March 13, 2020

Extra Market Commentary
Global measures to counter virus impact

The WHO has declared the COVID-19 coronavirus outbreak a pandemic – an infectious disease that will spread across much of the world. Central banks and governments are thus expanding their efforts to prevent the spread of the virus and soften the economic impact, but market turmoil will probably last another while. There is a great risk of new market downturns, but much of the negative news is already priced in. For long-term investors, we still see good reasons to wait out the turmoil.

In recent days, uncertainty about the spread of the coronavirus and its impact has accelerated. On March 11, the World Health Organisation (WHO) declared the virus outbreak a pandemic. This has clearly contributed to more intensive market turmoil. As a result of the virus spreading, the United States has decided to ban most passenger air traffic from Europe, except for returning US citizens and residents. Denmark, France, Norway and Portugal are closing schools, and in Italy more businesses are shuttering. Sporting events worldwide are being postponed or cancelled. While fewer people are being infected each day in China, the number of new daily infections in the rest of the world is on the rise. One factor that is fuelling further market worries is the recent plunge in oil prices, after the failure of negotiations between Russia and Saudi Arabia on new production restrictions. Overall, this has contributed to further stock market losses and turbulence in the fixed income market.

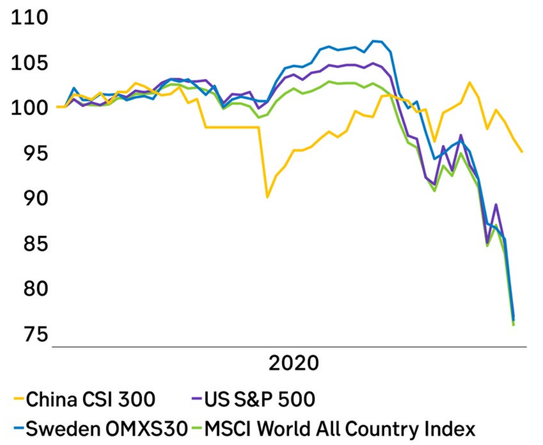
It is worth keeping in mind that during last year's rally, global stock markets as measured by the MSCI AC World Index rose about 24%, calculated in USD. From the start of the year until March 12, the global stock market index had lost about 24%, implying that we are back to similar levels as the start of last year.

Stimulus packages and movement restrictions
Meanwhile, robust measures are being implemented on a global basis to limit both the spread of the virus and its economic impact. China moved quickly to "lock down" areas where the risk of infection was considered high, and there are signs that the number of people being infected is declining. The country has started to re-open factories and other businesses. As a result, there are hopes that production in China can return to a somewhat normal level within about a month.

In other countries also affected by the virus, both governments and central banks have taken action. For example, a number of countries have cut their key interest rates but, even more importantly, they have pumped liquidity into the market, which among other things should make it easier for businesses to borrow. The European Union as well as individual countries such as Italy and the United Kingdom have launched crisis packages worth billions of US dollars to bolster health care, provide emergency loans to companies, offer additional paid sick leave days and introduce shorter work weeks. By cancelling various events, limiting large gatherings and letting people stay home, officials hope the spread of the virus can be slowed. At present, **the speed and scope of the virus spread are the main factors governing the markets.**

Continued on next page

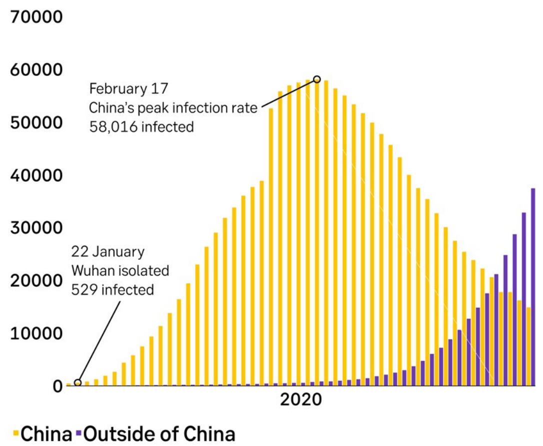
Stock market performance so far this year



Source: Bloomberg/Macrobond

It is clear that stock market reactions were limited as long as the virus outbreak was mostly in China.

Daily change in spread of coronavirus



Source: Bloomberg/Macrobond

The chart shows the number of people confirmed to be infected by the coronavirus minus those who have recovered and minus those who have died in China (yellow), and new confirmed cases in the rest of the world (purple).

The economy and stock market performance

What will happen now? Naturally, the situation is very unpleasant and there is great uncertainty – which is also reflected in the media. We are of course also affected, but it is still our job to try to look beyond the headlines and calmly assess the likely consequences for economies and markets.

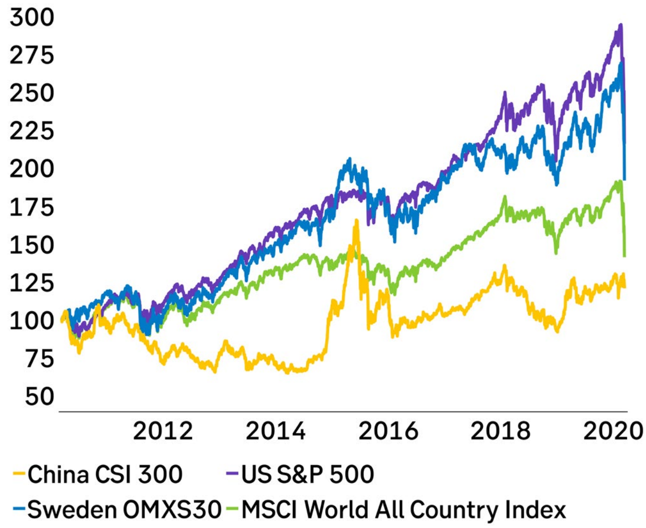
Our main scenario is a U-shaped economic trend – a rapid fall followed by a delayed economic recovery. The robust measures being taken, and experience from China, nonetheless provide hope that an overly unpleasant scenario can be avoided. On the other hand, we do not expect the economic impact to fade quickly. Time is a critical factor here, so it is both positive and vital that countries do what they can to limit the spread of the virus. If the rest of the world can follow the example of China, the economy and production will probably recover towards the end of the year. One or several quarters of economic slowdown could very well be followed by acceleration again, driven by the need to "recoup" lost production and consumption, fuelled by lower interest rates and stimulus measures. In such a scenario, the stock markets would probably be well above today's levels a few quarters from now.

It is important to remember that all the measures now being implemented to soften the economic impact of the virus epidemic – in the form of interest rate cuts and economic stimulus – will enable the affected economies to grow more vigorously once today's worries have faded. Prospects may then actually look brighter in terms of economic growth and corporate earnings than they did before the virus outbreak.

Conclusion

In the short term, there is an obvious risk of major stock market volatility. Today's turmoil in financial markets will probably persist until the rate of new infections slows. Governments and central banks will respond to the further spread of the virus with additional stimulus measures. If previous experience is a guide, and given the fact that stock markets have already tumbled, there is still many indications that long-term investors will be rewarded for waiting out the turmoil we are now seeing.

Stock market performance over the past 10 years



Source: Bloomberg/Macrobond

After their recent sharp declines, stock markets measured by the MSCI AC World Index in USD, have fallen somewhat more than what we saw in the autumn of 2018. Recession worries were behind both downturns. The risk must be considered greater today, but on the other hand interest rates and bond yields are also lower.

We have a risk exposure of around neutral in the portfolios we manage. Naturally, we are prepared to reduce the risk level if the market picture deteriorates further. But at present – because of the already large downturns – we consider it more likely that we are approaching a buying opportunity, even though today's market turmoil calls for short-term caution. If you feel uncomfortable with the market situation and uncertainty, it may be wise to review the risk in your portfolio. Because of short-term uncertainty, cautious investors may want to hold off on risky new investments for a while.

Roger Törnkvist
Economist
Investment Strategy
roger.tornkvist@seb.se

Pernilla Busch
Investment Communication Mgr
Investment Strategy
pernilla.busch@seb.se