Health crisis not to be confused with economic recession!

The "COVID-19" coronavirus and the sudden slump of the stock markets - the capitalization of global equities has fallen by more than $7.8 trillion **- underline the vulnerability of the financial markets to external shocks.** This vulnerability is heightened by the fact that this epidemic comes at a delicate time for the global economy. After 2019's sharp contraction in growth, the new year had started with a wind of optimism with signs of an upturn in activity, the continuing accommodative monetary policy of central banks and the vanishing of uncertainties over a trade war, thanks to the US and China signing the "phase 1" agreement. But this optimism is now overshadowed by wariness.

Markets fear the spread of the Chinese coronavirus and the threat this poses to health and the global economy. The more it spreads, the more likely it is to change the behaviour of consumers and businesses, bringing an **economic shock** to the entire production chain and trade, as seen, for example, by the global manufacturing index, which recorded its sharpest contraction since 2009 in February. By falling to 47.2 points, i.e. below the 50 point marker which theoretically is seen as the limit between economic expansion and contraction, the index effectively puts an end to three months of improvement. Even if this slowdown needs to be put into perspective, with the level of activity clearly higher than that observed during the last two recessions, it must be admitted that it poses a definite threat to world growth, which many international institutions, the OECD and the IMF for instance, have revised downwards. For the time being, our economists are forecasting global growth of just over 2% this year (1.2% in the US and 0.5% in the Eurozone), compared with 3.2% in 2019.

Although no one is really able to foresee how the disease and its consequences will spread, study of the SARS epidemic (Severe Acute Respiratory Syndrome) and its effect on the Chinese economy does allow us to draw the following conclusion: **SARS did not leave any lasting trace, either on the economy or on the stock market.** The early part of the second quarter of 2003 was marked by a panic reaction as economists rushed to lower their forecasts and the markets were pounded by profit-taking (the MSCI World Equity Index shed 8%). By the end of the quarter, with the epidemic under control, forecasts for the third quarter and the second half of 2003 had rebounded and markets recovered (the MSCI World Equity Index closed the year with a 24% gain), thanks to a surge in demand and government stimulus measures. If this pattern is repeated, **risk assets should regain some bite as the number of people infected begins to stabilise.** This already seems to be the case in China, which explains why, after shedding 13.3% (in euros), the MSCI Index of the world's major stocks seems to be attempting to turn the tide (nearly 2% regained since last Monday).

It will probably take one or two quarters for the COVID-19 epidemic to be brought under control and for economic activity to return to normal. In the meantime, **there will be strong pressure on central banks and governments to maintain accommodative conditions and inject sufficient liquidity to offset the risk of recession**. Central bankers are already answering the call. After a low of $19.3 trillion was reached last September, total assets held by the Federal Reserve, the European Central Bank, the Bank of Japan and the Bank of China have increased by more than $630 billion.

As mentioned in our previous publications, we are therefore maintaining a neutral position on equities and bonds. This means that the current **period of instability is offering buying opportunities to any investors who are underweight compared to the neutral weighting of their investment profile,** in particular in equity markets where valuations have returned to more reasonable levels (on average, they have fallen by between 11% and 14% globally). In addition, they also offer an average dividend yield of around 2.6%, which is 2% higher than the average yield on the safest bonds. In order to avoid taking excessive risk, **quality equities**, i.e. those with stable sales and earnings growth and an above-average return on equity, remain the best equipped, in particular on emerging markets, to deal with the instability that surrounds us. In the same vein, safe havens such as **public and private bonds with a good credit rating and gold continue to be recommended**.