What happened in the market?

Market Commentary from our investment manager, State Street Global Advisors

SUMMARY:

- The spread of the COVID-19 virus is the biggest unknown - we are keeping an eye on the level of cases in Europe and hope for infection rates everywhere to slow.
- We expect poor short term economic data and greater volatility during the second quarter of 2020.
- A long-term perspective is perhaps the best view during the COVID-19 outbreak.

The reaction from investment markets regarding the spread of COVID-19 has been swift. To understanding the implications, it's important that investors ask the following questions:

1. How does this virus compare with past outbreaks and market events?

The difficulty with comparing COVID-19 to previous outbreaks is that it is highly contagious and more transmissible than past outbreaks such as SARS and MERS. We can also see the impact of COVID-19 on financial markets has been larger than the impact of the 1987, 1998 and 2008 financial crises.

During the Global Financial Crisis, we saw an extended period of drawdowns over a longer period in 2007/2008. The impact of the COVID-19 event on markets has been abrupt and unexpected and we have seen a large drop in a short time period. As with all market events, each is different to the next, however historical data has shown that markets will eventually recover, and it's a matter of when.

As a result of the recent COVID19, we have seen an unprecedented global policy response to manage the situation and implement financial stimulus to help those impacted. Locally in Australia the Government will pump $320 billion into the economy which will be the largest ever economic stimulus Australia has seen. Simultaneously we have seen the RBA cut cash rates to the lowest level on record.

2. How do you evaluate markets when they are moving at this speed?

The coronavirus situation is a medically driven event, but investors have become excessively fearful of the knock on effects. We anticipate that the economic impact may be greatest in the second quarter of 2020, but it could be a relatively short lived period due to containment measures and the significant policy response which is intended to stabilize the real economy, the financial system and reduce volatility.

One way to evaluate markets during these extreme fluctuations is to look at market risk sentiment. In time, investors will have more clarity and confidence to form earnings expectations and an outlook.

3. What could indicate that markets are starting to recover?

We're not out of the woods yet and we anticipate poor headlines and volatility from upcoming economic data releases, however the following 3 signals would be strong indicators to look out for:

(1) A peak in virus cases and a slowdown in the rate of spread

(2) Clarity on company earnings in the upcoming reporting season; and

(3) Greater stability in technical signals like the volatility index (VIX) which provides a forward indicator of market sentiment.

In addition to this, it's important to acknowledge that Central banks, such as the Federal Reserve, are actively using monetary policy to aid liquidity. The US government has agreed on a $3Trillion (AUD) stimulus package. We continue to monitor other financial conditions and oil prices but as with every market drawdown we know that it will eventually come to an end - it's just a matter of when.

A long-term perspective is perhaps the best view during the COVID-19 outbreak.

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