

FOCUS

SPECIAL REPORT

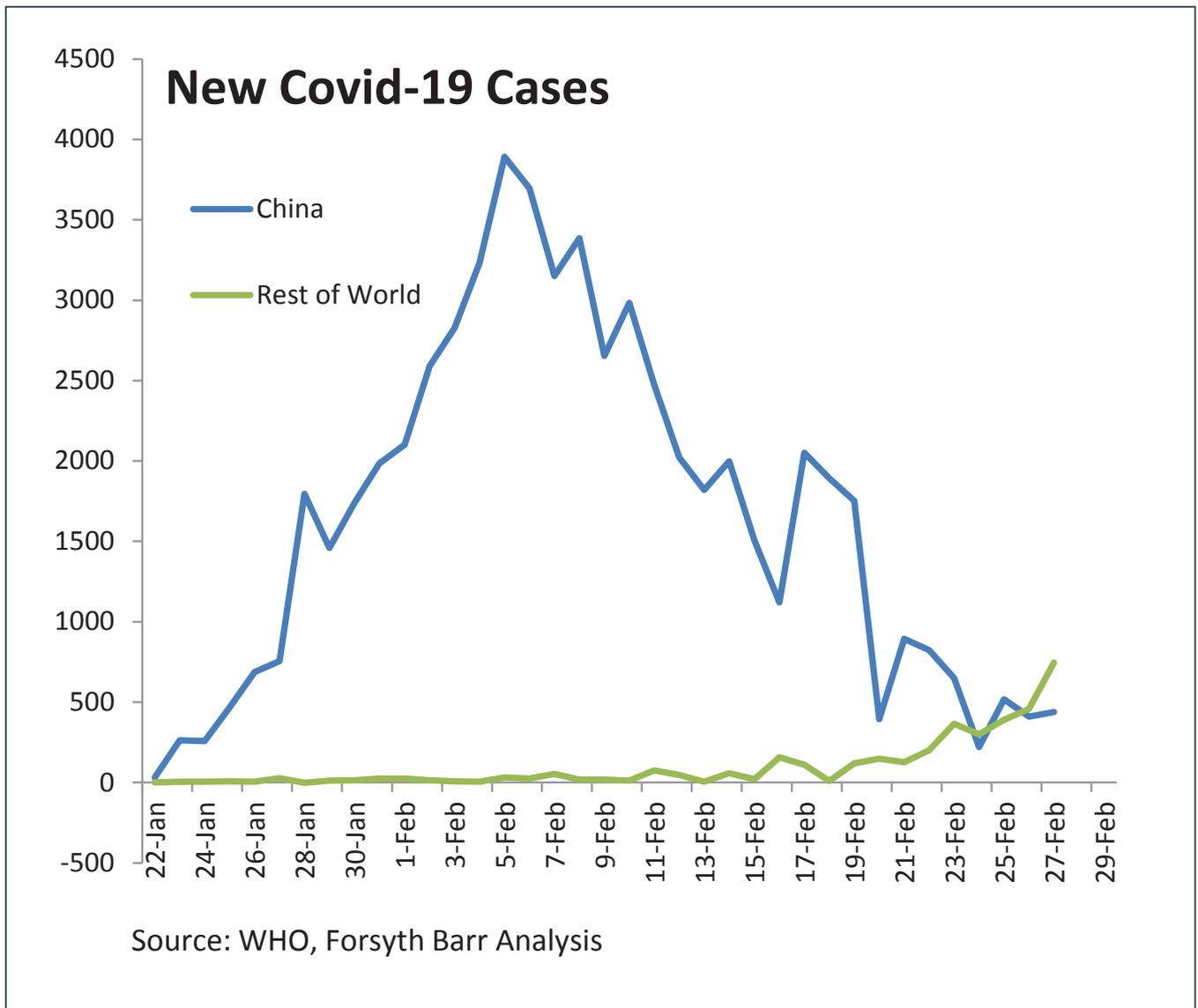
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Viral Markets

The novel coronavirus that began in Wuhan in December (Covid-19) has become a pressing issue for financial markets. What was viewed as primarily an issue for China has morphed into a global crisis. The tipping point (from an investor perspective) came last week when the number of cases outside China (principally in Italy, South Korea and Japan), began to accelerate (as illustrated in the chart below).

Encouragingly, the peak in new Chinese cases appears to have passed, providing some hope that the danger will ease relatively quickly. This is significant given China's size and role in global supply chains. That said, there is much still to learn about Covid-19, and we have seen limited evidence of medical professionals willing to make strong predictions about the likely progression of the virus. The counter to the optimistic scenario is the 1918 Spanish flu which killed an estimated 50 million people. There are many reasons why this scenario remains remote, not the least being advances in medicine over the past century.



So how does Covid-19 impact investors? Last week, after arguably blissfully ignoring the progression of the virus, sharemarkets around the world began falling. The catalyst was twofold: 1. the aforementioned progression of the virus outside of China; and 2. a steady stream of companies began to downgrade earnings, the highest profile being Apple, who on February 17 highlighted the supply chain impact of having most of China “down tools”.

Damage to share prices has begun to mount. The United States benchmark equity index, the S&P 500 has fallen 12.0% rapidly. The New Zealand sharemarket has been somewhat sheltered falling “only” 7.6% at the time of writing. Indeed some New Zealand stocks are actually potential beneficiaries from the virus.

The earnings impact of Covid-19 is beginning to be assessed. Our research partners at Citi now expect no earnings growth this year (previously +4%). Further reductions are possible.



How should we react? Turbulent markets always make us feel like we should “do” something. Sometimes (like the 2008 financial crisis), we should. However, often sitting back and monitoring the situation is the best option. We think that is the case now. Since 2008 there have been 19 sell-offs greater than 5%. The worst, in 2018, was 19%. Every sell-off is serious - from Greece teetering on the brink of complete collapse, to the United States Government sovereign downgrade in 2011. However since December 2008 the United States sharemarket has risen 230%, excluding dividends. In other words, reacting to a crisis by selling shares is often a poor decision.

There is much we do not know about Covid-19 or its potential impact. Things may get worse before they improve. Conversely there will be a growing response from governments and central banks to stabilise countries and markets. The significance of this should not be understated. Moreover, unlike 2008, the engine of the world economy, global consumers, has been behaving prudently, lending markets resilience. Either way, our judgement and experience suggest not reacting to this volatility. Well-constructed portfolios are built to ride through tough markets. The value of a company is not determined by next quarter's earnings, but the next 40 quarters or more.



Accordingly the best defence to uncertain events is to own sound, profitable businesses over the long-haul.

While volatile market conditions are unsettling, investors with clearly defined investment objectives are well-placed to manage investment uncertainty. Your Forsyth Barr Investment Adviser, supported by the resources of our research team, is available at any time to provide you with further assistance, if needed.



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