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Clarien Update

The new threat impacting financial markets is the spread of the COVID-19. Global equity markets have suffered a sharp and broad-based selloff in the last week, after appreciating strongly over the past year.

The crisis has clearly shown the effectiveness of Clarien's approach of holding a mix of equities, bonds, and alternatives in a portfolio, with strong performance from bonds helping cushion declines in equities. Equally, global diversification has helped smooth performance as the virus spreads around the world, and remains prudent given the uncertainty about which regions will ultimately be worst affected.

The critical question is whether the current market decline will prove to be sharp but temporary, or is it the start of something more sustained and precarious. The situation remains fluid and we are closely monitoring our list of indicators for signs of strains as growth conditions are negatively impacted. However, for now we are cautious and it is simply too early to know how the virus will develop with any certainty. The Federal reserve has now decreased interest rates by half a percentage point to help the U.S. economy keep strong in the face of these new risks to the economic outlook.

It is difficult to have conviction about the scope of the spread of coronavirus, its duration, and the economic disruption. But it is important to bear in mind the following:

- US economic fundamentals are on a solid footing. Interest rates and inflation are low, labour markets are healthy, consumer balance sheets are solid, and banks continue to be willing to lend. In other words, we are not seeing the typical conditions that would spark a recession.
- This suggests that any economic disruption from the coronavirus could be short-lived, especially because global health officials are now much more vigilant than they were when the virus first started spreading in China several weeks ago.
- Looking at historical sharp market sell-offs and spikes in market volatility during periods with generally healthy economic fundamentals suggest that the risk / reward for US stocks is becoming more attractive.

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In short, the economic ramifications from the virus are for the most part related to public health counter measures, rather than to fatalities or sickness. The principal distinguishing characteristic of COVID-19 is that carriers are contagious long before symptoms are present, which implies that quarantine countermeasures must be applied early and with draconian efficiency. The latter implies a hit to economic activity and corporate earnings.

In this regard, February has turned out to be a negative month for consumption activity and the service sector in China and quarantining is having a significant impact on manufacturing supply chains and the travel industry.

A number of companies have issued profit warnings while others have been relatively upbeat and view the impact as temporary. However, the majority of companies that have warned about an impact say they haven't been able to quantify it.

That said, the number of "active cases" in China (i.e. those that became infected minus those that have recovered or resulted in death) are now receding, which means that the adverse economic impact should fade as the year progresses, particularly with a potential for a modest boost from pent-up demand. **In contrast, the number of cases in the rest of the world is still rising, which will cause a series of isolated adverse macroeconomic shocks.**

It is premature to position bearishly and sell everything, with underlying global growth conditions still firm and policy settings very accommodative. Policymakers have moved aggressively in recent months and this past weekend to extend the economic expansion.

Market timing is very difficult in these situations. For example, six of the S&P's 10 best-performing days during the last 20-year period occurred within two weeks of the 10 worst days. Missing the 10 best-performing days significantly reduces long-term returns an investor can expect.

Monetary policy is very accommodative, bond yields are historically low, and a shot of global fiscal stimulus is possible in response to the pandemic. Any near term evidence that COVID-19 is becoming contained would likely cause another shift back into equities. There could be further downside first, especially if the number of cases in major countries such as the US, Germany, and the UK were to accelerate significantly.

We would not recommend long-term investors sell out of risk assets at this point. However, if events over the coming weeks point to the risk of a global pandemic being higher than we currently think, then we will adjust and move toward taking risk off if warranted.