ODYSSEY VIEW: CORONAVIRUS, HORIZON DISCRETIONARY PORTFOLIOS & THE GLOBAL MARKETS

Timeline of Concern

US equity markets have had their worst week since 2008. The S&P500 has tumbled 13% since its peak on the 19th February, a mere 7 trading days ago. The sell-off was broad-based with no sectors spared.

The market impact of the CoronaVirus, or COVID-19, began as it spread outside of China. The US market started to fall when South Korea, a major cog in the global supply chain, and then Italy, reported cases and the infection rate gained momentum. Major US companies such as Apple and Microsoft with exposures to China then started to report that their revenues would be negatively affected even as the rate of infection in China began to slow.

Up to now, the US has been relatively free of the virus. However, the penny dropped last Wednesday night as an infected patient was detected in California where the source of the infection was not known. This is called a community spread. The impact of the news was compounded by a top CDC official stating that she expected to see community spread in the US, as well as the Governor of California informing that the state was monitoring 8,400 people who had arrived from Asia on commercial flights. California had 28 confirmed cases, half of whom were on board the Diamond Princess Cruise ship. On Friday, the WHO raised their risk assessment of the COVID-19 to “very high” as the number of infected countries spread to 49. In all, the US has 71 confirmed cases and has just announced the first death on Sunday.

Comparison to seasonal Flu and SARS

COVID-19 is a coronavirus form of influenza similar to SARS. Its origin is not currently known apart that it began to spread from a Wuhan seafood market. Whereas SARS had a mortality rate of 11% (probably underestimated due to China data) mortality rate for the Coronavirus is significantly less at approx. 2%. Compared to the seasonal Flu, this mortality rate is 4-5x for those that see a doctor for Flu treatment but less than the 7-8% for those that end up being hospitalised. 12,000-80,000 people have died in the US each year from influenza since 2010. 14,000 people already died in the US in the current influenza season. The season is already towards the latter stages – March is usually the last significant month for cases in the Northern hemisphere.

Deaths from COVID-19 have predominantly been in old people, those with respiratory vulnerabilities and medical workers. In Singapore, with 96 infections, none have died, 62 have been discharged from hospital.

Current State

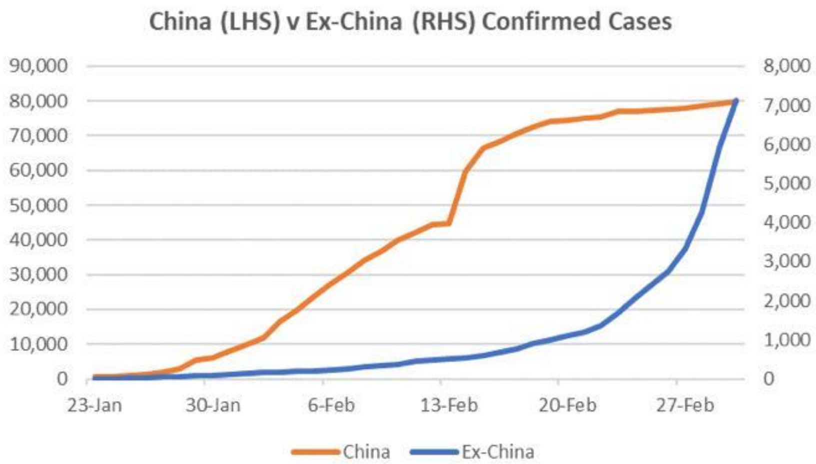
WHO has said the cases of COVID-19 have peaked in China. There are almost 80,000 confirmed cases.

However, international infections have jumped and cases have been almost double that of China in the last 8 days. Infections in Sth Korea have ballooned to over 3,500 and are growing faster than China.

The consensus estimated impact to China for Q1 is expected for GDP growth to fall to 4.5% from the 6% recorded in Q4 2019. This may be optimistic considering the just-released February China PMI of 35.7 is the worst on record, and follows a reading of 50.0 in January. The consensus expectation was 46.0. Only 30% of China's SMEs had resumed work last Wednesday.

Country	22-Feb-20		01-Mar-20		8D Change	
	Cases	Deaths	Cases	Deaths	Cases	Deaths
China	77,042	2,445	79,862	2,761	2,820	316
Sth Korea	602	5	3,526	17	2,924	12
Italy	76	2	1,128	29	1,052	27
Iran	28	5	593	43	565	38
Japan	132	1	241	5	109	4
US	35	0	71	1	36	1
Others	896	4	1,571	123	675	119
Total ex-China	1,769	17	7,130	218	5,361	201

Source: WHO, John Hopkins CSSE



Source: WHO, John Hopkins CSSE

Waiting for Major Economic Response

China

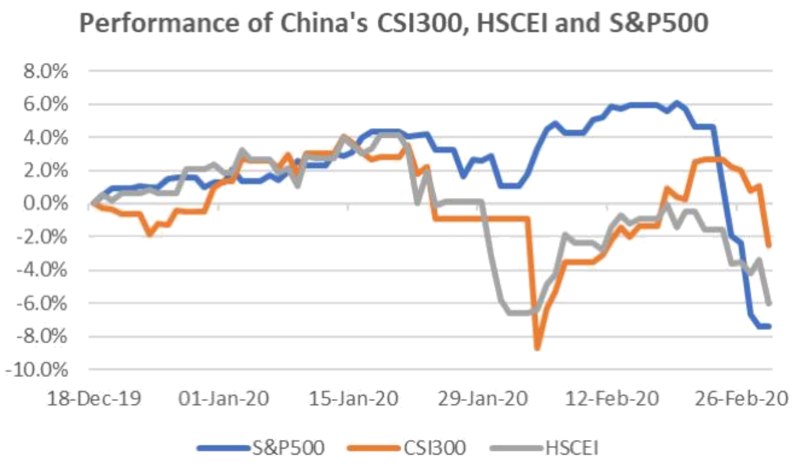
China has already cut the 1Y loan prime rate by 0.1% to 3.15% but significantly more stimulus is expected. Many expect the 0.1% cut is preparation of a reduction in the medium-term lending facility. China's Bank RRR is still at 12.5%, compared to 6% in 2000-2003, so there is plenty of room to boost lending liquidity.

Other Countries

Singapore has committed SGD6bn to support their economy and a Korean stimulus package is currently being prepared. Korea has already offered USD356mn in loans to assist struggling businesses. In US there is always the Powell Put. With the interest rate at 1.75% there is probably still some ammunition.

Other Equity Market Responses

The CSI300 troughed on 3 Feb after plummeting by 12% (January break due to Chinese NY) but then saw a V shaped recovery that erased the majority of losses until the US started to fall. The HSCEI was pummelled first by mainland and then US reactions. MSCI Europe has behaved like the US, peaking on 19th February before falling 13%.



Source: Bloomberg

Impact on Companies

A whole slew of companies that have China exposure have already announced their businesses are being negatively affected. These include Apple, Microsoft, Mastercard, Mondelez, Nike, Adidas, Proctor and Gamble, L'Oreal etc.

Our View

The WHO had expressed difficulty in accessing reliable information during the SARS crisis in China. It is possible that cases were dramatically underreported. Hence, we are seeing quite aggressive reaction in China and in other countries. The extent of travel restrictions in China and overseas have been a surprising but considering China outbound tourism has grown from 16mn in 2002 to 150mn in 2018, it should not have been. History indicates travel restrictions don't stop diseases from spreading. However, it may help to slow the infections until the Flu season naturally dissipates.

If the virus is similar to previous forms, its life is short lived. The 1918-1919 Spanish Flu was a very different situation in our opinion (different medical and hygiene era). Factories have closed but nothing is destroyed. People just need to go back to work. China is already starting to do that, albeit slowly. This has been confirmed by Apple. While the Virus is starting to spread internationally, first world countries are far from complacent and are treating the spread seriously.

The US equity market was at rich valuations in mid-February with current year estimated (est.) PE of 19.7x for the S&P500. This is similar to the Jan 2018 level that was the highest since 2002. The market was vulnerable to profit taking. EPS growth for Q4 2019 was essentially flat and grass shoots indicated by promising PMI numbers were still in their infancy. The est. PE valuation is now at 17.0x, essentially taking valuations back 6 months to August 2019, but still above the 10Y average of 16.0x.

Source: Bloomberg

We believe the market will stabilise and begin to recover once there is news that infection rates begin to decline. We remain optimistic that March/April will experience the worst in the international spread of the infection. Our sanguine view is based on the seasonal Flu cycle as well as an expected aggressive and proactive response to the infection. In past sell-offs, the market has tended to stabilise and recover once the participants believe the negative news flow is past its worst. There is also the added potential of a major stimulus by China and other countries, and it is likely the Powell Put is still in play.

Implications for Portfolios

For clients that are growth oriented and heavily Equity market centric we would not be sellers at this stage. Despite its gravity, there is currently no evidence that the spread of COVID-19 will last longer than previous iterations. Therefore, we expect the infection momentum to slow by April/May.

However, fear of the virus has obscured another risk to the market, that of the Democratic nomination which is currently led by Bernie Sanders. March 3, Super Tuesday, will provide clarity on who is likely to be nominated to run against President Trump. Many of Mr Sanders policies have been noted as a concern for equity market participants. In addition, the economic green shoots that the market was expecting in January may now not come to fruition in 1H 2020 due to the business disruption, regardless of any supportive measure governments may implement.

What does this mean strategically? We would advocate for a diversified portfolio for 2020. This is not the diversification gained from investing in additional sectors or regions, but refers to investments that have low or even negative sensitivity or correlation to equity markets. This could include structured products that have downside protection/buffers, private investments, short dated investment grade credit and various alternative products that price on the NAV of real assets. There are also alternative funds that actually perform better during periods of equity market volatility, yet do not lose money when equity markets move up. We will endeavour to broaden our specific recommendations in a number of asset classes to assist in diversifying your portfolio over the coming weeks.

For those that continue to favour equity markets but are perturbed by the volatility, our Horizon managed portfolios have a high equity component but are actively managed for risk. YTD, these portfolios have only lost 2-5% compared to the MSCI World Index that has lost 9%. Currently the portfolios have significant cash, i.e. Odyssey will be looking for opportune timing to add Equity risk.

Performance as at 28/2/20	YTD
MSCI World	-9.3%
S&P500	-8.6%
Horizon Growth	**-5.1%**
Horizon Balanced	**-5.1%**
Horizon Income	**-2.6%**

Click here if you are interested in our portfolio solutions

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