TierOne

Market Update 18th March 2020

Summary

COVID-19 is extremely contagious and can be transmitted by people showing no symptoms (asymptomatic). Evidence now shows that in general, it has relatively mild effects in the very young, and is most worrying when contracted by older men or those with underlying conditions such as hypertension, diabetes, breathing issues. There is also evidence that it can re-occur in previously affected patients, although whether they will be contagious again has not yet been resolved. To date the mortality rate has been low outside of Third World countries but is significantly worse than influenza with some studies showing that up to 20% suffer long term health impairment. The main problem with the disease is its rapid rate of spread and there have been some predictions that it will increase at a tenfold rate globally every 19 days if social distancing is not observed. As the contagion spreads and the health care system comes under increasing pressure, mortality may increase. Singapore has had no deaths as anyone who needs to, has access to an ICU bed, there have been high levels of testing and community tracing.

Its rapid spread across the globe has resulted in almost immediate shutdowns of large parts of the global economy. These characteristics mean that there is the potential for a prolonged and severe hit to economic activity globally, a recession. As a result it is impossible to rule out significant further falls in stock markets notwithstanding the sharp declines to date. Shorter term equity markets are oversold but valuations in absolute terms are not yet at bargain basement levels, especially with so much uncertainty as to what corporate earnings will be. Equity markets have been able to live with higher valuation levels due to a belief that corporate profitability will remain robust.

The economic disruption from the Coronavirus was compounded by the effects of a sudden and unexpected shock to the oil price on economic activity and most recently by the unprecedented spread of travel bans and restrictions. The oil price shock, in particular, will impact certain countries and sectors much more seriously than others and it is therefore important to gauge whether contagion effects from this negative oil price shock will impair credit quality to such an extent that wider sectors are impacted. OPEC could not agree on production cuts. Russia refused cuts, appearing to believe they can bankrupt US shale producers. As a result, Saudi Arabia has now decided to take on Russia in a price war (Perhaps encouraged by the ongoing Shia/Sunny conflict. Russia has supported Shia states while Saudi is Sunni and so this might be considered a further extension of the proxy war). Of course, the first impact is on oil shares but is also affecting US high yield corporate debt which has very high exposure to energy (exposure in our portfolios is low). While our funds are generally economically less cyclical, quality stocks/highly rated names have still been impacted in the selloff. The oil price drop is a further deflationary shock to global economy. Our exposure to oil producers and lenders to oil producers is negligible.

Short term volatility is also impacted by “risk parity” funds and algorithmic (computerised) trading with losses forcing other short-term market participants to sell. This explains much of the unprecedented levels of market volatility with intra-day swings of up to 12% in developed stock markets. ….. more

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