INVESTMENT UPDATE: SHADES OF 2008

13th March 2020

Reminiscent of the depths of the financial crisis, the past week has seen troubling headlines emerge at such a rate it has, at times, been difficult to keep pace. Equity markets seem to have lurched lower day-by-day, with Thursday's falls in the US and Europe the worst one-day decline since 'Black Monday', October 19th 1987. Faced with such turmoil, a recap of the week's major developments may be worth our while.

With markets already reeling from the continued spread of coronavirus, Monday's tone was dictated by the failure of OPEC to agree measures to support the oil price. Instead, Saudi Arabia promised to flood the market with supply, sending oil prices down some 25%. UK equity indices, of which BP and Royal Dutch Shell are large components, were particularly hard hit. However, the main concern was arguably to be found in the US bond market where there is significant exposure to small companies extracting oil and gas from shale and tar sands. The sharp fall in the price of oil may force some of these companies into bankruptcy.

Tuesday initially offered some respite, with hints that governments – noticeably Germany and the US – might ramp up spending to support their economies. Though questions emerged over the Trump administration's ability to deliver a timely and credible stimulus, US equities ended the day strongly, up nearly 5% by the closing bell.

On Wednesday morning the Bank of England convened an emergency meeting of the Monetary Policy Committee and cut interest rates by 0.5%. Perhaps more importantly, it also unveiled a slew of measures designed to support small and medium sized companies through the economic fall-out from coronavirus. This was followed by Chancellor Rishi Sunak's announcement of the most fiscally expansive budget since 1992. Any positive sentiment was quickly dashed, however, as the World Health Organisation declared coronavirus a pandemic, and as troubling signals began to emerge from the US Treasury market.

Debt issued by the US government is often called the world's risk-free asset. Backed by the US government's ability to print the global reserve currency, the likelihood of default is effectively zero. The market in US government debt is the largest and most liquid in the world. In times of heightened risk aversion, the price of US Treasuries typically rises. On Wednesday, however, it fell. Volatility rose, liquidity declined and traders experienced difficulties buying and selling US government debt, sending shockwaves through the financial system. It is this, more than anything else, that has echoes of the financial crisis.

Against this backdrop, and with President Trump having issued a ban on travellers arriving to the US from Europe, equity markets suffered extraordinary falls on Thursday. Despite unveiling important measures to support small businesses, the policy response from the European Central Bank was deemed inadequate, exacerbating the decline. By the end of the day, many markets had experienced losses surpassing even those suffered at the height of the financial crisis.

As we write this on Friday morning, equity markets across Europe are up between 5% and 8%. Though it may appear wilfully obtuse in the midst of a global pandemic, there are reasonable financial grounds to support these moves.

Firstly, the US Federal Reserve has pledged $5tr – nearly twice the annual economic output of the United Kingdom – to support the functioning of the US Treasury market. Lessons have clearly been learned from the financial crisis: though the monetary authorities can do little to affect the spread of the virus, they can ensure essential market mechanisms are not infected.

Secondly, central banks continue to do what they can to support businesses through the fall-out from the pandemic. This morning, central banks in China, Japan, Australia, Norway and Sweden have all acted to ease business conditions and provide credit for the small and medium sized companies that are likely to be hardest hit by efforts to contain the virus.

Thirdly, the sell-off in equity markets has been one of the sharpest on record. This raises the questions of whether valuations are now sufficiently attractive to compensate investors for holding equities through what is likely to remain a volatile period.

Finally, there is a recognition that the economic threat posed by coronavirus is likely to be temporary, while the impact of the global policy response will be much more long-lasting. Even if it takes several months for new infection rates to peak globally, there remains the potential for a sharp rebound in the second half of the year. The reduction in interest rates and increased spending that central banks and governments are now deploying should be expected to significantly enhance the recovery.

To end, we should acknowledge that as investors, we must focus on the economic and financial implications of the virus and the measures taken to contain it. However, this does not make us blind to the very human nature of current events. For reasons beyond investment, we hope the threat posed by the pandemic recedes quickly.

Colin Gellatly

Deputy Chief Investment Officer, Omnis Investments

Issued by Omnis Investments Limited. This update reflects Omnis' view at the time of writing and is subject to change. The document is for informational purposes only and is not investment advice. We recommend you discuss any investment decisions with your Openwork financial adviser. Omnis is unable to provide investment advice. Every effort is made to ensure the accuracy of the information but no assurance or warranties are given.