Weekly Market Summary

February 21st, 2020

What's Next for Global Markets? Are Investors Left With Strong Convictions?

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Latest Update on Coronavirus: Confirmed cases last at 76,731 (versus 64,452 last Friday), 2,247 deaths (versus 1,491). China continues to adjust the methodology as well as the number of new cases, leading to doubts about the data. Growing concerns over the pace of infections in other Asian countries, especially in South Korea where new cases almost tripled over the past few days, bringing the total number to 156. The head of the World Health Organization is stressing that countries should respond more strongly or risk a wider threat from the spreading of the virus outside of China!

Economic indicators define the economic performance of a country and are usually updated on a monthly basis. Their release stretches over the full month and provide the key basis for minor / major moves in financial markets (FX, Rates, Equity and Commodity instruments). Professional traders and investors - with different appetites for risk, varying time horizons and diverse motivations - usually actively prepare for and trade on the back of these releases (referred to as fundamental analysis), at times swiftly shifting views and reversing positions once the data flow confirms a sudden but permanent change to the general economic outlook. However, economic data (specifically the Unemployment Rate, Consumer Price Index, Unit labour Costs, GDP, Balance of Trade, Corporate Profits) can be considered lagging indicators – meaning that they become apparent and change in value only after a large shift has taken place ("after-the-fact"), therefore merely confirming long-term trends rather than predicting them.

Over the past year, large market gains and losses – be it in the equity or fixed-income markets – were built on hopes and/or discontents governing the ongoing US-China trade standoff (and to a lesser extent the Brexit saga), rather than being driven by weak / solid economic data releases. Such resulted in irrational and erratic market moves since no one really knew the specific policies and legislations that would be proposed, agreed and implemented over the near future, their exact go-live date and impact on future economic releases. And whilst the China trade deal and U.K. election result - in late 2019 - managed to take out a major tail risk overhanging markets and companies, lack of clarity over the future economic outlook currently remains firmly in place, driven by uncertainties over the coronavirus' impact on global supply chains and the health of the global economy. The virus is not the driving factor behind those worries, however. Instead, it is the way consumers, businesses and governments respond to an outbreak that matters most! For instance, people are more likely to stay home during an outbreak to avoid getting sick, preventing them from traveling, shopping and working. Doing so limits demand for consumer goods and energy; Meanwhile, decisions by companies and governments to close shops and idle factories curtail production.

What makes this all so strange is that a variety of facts are known about the economic consequences of coronavirus, but their impact outside China will be delayed and their magnitude remains uncertain (an uneasy position, like knowing an earthquake has struck near, though little visibility on whether a tsunami will follow) Add to that fading trust from experts - both inside and outside China - about the reliability of China's official statistics and you have the perfect recipe for economic blows / unpleasant surprises over the coming weeks and months. Some of the effects will be material: from fewer items on store shelves to price hikes and a slowdown in product development. The real impact will show in the upcoming data describing the reality of the past two months, much of which has yet to be reported. Governments and private businesses require statistics to better understand what is happening in the world, but a lot of the official data (for example releases from the US Bureau of Labour Statistics) usually take time to reflect on-the-ground commerce, irrespective whether the worst of the outbreak could be over by then.

For now, the data points that can be aligned to make sense of the macroeconomic picture are not good: Chinese oil demand was down 20% earlier this month, "*probably the largest demand shock the oil market has suffered since the global financial crisis of 2008 to 2009, and the most sudden since the September 11th attacks*," as Bloomberg put it. Factories are not running at full capacity either, given that pollution, a reliable and hard-to-fake indicator of economic activity, has plummeted according to Morgan Stanley.

Container ships are sailing with smaller than normal cargo loads and prices for bulk carriers that move iron ore or coal have collapsed, whilst car sales have plunged 92% during the first two weeks of February according to a report released by China Passenger Car Association earlier this week. Outside China, Apple Inc. surprised markets earlier this week by announcing that its quarterly sales would miss forecast due to the impacts from the coronavirus on production at its iPhone manufacturing partner site facilities; Disney said it could take a $175 million hit in operating income if its theme parks in China are shuttered for the next two months, and manufacturing giants General Motors, Toyota and Airbus have all warned of slow returns to production. The chief executive at British luxury brand Burberry has expressed his concerns that the virus is having a "*material negative effect on luxury demand*" and Qualcomm, the world's biggest maker of smartphone chips, warned that the outbreak was causing "significant" uncertainty around demand for smartphones as well as the supplies needed to produce them. “The floodgates are opening,” said Invesco chief market strategist Kristina Hooper. “*Companies are beginning to warn that the coronavirus outbreak will impact earnings and stocks have begun to react negatively*.” The coronavirus “*will have a bigger impact on the global tech supply chain than SARS and creates more uncertainty than the U.S.-China trade war*,” according to another prominent analyst. Compounding the risk is the fact that the world outside China has changed a lot since 2003; Globalization has encouraged companies to build supply chains that cut across national borders, making economies much more interconnected. Also important is the fact that major central banks have already used up much of the ammunition they would typically deploy to fight economic downturns since the 2008 financial crisis, whilst global debt levels have never been higher. Additionally, rising nationalism may make it harder to coordinate a worldwide response, if and when that becomes a requirement.

Nonetheless, not all the news flow is negative! Many economists say the current level of disruption is manageable; If the number of new coronavirus cases begins to slow, and China's factories reopen soon, the result will be a fleeting hit to the Chinese economy in the first quarter and just a dent in global growth. After all, China's government had moved quickly this time to counter the economic fallout from the coronavirus, announcing new tax breaks and subsidies designed to help consumers. At the same time, the People's Bank of China cut key interest rates and injected huge amounts of cash into markets in order to help take the pressure off banks and borrowers. Also, the International Monetary Fund (IMF) has reiterated that global economic growth appears to be bottoming out, though it cautioned that risks including the coronavirus dominate the outlook. “After a marked slowdown last year, global economic activity is expected to moderately strengthen in 2020,” the IMF stated in a surveillance note released on Wednesday. “Monetary and fiscal policy actions were instrumental in supporting activity, thus avoiding a deeper downturn.” And the CEO at Maersk, the world’s largest container shipping company, has predicted a “sharp” rebound in activity over the coming months, based on an expectation that the fallout of the virus on global trade may soon peak.

Still, over the past 48 hours, markets have applied an after-the-fact rationalisation to the price action, with a selective approach to hourly headlines. News that the pace of increase in the number of confirmed COVID-19 cases in China has dropped sharply, possibly due to another methodology change, was ignored. Instead, evidence of an acceleration in the infection rate outside of China did lead to a large drop in risk appetite, with stocks moving lower and Treasuries, the US Dollar and gold fast advancing. Yields on 10- and 30-year US treasuries have broken below 1.50% and 2.00%, last trading at 1.47% and 1.91% respectively (we started 2020 at 1.92% and 2.39% for 10s and 30s! “Liquidity-on”, Hurrah!), the greenback continues gaining versus some 30 major world currencies (financial markets can’t get enough of the Teflon US dollar) and gold is headed for its biggest weekly gain in more than six months as prices hit a seven-year high (last at $ 1,636 an ounce). Irrespective of the rationale, it is clear that risk appetite is struggling for direction, with one day's gain typically reversing the next.

It is often assumed that markets have absurdly overvalued prices of financial assets and then precipitated the price reversal once they had realized the glaring disconnection between the economic reality and the valuation of those financial assets in question.
Will this time be much different?

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