Market Update – 10 March 2020

Firstly, we hope you and your families are in good health and taking the necessary steps to remain that way as the coronavirus continues to spread around the world.

This article will hopefully assist in your understanding of the impact on financial markets both in the short term as we experience significant volatility as well as the possible long-term effects on your investments and the opportunities presenting themselves.

Financial Markets and Monetary / Fiscal Policy Activity

As you are aware, world financial markets are experiencing significant volatility. The graph below shows the ASX All Ordinaries Index rising over the past 12 months and reaching a peak on 20 February 2020. Since then, the Australian equity market has suffered significant falls of around 20%, including a drop of over 7% on Monday 9th March with a closing price of 5,822.

Source: Desktop Broker

The market recovered 3.0% the following day, but is still sitting below its level of 12 months ago. Meanwhile, the longer-term bond yields have continued to fall, pricing in further official interest rate cuts, with the average global sovereign bond yield falling below 1.0% for the first time ever.

The main driver of recent falls has been concerns over the impact of the coronavirus, especially in regard to the tourism industry including airlines, cruise operators and travel agents etc. However, the broader market is also impacted as investors struggle to realistically price the risk of a pandemic. Market volatility has exacerbated significantly.

There are however other factors at play. The large falls on Monday were driven by OPEC members failing to agree on oil production levels, resulting in a large fall in the oil price with flow on effects through the oil industry. Again, this only helps exacerbate market volatility.

There has been some respite in the falls both in early March and also this week due to announcements of official interest rates being lowered (e.g. US Treasury dropping official interest rates by 0.5% after a drop of 0.25% in Australia) and announcements regarding increased Government spending.

Short-Term Outlook

The containment strategy adopted of closing certain regions (e.g. firstly Hubei province and now the whole of Italy) may assist in containing the spread of the virus but consequently, this will result in economic slowdowns across the world.

It appears Australia and the global economy is heading for a recession (i.e. two quarters of negative growth). However, as people return to work and production ramps back up, a quick turnaround may occur.

Financial markets can be inefficient in such times and as such, various tools are likely to be employed to assist markets. Governments in the form of fiscal spending and Central Banks in the form of interest rate reductions/Quantitative Easing help stimulate demand and provide adequate liquidity in markets. These tools can be reversed once the threat is contained and/or reduced.

No one knows when the increased market volatility will end and investment markets bottom. New cases of the coronavirus in mainland China appear to have slowed suggesting that within a few months (e.g. the start of the northern hemisphere summer), the peak of the virus around developed nations may well have been reached.

Long-Term Outlook

Although the date for release is uncertain, significant coordinated efforts around the world are being made to develop a vaccine. When this becomes more certain and/or the number of infections start to subside, we can reasonably expect an end to the market uncertainty and volatility. Furthermore, as production picks up, economic growth will start to flourish. Hence, the long-term financial impact of the virus may not be that significant.

Opportunities and Conclusion

The situation remains very fluid and unpredictable, however we suggest that investors who are fully invested stick to their guns and ride out the volatility. Markets are down and, although we may not yet have seen the bottom of the market, now is not the best time to sell.

However, those with significant cash balances may take this as a buying opportunity whilst markets are down from February highs. Indeed, with bond yields at record lows, selling fixed interest investments and moving overweight to equities in the short term may assist in boosting longer term returns.