Navigating Coronavirus market volatility

Staying calm amongst the chaos

The last couple of weeks have felt like a rollercoaster ride for many investors. Financial markets around the world are reacting to the uncertainty around the impact of the Coronavirus ("COVID-19"). As at 5 March 2020, the World Health Organization reported that 89 countries have confirmed ("COVID-19") cases, with the Republic of Korea and Italy having the highest number of cases outside of China. The total confirmed COVID-19 cases in Australia stands at 58.

Investors have endured days of increasingly grim updates on the spread of the virus, as new infections continue to rise even as countries enact unprecedented measures to contain the outbreak.

Over the last trading week of February, the major US indices saw the worst losses since the GFC in 2008, with the Dow Jones Industrials falling 12.4%, the S&P 500 down 11.5% and the Nasdaq shedding 10.5%. When a stock index falls by more than 10% (but less than 20%) from their 52-week highs, it is often said to have entered "correction" territory. That's a fairly neutral term for what feels like a nerve-wracking drop to many investors.

Domestically, the Australian market fell 9.8% over the week, down 8.1% in February, the worst month since August 2015.

We want to arm you with information to navigate this period of market volatility.

Is this similar to SARS from an economic perspective?

From an economic perspective, comparisons to the SARS virus in 2003 seem somewhat misguided considering China's growing dominance in the global economy. China's economy is immensely larger today than it was in 2003, more than eight times the size. It is also substantially more integrated into the global economy and more extensively linked into global supply chains. Today, China represents 16% of global gross domestic product (GDP), up from 4% in 2003.

The following table highlights market movement following epidemics and fast-moving diseases. Historically, initial market corrections are often short-lived.

Unfortunately, the nature of each of these outbreaks differs. The current case is especially difficult when we are in the midst of one where the trajectory of the spread and the timing of availability of any treatment strategies still remain unknown.

What is the likely economic disruption globally?

The continued spread of the virus and the disruption to supply chains across the globe has begun to filter through markets, causing the heightened volatility that has been witnessed over the past week. While it's still relatively early to determine the extent of the impact, certain sectors and companies will face significant pressure on earnings the longer the virus remains uncontained.

Supply chains have already started to see the effects of factory shutdowns. Hubei province, the epicentre of the virus outbreak and an area under significant quarantine, is a key location for electronics and technology manufacturing. Additionally, commodity imports into China have been disrupted as factory shutdowns have halted the manufacturing sector's demand for external resources, such as petroleum and metals.

The extended closure of Chinese industries, restrictions on people movement, disrupted supply chains, declines in key commodity prices, bans on Chinese travel and the flow-on effect to confidence will impact the countries and regions most heavily reliant on China.

Ultimately the full impact will be determined by the rate of spread of the virus and the medical and scientific communities' ability to develop a treatment that can be distributed at scale.

From an Australian equities perspective, 2020 earnings estimates for the Resources (Energy, Iron Ore and Copper), Tourism/Travel and Consumer Discretionary sectors are likely to be impacted due to the virus especially when combined with recent bushfires across Australia.

On 3rd March 2020, the Reserve Bank of Australia (RBA) further cut its interest rate from 0.75% to a record low of 0.5% in an attempt to calm investors and diffuse the concern about the impact that COVID-19 will have on the economy. The RBA also gave guidance that it would ease rates further to provide additional support to employment and activity if need be.

What if it's the start of a bear market?

History shows that no bull market runs forever. While they can be worrying, bear markets are a part of long-term investing and can be expected to occur periodically throughout every investor's lifetime. However, it's important to keep them in perspective.

The following table shows 'bull' and 'bear' markets over the course of the past 40 years for the S&P/ASX All Ordinaries Index and the past 50 years for the MSCI World ex Australia Index in $AUD. The contraction/expansion percentages are the market returns for the respective indices between the specified date ranges. Historically, bear markets have tended to last for a significantly less amount of time than bull markets. A bear market is defined as a decline of 20% or more.

S&P/ASX All Ordinaries Index				MSCI World ex-Australia Index ($AUD)			
Start date	**End date**	**Contraction/Expansion %**	**Days**	**Start date**	**End date**	**Contraction/Expansion %**	**Days**
1/01/1980	30/12/1980	47%	364	1/01/1970	28/12/1972	31%	1092
30/12/1980	31/03/1982	-37%	456	28/12/1972	30/08/1974	-46%	610
31/03/1982	29/10/1987	387%	2038	30/08/1974	29/09/1987	1747%	4778
29/10/1987	29/02/1988	-44%	123	29/09/1987	31/08/1988	-22%	337
29/02/1988	24/02/1994	85%	2187	31/08/1988	30/08/1989	39%	364
24/02/1994	31/01/1995	-21%	341	30/08/1989	28/09/1990	-28%	394
31/01/1995	1/11/2007	274%	4657	28/09/1990	29/11/2000	471%	3715
1/11/2007	6/03/2009	-55%	491	29/11/2000	5/03/2009	-50%	3018
6/03/2009	29/02/2020	109%	4012	5/03/2009	29/02/2020	282%	4013
		Average Bear Market	**353**			**Average Bear Market**	**1090**
		Average Bull Market	**2652**			**Average Bull Market**	**2792**

Source: Morningstar direct

Please note: Declines of less than 20% will be captured in the expansion figure until the index falls by more than 20% i.e a fall of 18% won't be picked up in the negative contraction.

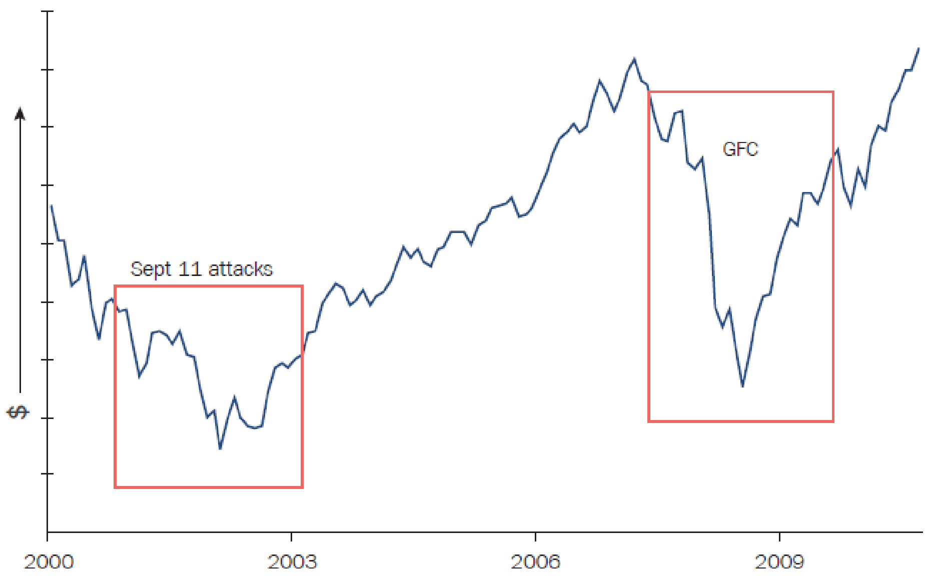
Key principles to focus on

Remember why you're invested

Short term volatility understandably causes anxiety for investors who get nervous and look to veer from the original strategy. It is key to reinforce the purpose of why you are investing in the first place. Most people are investing for the long-term so we can't let short term volatility destroy the intended investment strategy, by selling down risky assets at precisely the wrong time.

In the short term markets can be volatile, however, over the long term, history has shown that markets tend to move in cycles. While markets face periods of rapid decline, they eventually recover and move on to reach new highs. For example, the market down turns following the September 11 terrorist attacks in 2001 and the global financial crisis (GFC) of 2008 were both eventually followed by a strong market recovery, as Graph 1 below illustrates.

Graph 1: Portfolio value of 60% equities and 40% bonds



Source: Equities represented by Standard & Poors (S&P) 500 Index and Bonds Bloomberg Barclays Global aggregate Bond Index (USD).

Diversification

It's important to remember that during periods of increased volatility in financial markets remaining diversified can help manage your exposure to risk. Investments can be diversified across different asset classes, industries and countries as well as across investment managers with different approaches. When building a diversified portfolio, it is important to consider the 'role' each strategy will play in the portfolio. No one type of investment, asset class or investment manager provides the best performance over all time periods. The idea of diversification is to smooth your returns so they are more consistent and better for a given level of risk over the longer term. One of the most effective ways of reducing investment risk is to diversify across a range of asset classes.

Your asset allocation remains based on long term historical data and market assumptions. We utilise well resourced, leading investment specialists to advises how to spread your investments across a range of asset classes for the current market conditions.

As a result, we are not proposing changes to the long term asset allocation of your portfolios because of the recent market volatility.

Time in the market – not timing the market

Trying to time the market is fraught with danger and is near impossible. While markets can face periods of rapid decline, history has shown that they eventually recover and move on to reach new highs. Historically, large gains and losses tend to cluster, and as legendary investor Peter Lynch warns, "Far more money is lost by investors trying to anticipate corrections… than has been lost in corrections themselves".

It is important to remember, whilst the market has experienced negative performance over the past week with the S&P 500 down 11.5% slumping into official 'correction' territory, global equities rallied on Monday with the S&P500 closing 4.6% higher off the back of prospects central banks would inject stimulus into the economy and liquidity into financial markets. Selling down after these losses have already been incurred could possibly lead to missing some of the best gains in the future.

Reminder of the stellar returns investment markets have experienced

It is important to stay focused on what has been an exceptional time for investors since the GFC and particularly over the past 12-months to 31 January 2020. Even a correction of 15% would mean equity markets have still delivered very healthy returns over the past year.

Performance as at 31-Jan-2020	1yr %	3yr %	5yr %	10yr %
Australian Equities				
S&P/ASX 200 TR Index AUD	24.72	12.36	9.33	9.08
S&P/ASX Small Ordinaries TR Index AUD	18.84	12.12	11.18	5.28
Global Equities				
MSCI World ex Australia NR Index AUD	28.31	16.33	12.44	13.15
MSCI World ex Australia NR Index (AUD Hedged)	17.93	11.37	10.05	12.52
MSCI Emerging Markets NR Index AUD	13.07	12.50	7.69	6.76
Property & Infrastructure				
S&P/ASX 200 A-REIT TR Index AUD	19.57	13.22	10.65	12.57
FTSE EPRA/NAREIT Developed NR Index (AUD Hedged)	11.6	8.64	5.76	11.48
S&P Global Infrastructure TR Index (AUD Hedged)	20.98	12.27	8.46	11.64
Fixed Interest				
Bloomberg AusBond Composite Index AUD	9.06	5.73	4.32	5.85
Bloomberg Barclays Global Aggregate TR Index (AUD Hedged)	8.09	4.86	4.13	6.32

Source: Morningstar direct