Coronavirus: Update

In recent weeks, the economic context, which was already not very bright, has been rapidly darkening. Of course, the primary reason for this is the expansion of the coronavirus epidemic. But this requires some explanation, as the economic shock increasingly outweighs the direct effect of the epidemic. Let's try to structure the triple threat to the global economy here:

1. ***The epidemic threat***: to curb the virus, China imposed drastic confinement measures. The countries most affected by the epidemic are doing the same, which will exacerbate companies' supply problems. This is a serious economic problem that may affect a growing number of companies, even outside the confined areas. At the same time, the people in the confined areas are reducing their consumption (miscellaneous services, leisure, Horeca, tourism). The rest of the population has probably also limited their spending. Hence, in addition to the supply shock related to provisioning, there is a demand shock on consumption. In the short run, the incapacity to produce or sell and the urge to consume less will have an impact on the added value created by companies (and therefore on GDP), but may also give rise to financial concerns (lack of liquidity).
2. ***The financial threat***: the uncertainty created by the epidemic and its economic consequences initially triggered a correction on the equity markets. This is normal, since earnings expectations have at best become more uncertain, but in a growing number of cases, must be revised. This is leading to fears that in turn, the brutal corrections seen on the financial markets will have an impact on the economy: we know, for example, that household consumption in the US responds to significant financial market corrections. But we also see an increase of risk premiums, tightening financing conditions. The threat is all the greater as corrections multiply and become ever sharper. This suggests that the stock markets have entered a phase of panic in which economic news and the epidemic are no longer very important: the market reacts more to its fears, and in a brutal manner.
3. ***The oil threat***: the oil price correction (of which a 30% drop in 24 hours) is indicative of panic, and came in reaction to the fear of a price war launched by Saudi Arabia. Following the economic slowdown, OPEC countries were expected to reduce their production to stabilise oil prices. But these countries were unable to come to an agreement. On the contrary, Saudi Arabia decided to cut its oil prices. The fall in prices could *a priori* be good news for consumers' purchasing power. But other factors should also be taken into account: on the one hand, this situation reflects geopolitical tensions between producer countries, which could further worsen the global economic environment. On the other hand, the dizzying fall of oil prices may have serious financial consequences for companies operating in this sector or financial counterparties. This could in turn further inflame the financial problem.

To date, we remain focused on the first of the three threats described above. But the exact economic magnitude will depend on the epidemic itself and its duration, as well as on the measures that will be taken to limit collateral damage. For the global economy as a whole, we expect a shock in the first half of the year. This would then translate, in the euro zone, into a 0.3% contraction of GDP in 2020. However, these figures could be quickly adapted according to the evolution of each of the threats mentioned above.

Panic often provides bad counsel!

Considering the fragility of the scenario, we understand that the financial markets have seen their volatility (i.e. their erratic behaviour) increase very sharply (+300%) in the space of only three weeks. Whether equities, bonds, commodities or currencies, **all the main asset classes have had to face a sudden aversion to risk they had not seen since the collapse of Lehman Brothers in 2008**! While, ordinarily, financial stress has a tendency to materialise above all on emerging markets, traditionally considered as less stable and more risky, the epicentre of the crisis is, this time, chiefly located on the markets of developed countries. An observation reflecting that investors have been seized by panic, indiscriminately and in an extremely pronounced manner.

Given the contraction in stock prices – worldwide, equities have lost almost 25% of their value (in euro) since their mid-February peak –, **the stock market has already priced in the fact that companies are unlikely to be able to escape an earnings recession**. This outlook calls for central banks and governments to take concerted action to support activity and inject sufficient liquidity to minimise the risk of default as far as possible and stabilise the financial system.

Unfortunately, it has to be acknowledged that, for the time being, **the lack of coordinated responses by public authorities to the health crisis and the resulting lack of visibility greatly complicate forecasts**. The protectionism displayed by certain States is clearly not up to the health and economic challenges!

Even if history teaches us that succumbing to emotions is often prejudicial in a long-term investment perspective, **caution is still called for**. This is why we maintain a neutral stance on equities and bonds in our investment strategy. But, as much as the experience of previous epidemics can serve as a guide, we can expect that when the COVID-19 epidemic reaches its peak and the quarantine on the economy is lifted, the markets will regain their momentum. In any event, this is what already seems to be happening in China, where equities have regained the bulk of their recent losses. In the meantime**, we recommend keeping quality stocks**, those with stable sales and earnings growth and above-average return on equity. This is particularly the case in emerging markets, which are best equipped to deal with the prevailing instability. In the same vein, **we continue to recommend safe havens, whether public or private bonds with good credit quality or gold**.