OUTLOOK FOR FINANCIAL MARKETS as at 4/3/2020 (updated Monday 17/3/2020)

As I write this, the media is saturated with stories of the Coronavirus (COVID-19) outbreak. Reports including complete lockdown in the city of Wuhan (Hubei province in China), Italy, France and Spain. Countries across the world have closed borders and are encouraging self-imposed social distancing in an effort to control the spread of the virus. Many travel plans, social gatherings, and sporting events have been postponed or cancelled, along with food and toilet paper shortages in Australia, just to name a few.

What I would say is the world has had to deal with these type of situations before – Influenza, Swine Flu, Asian Flu, Spanish Flu, Bird Flu, SARS, Ebola, AIDS, Cholera, Smallpox, Typhoid, Measles, Encephalitis, the Plague, Bubonic Plague etc. and in more recent times due to improvements in technology and resultant treatments has been able to overcome and control these viruses more quickly. They are already working and apparently making progress on finding treatments to eventually bring COVID-19 under control. I am no medical expert, but I feel optimistic that this situation won't take too long to control.

Researchers currently think that between 5 and 40 coronavirus cases in 1,000 will result in death, with a best guess of 9 in 1,000 or about 1%. But this depends on a range of factors: your age, sex, general health and the health system you are in. In fact, the death rate could be a lot lower because most cases of most viruses will go uncounted because people tend not to visit the doctor with mild symptoms. None the less, with the deaths and hospital admissions reported, many people have been understandably spooked and the authorities are doing their best to take steps to control the outbreak. What this has meant is that in China, possibly Iran, South Korea, Italy and now some other countries, some manufacturing has been temporarily shut down resulting in shortages of some items people use, but more importantly shortages in components some other manufacturers need to complete whatever products they manufacture. Supply chain disruptions affect all sorts of things and short term have the potential to impact economic growth and therefore company profits. That has been the catalyst for the sell off in sharemarkets since the 20th February – USA shares as measured by the S&P500 are down 29.5% since their most recent peak (19/2/20 to 16/3/20) and Australian shares as measured by the All Ordinaries Index are down by 26.5% (20/2/20 to 17/3/20).

Is it a good time to buy or sell?

I don't know, nobody does. Shares in the USA as measured by the S&P500 index fell significantly during the 21st to 28th February, followed by a 4.6% rise on Monday 2nd March, a 2.9% fall on Tuesday 3rd March, a 4.2% rise on Wednesday 4th March and a 5.0% fall across the 5th and 6th March. Then it gets even crazier – 12th March down 9.5%, 13th March up 9.3%, 14th to 15th the weekend, then on Monday 16th down 11.98% after which you would expect the Australian market to fall on Tuesday, but no, it was up 5.43%.

My observation is that share markets are being whip-sawed around by lots of artificial factors which account for the vast majority of market trades (*80% to 90% +)* at the moment:

- Program trading driven by algorithms;
- High frequency traders trying to take advantage of the volatility;
- Short sellers and hedge funds adding to the selling pressure and trying to make money off falling prices;
- Chartist who draw little pictures and use these to decide what to buy or sell;
- Index Funds (*including Exchange Traded Funds – ETFs*) are very large market participants and they get forced to buy or sell various shares based on what others are doing, thereby magnifying share price movements.

Fundamental analysis and attempts to determine the fair value of various shares have taken a back seat, but in due course prices will move back towards fair value. This may happen quite quickly, or we may have to be a little more patient (*might take 1 to 3 years*).

Central banks are providing stimulus (*i.e. the Reserve Bank of Australia cut its official cash rate by 0.25% to 0.5% on the 3/3/20 and the US Federal Reserve cut its official cash rate later that day by 0.5% to the1.0%-1.25% range)* and just yesterday reduced interest rates by a further 1.0% to zero. Governments including Australia, China, the US etc have also announced plans to spend more money to stimulate their economies. The Federal Government in Australia has announced $17 Billion in extra spending to support households and small business.

My prediction is that even though economic growth and company profits will almost certainly decline in the short term, they will eventually recover (*perhaps quite quickly*) leading to increases in things like share prices. I don't believe coronavirus will have much impact on medium to long term investment returns and as a consequence, investors should stick with their investment strategies (*be diversified*), be patient and ride out any short-term declines in the value of those investments and avoid realising any losses. This is the best strategy if you cannot accurately predict short term price movements (*it is extremely difficult to time the market*). I believe that the medium and long-term outlooks remain sound.

The only qualification I would make to this approach is for new investors (*with cash ready to invest*) to gradually build-up to their planned sharemarket exposure over a number of months (*or until things become clearer*) rather than investing all of this planned exposure on day 1.

Note, some investments still work in the current environment. In a diversified portfolio some of your investment's valuations will be largely unaffected in the short term by the current economic impact of COVID-19:

- Direct commercial property investments leased to quality tenants on long term leases;
- Private Equity investments which are not listed on a stock exchange. Listed investments can fluctuate well in excess of any changes to the underlying valuations;
- Direct infrastructure investments that are not listed;
- Some Hedge Funds;
- <u>Some</u> Fixed Interest Bond Funds might well make some short-term gains.