THOMAS MILLER INVESTMENT

Investment Commentary

Implications of COVID-2019 for client portfolios **February 2020**

Introduction

■ Having appeared resilient in the face of emerging concerns about the Covid-2019 outbreak in January 2020, equity markets have fallen sharply over the past week (and continue to fall at the time of writing). The sharp declines appear to have been triggered by news that the virus was beginning to spread rapidly outside China, particularly in South Korea and Italy.

■ Apart from the human costs, from a financial market standpoint, the concern is that the outbreak will constrain economic activity and dampen corporate earnings. Indeed, many companies have revised revenue and profit forecasts lower in recent days.

Economic impact & policy response

■ At the start of 2020, global growth was expected to be around the same as in 2019 with the emerging market economies expected to fare better than their developed market counterparts. Among the major EM countries, China was expected to slow from a growth rate of 6.1% to 5.9%. It now seems clear that the emergence of Covid-2019 will push the growth rate for China notably lower. As an example, SARS was estimated to have reduced China's GDP by 2–3 percentage points in Q2 2003 and by about 1 percentage point over the full year 2003. Clearly China is a much bigger component of the global economy now than it was in 2003.

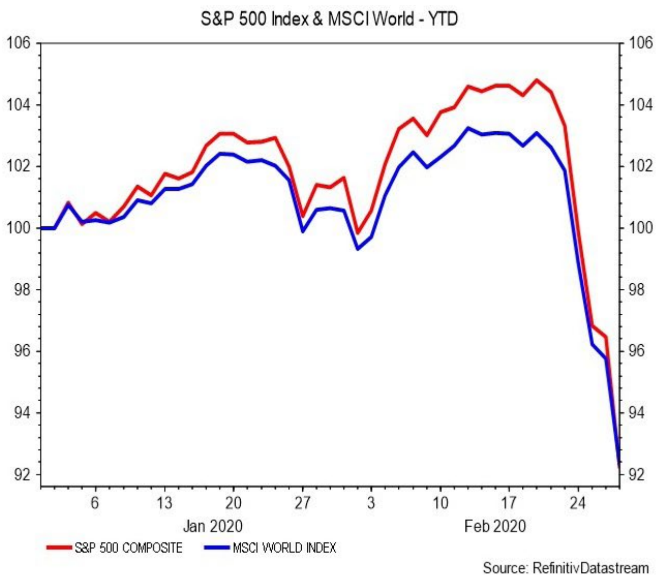
■ Forecasts for the major developed economies indicated that a slowdown in the pace of growth was expected in 2020. Overall, the projections pointed to a year of trend or slightly below trend growth rates for the major developed economies. Outside China, the impact clearly depends on the severity of the outbreak. Overall, the concern is that a protracted outbreak could disrupt economic activity sufficiently to turn weak growth into outright recession in several developed market economies (with Italy and the broader Euro-zone being particularly vulnerable).

■ In response major central banks are expected to loosen monetary policy further in an attempt to stimulate growth. Indeed, China has announced a broad range of stimulus measures in recent weeks. Likewise, market prices now also imply further rate cuts by the ECB and Fed.

Financial market impact

■ The charts below illustrate the performance of equity markets since the turn of the year (and longer-term for a greater perspective). As at 27th February, the US S&P 500 index was down

Chart: Global equity market performance (2020 YTD and last 5 years)



Source: RefinitivDatastream

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about 4.5% for the year while the UK's FTSE 100 index was down about 10.0%. Euro Stoxx was down about 7.8% over the same period (all in local currency terms). Some sectors have been worse-hit than others, with those immediately affected by the fallout – airlines, travel, energy – suffering some of the largest falls.

■ The sell-off in equities has resulted in a flight to safety and safe-havens such as developed market government bonds have rallied sharply. For instance, yields on 10-year US Treasuries have declined by over 70 basis points so far this year. The decline (rally) in bond yields (prices) has helped to mitigate the impact of falling equity prices on client portfolios. On the whole, alternatives have held up well, with the USD Share class of the TMI Diversified Assets Fund up about 1% for the year so far (as at 27th February).

Looking ahead

■ At this point, there is no way of knowing exactly how far the decline in the prices of risk assets will go as it all depends on news about the spread of Covid-2019. Importantly, TMI's investment process is designed to ensure that client portfolios are resilient to events such as this – we have worked with each client to determine the appropriate strategic asset allocation in line with the profile of their expected future liabilities, risk tolerance, capital and regulatory constraints and, where required, corporate credit rating requirements.

■ At this point the best response is to focus on long term investment objectives and implement asset allocation strategies that align with those objectives. For institutional investors, this means maintaining allocations to the main asset classes in line with the positions set out in rigorously designed investment mandates. We are keeping a close eye on incoming data and reassessing the implications for client portfolios on a daily basis. We expect that the ongoing sell-off will ultimately provide attractive opportunities to tactically increase allocation to risk assets and boost risk-adjusted returns.

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