We are not panicking yet – and we encourage our clients to do the same…

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GRAYCAPITAL

Markets have sold off aggressively over the last week, as previously complacent investors overreact and flee risky assets in favour of safe-haven assets such as government bonds and gold.

We would like to caution clients not to engage in knee-jerk reactions and disinvest or reduce equity exposure indiscriminately. Within the portfolios we manage, our asset class positioning has not been aggressive, and in many cases higher total fixed income exposures and higher offshore exposures relative to peers should cushion the effect of falling equity prices.

At the start of 2020, most portfolios' asset class exposures were positioned close to benchmark and the view was that we would have to see a positive trend in PMI Manufacturing (summarises whether market conditions, as viewed by purchasing managers, are expanding, staying the same, or contracting and is a broad measure of the expected direction of economic trends in the manufacturing sector), which would feed into a positive trend in expected equity earnings growth, which would only then entice us to hold a significant overweight equity exposure in portfolios.

The Coronavirus crisis is now global in nature, contributing to panic-driven selling in equity and oil markets. Until it is clear that the Coronavirus health crisis is peaking, and more clarity on the negative impact on economic growth and company earnings emerge, we expect equity prices to be volatile. It is encouraging to note that the number of active cases in China (those that have become infected less those that have recovered or resulted in death) is decreasing daily. Unfortunately, the number of cases in the rest of the world is still rising. For investors, some cautiousness is prudent in the short run, until it is clear that China is past the worst and investors regain confidence that the global epidemic will eventually burn itself out.

Our view is that the Coronavirus outbreak will result in painful market volatility but will not necessarily result in an economic recession and the start of a bear market. Monetary conditions are still very accommodative, global bond yields are very low and global fiscal stimulus in response to the pandemic is possible. Threats of war, terrorism and virus have typically provided buying opportunities in the past, and the Coronavirus may well turn out to be another example.