The negative effects of the crisis are increasing

As the coronavirus epidemic progresses, economic growth and stock markets are contracting. In order to reduce the speed at which the virus spreads, several European countries have taken containment measures that are slowing business activity even further. Let us analyse the impact on the economy and financial markets below:

- With the implementation of total or partial containment measures in several European countries, economic activity is seriously hampered. The Chinese experience clearly shows that this has profound consequences for economic growth. In the first two months of this year, when the Covid-19 virus hit China and parts of the country were quarantined, Chinese retail sales fell by 20% compared to the same period last year, while industrial production fell by 13.5%. It is feared that also in Europe , and with some delay in the United States, the negative effect on growth will be so great that a recession becomes inevitable. We are now forecasting negative growth of 1-1.5% in the Eurozone in 2020, while US GDP is expected to shrink by about 0.5%.
- The negative economic shock caused by the epidemic is could potentially trigger a financial crisis, thereby aggravating the economic crisis. Fortunately, the banking system is now much stronger than in 2008. But many companies that are currently at a standstill and therefore have little income could be put at risk. To avoid this, governments are taking far-reaching measures such as guaranteeing loans, so that businesses can stay afloat in this economic storm. Central banks are also doing everything they can, like cutting interest rates, injecting liquidity and buying government bonds on a large scale, to avoid a credit crunch. As a result of these actions, we believe that during the second quarter the situation should stabilize, allowing for a slow economic recovery.

Financial markets may not yet out of the woods

- Patience is the mother of virtues. This also applies to the stock market, where investors may be tempted to become buyers again. A comprehensive study of performance following 20% drawdowns in the past century shows positive 12-month returns three quarters of the time for U.S. stocks. The mean performance was a 9.2% gain.
- But even though the stock markets have fallen by 30%, they are probably not out of the woods yet. In the past 50 years there have been three crises in which the S&P 500 has dropped about 50%: the 2008 global financial crisis, the bursting of the 2000 dot-com bubble and the 1973 oil shock.

- The worst for markets may be behind us, at least in terms of extreme dislocations, but the conditions for a sustainable rebound are not yet in place. The knife is still falling. The overall sell-off in the last few weeks has come with such speed that it marks the fastest ever fall into a bear market from all-time highs and the VIX gauge of equity volatility surged to its highest since 2008!
- This profound instability, which is also perceptible in all other markets (bonds, commodities and currencies), reflects investors' growing concern that the measures central banks and governments have taken, or have pledged to take, to counter the economic impact of the Chinese coronavirus (Covid-19) and the oil crisis are not sufficient to offset the economic damage caused by the confinement of the population and the decline in activity in many sectors.
- Of course, no amount of rate cuts or liquidity injections by central banks will stop the spread of the virus. But making sure the financial system is working properly takes a big worry off the table, especially for long-term investors, who can take advantage of the large discount on quality assets through measured, gradual purchases.
- However, it is important to be aware that in order for risky assets to bounce back in a sustainable manner, two conditions still need to be met: governments need to adopt massive fiscal and budgetary stimulus measures in a coordinated manner, and industrialized countries need to get past the peak of the pandemic.
- In the meantime, we continue to favour, either directly or through a fund, stocks and bonds of the least indebted companies.