KLEINWORT HAMBROS

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COVID-19: Be guided by data and principles

The economic outlook has changed completely since January. If you can't recall a reversal of similar magnitude, that's because there hasn't been one in living memory. Here, Fahad Kamal, Chief Market Strategist of Kleinwort Hambros, assesses the economic impact of the coronavirus so far and the implications for investors.

The figures from the first quarter are hard to believe: one million confirmed cases of the new Coronavirus worldwide, with 53,000 deaths by early April; severe recessions, with contractions of 10% to 20% now expected for the major global economies over the first two quarters; unemployment rates in advanced economies swinging within weeks from record lows to double-digit territory; the fastest bear market in history, as global equity markets plunged 20% to 30% from their mid-February peaks; a 60% collapse in the price of crude oil; and high-yield corporate bonds generating returns of -13%.

In January, the consensus view was that the coronavirus would be contained, as SARS and Ebola had been. Although the pandemic took us by surprise, we constantly discuss tail risks: events which have a low probability but a potentially high impact and can lead to sudden declines in the prices of riskier assets, such as equities. As a result, we retained significant exposure to government bonds, gold and low-volatility alternative investments in clients' multi-asset strategies.

Now what we all want to know is how long it will take for the coronavirus to be brought under control. Then, how long will it take economies to recover? And have equities and other risk assets reached the bottom of their declines?

The answers can only be known with hindsight. So we always rely on the discipline of our investment process to assess the balance of probabilities. Currently, our process is signalling caution for the following reasons:

- **Economic regime:** We are entering a global economic recession, and recessions are not good for riskier assets.
- **Valuations:** it's hard to assess global equity valuations, given rapidly moving share prices and uncertainty about earnings. But they don't look unambiguously cheap, and there is room for further falls.
- **Momentum:** The momentum signal is clear, with global equity markets across all regions trading well below their respective ten-month moving averages.
- **Sentiment:** Arguably, this might suggest increasing exposure to riskier assets. However, sentiment may continue to deteriorate, given the enormous uncertainty surrounding the outlook.

Our views are also guided by the following considerations:

- **Drawdowns:** By early April, global equities' maximum decline from their recent peak was 25%, around the average drawdown over history. However, the drawdowns were about 50% in 2000 and 2008 and over 80% in the Great Depression. So equity markets could have much further to fall.
- **Volatility:** Markets are very volatile at present. From 2015 to the end of 2019, the MSCI AC World Index moved by more than 3% in any direction on just two days; since 27th February 2020, it has done so 13 times.

We aim to get the big decisions right (the broad weight of riskier assets versus safer assets in portfolios); to take risk only when it is likely to be well rewarded (i.e., valuations for risk assets are attractive); and to avoid large losses. We have therefore reduced risk across our multi-asset strategies. Perhaps the worst is already over. But we think it wiser not to be over-exposed in case the worst is yet to come.

Contact us

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