured a fierce sell-off in the past month as global markets reeled from contagion fears arising from the Covid-19 outbreak. At the time of writing, the number of new infections surpassed that of China with fresh cases springing in Italy, South Korea and Iran.

Investors have been closely tracking the outbreak to assess its potential impact to the economy as a result of wide scale city and factory shutdowns, as well as travel restriction bans. Global supply chains have also seen disruption due to stalled manufacturing activity, impacting markets like Taiwan and Korea which are heavily interlinked.

The Covid-19 epidemic has quickly overtaken headlines as a black swan event that could delay an economic recovery. Indeed, markets were too quick to give the all-clear signal at the initial flare-up of the epidemic and subsequently corrected in late February again.

However, the ensuing market correction is likely overdone with volatility exacerbated by the presence of algo-traders. The washout in financial markets was so severe that it even prompted the World Health Organization (WHO) Director-General Tedros Adhanom Ghebreyesus to call for composure and said global markets "should calm down and try to see the reality."

Telling investors to calm down may sound paradoxical, but it does allude to the irrational behaviour seen in markets especially in volatile times. Perhaps investors should heed the WHO's advice and take a step back before following the herd?

Lessons from History

David Ng, Deputy Managing Director & Chief Investment Officer says it is worth revisiting history to understand how markets behave in past epidemics, the most recent being the Severe Acute Respiratory Syndrome (SARS) outbreak in 2003.

"The lesson from SARS is that the economy and stock markets can quickly recover once the virus contagion recedes. With more decisive measures and effective control policies by governments in containing the outbreak, we view that the global economic recovery risks being delayed rather than derailed," said David.

Whilst the impact of the Covid-19 outbreak could last for a few quarters, David expects that the impact on stock markets will be shorter.

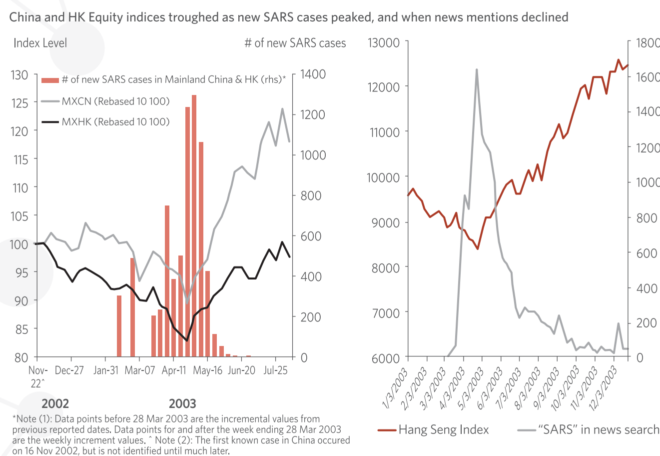
"Once Covid-19 recedes, we believe the global economy will bounce back as months of pent-up demand flows into the economy just like when SARS receded. We do not know when this will happen. But we suspect that Covid-19 will recede within a few quarters based on what we have learned about past viruses."

However, the economic impact of Covid-19 is expected to be larger than the 2003 SARS outbreak given that China now constitutes a bigger part of the global economy, according to David.

"Import demand from China makes up 2.4% of global GDP today as compared to 0.4% in 2003. As such, a weaker Chinese economy today will undoubtedly affect the global economy more so than in 2003.

"Whilst we could see impact to China's 1Q'2020 GDP, additional fiscal and monetary support may cushion downside to its economy albeit with a lag effect. The quick and measured response from Chinese authorities in containing the outbreak has also soothed fears, as authorities draw upon lessons from past outbreaks like SARS and MERS," states David.

China and HK Equity indices troughed as new SARS cases peaked, and when news mentions declined



*Note (1): Data points before 28 Mar 2003 are the incremental values from previous reported dates. Data points for and after the week ending 28 Mar 2003 are the weekly increment values. ^ Note (2): The first known case in China occured on 16 Nov 2002, but is not identified until much later.

Whilst the rest of the world has only begun to see infection rates climb, strict containment measures undertaken by China has already started to yield results.

The central Hubei province which was the epicentre of the country's coronavirus outbreak, reported less than 200 cases of new infections for the first time since January. Factory production and electricity consumption have also gradually begin to pick-up. Apple and Starbucks which temporarily shuttered their retail outlets due to the outbreak have also started to reopen their stores in stages.

Fear is More Contagious

Investors may be tempted to react impulsively as markets continue to be rattled by coronavirus jitters. But if there is anything more contagious than any viral outbreak is the spread of fear and investors can be a panicky bunch. Once the COVID-19 contagion recedes, there will be little impact to long-term investment decisions and fundamentals.

Investors may harken back to the 2003 SARS episode, when markets staged a recovery once the virus was effectively contained. At the height of SARS, the S&P 500 endured a 14.2% correction from November 2002 to March 2003. Once the outbreak receded, the S&P 500 subsequently finished up 28.7% by the end of 2003.

So how should investors position their portfolios in the interim? The best course of action may be for investors to do nothing at all and stay focused on their long-term goals.

"It is crucial that investors stick to their asset allocation and stay prudent in this current volatile landscape. Investors who remain disciplined in their approach by investing consistently and stick to their long-term asset allocation would eventually reap the benefits and fare better overall.

"Investors who try to chase short-term winners or attempt to time the stock market typically fares poorly in the long run," continued David.

Any professional investor would attest that it is extremely difficult to time the market accurately and consistently. There are contrasting views as to when infection levels will peak and if the market has bottomed out yet. Investors who remember the 2003 SARS episode would be remissed if they were to lose out on a similar rebound again when markets stage a recovery once the coronavirus abates.

In times of heightened anxiety in markets, the best remedy for investors is to diversify.

It's a constant reminder again to investors that volatility is here to stay and no single asset class has been a consistent outperformer every year. A diversified portfolio consisting of a suitable mix of equity and bond funds can help smoothen returns and reduce risk. As a defensive asset class, fixed income has held up better compared to equities and would have offset some of the losses in a portfolio.

This would make for a less bumpy investment journey and would reduce jitters when faced with adverse market conditions. In turn, this would induce investors to stay invested and reap the benefits when markets eventually bounce back.

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