Strategic Wealth Market Update

25th February 2020

COVID-19 Outbreak
Strategic Wealth Investment Committee

The corona virus (COVID-19) has been a major news item in the media. Until the past few days, the investment markets, while monitoring the situation, were relatively comfortable with the way the issue was being managed in China. That changed late last week when news of the more significant spread of the virus beyond China became known. That event created uncertainty and uncertainty is one thing that unsettles markets.

Hence, the recent sell-off of shares over the past few days as investors digest the implications of the short and medium-term impacts on economic growth for China, Australia and other key economies.

To help you understand the potential implications of the spread of the corona virus beyond China, we have attached a report released today by the Strategic Wealth Investment Committee. We will continue to monitor the situation and keep you apprised of major developments.

Kind regards,

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1. Introduction

The Strategic Wealth Investment Committee (SWIC) comprises representatives from Strategic Wealth, JANA Investment Consultants, Philo Capital Advisers and an independent investment consultant. The investment committee's role is to oversee the management of the Strategic Wealth Managed Portfolio Solution and it formally meets on a quarterly basis to assess market conditions and the implications for investment portfolios. A meeting of SWIC was held on February 24, 2020 and the COVID-19 (coronavirus) was key issue discussed. This Note provides a brief update on the current outbreak, market movements over recent days and SWIC's views. SWIC acknowledges the human tragedy that is the COVID-19 outbreak, which has taken more than 2,600 lives and caused serious illness to thousands of others.

2. Update on COVID-19 Outbreak

Since the Chinese authorities announced publicly the existence of the COVID-19 on 31 December, the disease has continued to spread, predominantly within China, and mainly within the epicentre of the outbreak, the city of Wuhan and the province of Hubei in which the city is located. However, over the past few days, the number of cases outside of China has increased significantly, sparking concerns that the outbreak may become more widespread and even evolve into a global pandemic.

As at the date of this Note, according to Johns Hopkins University, the current situation with respect to the virus is as follows:

- More than 79k total confirmed cases, of which all but 2k are in Mainland China;
- Total deaths of 2,628; and
- Total recoveries of more than 25k.

Analysis by JPMorgan reviewed by SWIC is useful in understanding the trend of the spread of the disease:

- The outbreak remains overwhelmingly concentrated in Hubei province, with more than 80% of the confirmed cases in Mainland China in that province;
- While the total number of cases continues to increase each day, the rate of increase is declining across Mainland China;
- As the number of deaths continues to rise while the rate of new infections declines, the mortality rate is rising, and is now above 3% in China;
- Based on current trends, JPMorgan forecasts the number of confirmed cases in China to peak at around 114k in the first week of March; and
- The most significant development over the past few days has been the spread of the virus in other countries, with a sharp increase in the number of infections amongst people without recent travel history to China.

According to Johns Hopkins University data, the number of cases outside of Mainland China now exceeds 2,000. In particular, outbreaks of the virus have occurred in South Korea (833), Italy (230), Japan (159) and Singapore (89).

While concerned with the spread of the virus outside of China, the World Health Organisation (WHO) has not yet declared COVID-19 to be a global pandemic, but acknowledges that it is possible that the outbreak could become so.

3. Investment Market Response

Until last Friday, equity markets had essentially assumed that the economic impact of the virus would be largely contained to China and that it would be transient, predominantly impacting growth in the March quarter. Investors had focused on the strong earnings results delivered by a number of companies in the current reporting season and some strong economic data in the US over recent weeks. It is also quite likely that the expectation that a reduction in economic growth, even if short-lived, will result in continued or even further monetary stimulus which also provided a positive backdrop to markets.

However, over the past two trading days, investment markets have responded to the spread of COVID-19 outside of China and concerns that the impacts may become material to the global economy. The table on the next page summarises market movements on 24 February and for context, since the virus outbreak was announced on 31 December.

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Market	Movement – 24 February	Movement - Since 31 December
Australian Equities – S&P/ASX300	-2.3%	+4.3%
US Equities – S&P500	-3.4%	-0.2%
UK Equities – FTSE 100	-3.3%	-5.1%
Japan Equities – Nikkei	Closed	-1.1%
China Equities – Shanghai	-0.3%	-0.6%
Hong Kong Equities – Hang Seng	-1.8%	-4.9%
AUD/USD	-0.4%	-5.9%
Oil – West Texas Intermediate Crude	-4.1%	-15.8%
US Bonds – 10 year bond yield	-0.11% to 1.37%	-0.51% from 1.88%
Australian Bonds – 10 year bond yield	-0.02% to 0.92%	-0.45% from 1.37%

4. SWIC's View

There is no doubt that the economic impacts of the virus will be significant, especially for China, and if the outbreak becomes a pandemic, then globally. The unknown is whether this is for a few months or longer. Some analysis reviewed by SWIC estimate that even in a 'best case' scenario for China (i.e. the outbreak is brought under control soon), China's March quarter GDP will be around zero, compared to c.1.5% of recent quarters. If this is for a short period, the medium term effects will be small but obviously could be more meaningful if the outbreak does not peak soon and the current situation persists or worsens.

If the outbreak worsens and/or becomes a global pandemic, the assets that are most likely to be disproportionately impacted in the short term outside of China would be those of countries whose economies are closely interlinked with China. This would include the AUD and Australian equities, with Australian bonds likely to benefit. As shown in the table earlier, since the beginning of 2020, we have already seen the AUD and the Australian 10-year bond yield fall since the outbreak began, while the local equity market has fallen back in recent days after very strong performance at the beginning of 2020.

SWIC's views on strategy in light of the COVID-19 outbreak and recent market volatility can be summarised as follows:

- Since the GFC, we have enjoyed a strong rally in equity markets and all other 'risk' assets, including credit, property and infrastructure. This rally has been punctuated by periods of extreme volatility. This could be another of those periods, or it could be the beginning of a major correction, particularly if there was to be a significant deterioration in the global economic outlook arising from the COVID-19 outbreak
- The Australia as an economy is relatively exposed to a more significant and longer-term slowdown in the Chinese economy. In addition, a number of the key sectors of the market appear likely to be constrained in their future earnings growth potential. As a consequence, it is appropriate to review exposure levels to Australian equities. Our managed portfolios solutions are holding a slightly underweight position to the Australian equity market until the growth outlook becomes clearer.
- The initial sell off in the Australian Dollar would be expected to continue if the COVID-19 emergency proved more dramatic and longer lasting in its economic impacts. The unhedged international share component of portfolios are expected to help in this situation.
- Cash and liquid assets are beneficial at times like these and a drawdown on these reserves avoids the need to sell growth assets whose valuations have been impacted by the market uncertainly.
- While it is time to be cautious, we should not lose sight of our long-term approach to investing. Market falls are inevitable and hard to time. Exposure to growth assets such as equities is essential for long term investment portfolios. Individual portfolio managers will be making decisions on which specific equities will perform best through this event.

We shall continue to monitor developments with respect to COVID-19 and markets closely and provide additional updates if the market correction continues or our views change.

General Advice Warning