Irish Life

CORONAVIRUS PANDEMIC STUNS MARKETS

Having started the year well and after reaching new all-time highs in mid-February, equity markets fell sharply in the second half of the quarter. The key driver was the spread of the coronavirus across the globe and the measures introduced to contain it, which caused the global economy to enter a recession. In contrast, Eurozone sovereign bonds rose slightly, due to investors moving into safe- haven assets as the outlook for growth deteriorated significantly.

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Coronavirus threat intensifies

News of the outbreak of a SARS-like respiratory virus in China emerged in mid-January. Initially, markets used the SARS experience from 2003 as a template to estimate the effect of the virus on growth, expecting the impact to be relatively shallow and transitory. Against this backdrop, equity markets reached new highs, but in mid-February, there was a surge of new cases outside China – at first in Italy and South Korea, then across the globe. This led to a rapid reappraisal of the impact of the coronavirus on global growth.

The measures introduced to contain the virus included severe restrictions on economic activity and people's movements. As the virus spread across the world, many economies effectively came to a standstill, causing a large shock to the global economy and affecting corporate earnings.

With the global fatality rate from coronavirus at 4.9% (and just under 12% in Italy), the human cost of the crisis is obvious and highlights the urgent need for a solution. While trials and tests for potential cures and vaccines are being undertaken, none to date indicate that a medical solution is likely in the short term. As a result, economic and personal restrictions are currently the only available tools to combat the spread of the virus, but their negative impact on the economy has been severe, with obvious repercussions for markets.

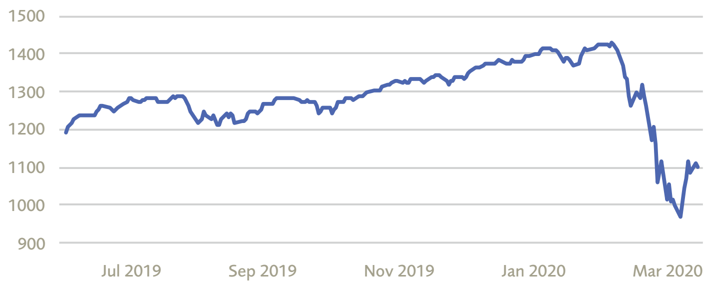
Markets will be sensitive to news flow on case numbers and underlying economic activity levels. Any signs of a peaking in case numbers and a successful containment of the virus in a global context would be well received. The significant and unprecedented levels of fiscal and monetary support provided by global authorities can also ease some of the short-term economic pain and provide the basis for an economic recovery once the virus is contained.

What's been done to support the global economy?

Global authorities have responded quickly, introducing large-scale support programmes incorporating a wide range of measures. The overriding objective of these is to provide companies and consumers with the means to survive the severe recession and be a position to recover when restrictions are eased. The packages aim to ensure funding markets stay open and that companies have adequate access to credit.

CHART OF THE QUARTER

Global Equities



Source: ILIM, Bloomberg. Data is accurate as at 31 March 2020.

Consumers are being supported by increased unemployment benefit payments and by subsidised employees' pay, while staff remain on company payrolls rather than being made redundant. Global central banks have cut interest rates to new lows, while record levels of asset purchases have been announced:

- The US Federal Reserve (the Fed) cut interest rates by 150 basis points (bps) while announcing an open-ended asset purchase programme. It also relaunched purchases of commercial paper and asset-backed securities, and set up a scheme to provide direct funding to companies.
- The European Central Bank (ECB) increased the level of asset purchases in two tranches by €870bn in total. There is now greater flexibility around the amounts in individual assets and regions which can be bought under the Pandemic Emergency Purchase Programme (PEPP), which itself amounts to €750bn.
- The Bank of England cut interest rates by 65bps to 0.1% and announced additional asset purchases of £200bn while also indicating that funding will be made available to companies.

MARKET ROUND-UP

Equities

Over the quarter, the MSCI AC World equity benchmark fell -19.9% (-19.4% in euro terms). The hit to equities across regions was indiscriminate, with most experiencing similar levels of declines. Japan slightly outperformed, falling -17.2% (-14.7% in euro terms) as the number of coronavirus cases in Japan was relatively contained compared to elsewhere. Emerging markets fell -19.0% (-21.8% in euro terms). Chinese equities outperformed, falling only -10.3% as economic activity levels showed signs of returning to normal by the end of March, while earlier restrictions began to be lifted. The UK fell -23.9% (-27.2% in euro terms) as uncertainty over Brexit-related trade negotiations with the EU acted as an additional drag. Pacific Basin equities fell -21.1% (-25.9% in euro terms) given the spill-over across the region from the initial outbreak of the virus in China.

Bonds

The ICE BofA Merrill Lynch Eurozone >5-year sovereign bond benchmark rose 0.5%. Core global bond yields fell as the global economy slowed, while the announcement of large-scale asset-purchase programmes by a number of global central banks also added to downward pressure on yields. German 10-year yields ended the quarter at -0.47%, having reached an all-time low of -0.91% in early March. Global bond yields rose from their early March lows, as the expected increased levels of bond supply after the large fiscal spending plans announced by governments weighed on bond yields in late March. Peripheral spreads widened during the quarter, as both Italy and Spain became the centres of the virus outbreak in Europe. Some misguided comments by ECB President Christine Lagarde (she remarked that it was not the ECB's role to narrow peripheral spreads) also contributed to the widening of spreads in March. The subsequent commitment by the ECB to prevent fragmentation within the Eurozone financial system and the announcement of an additional €750bn asset-purchase programme enabled Italian spreads to narrow again prior to quarter-end. By the end of March, 10-year Italian spreads against Germany stood at 199bps, while in Spain, they had widened to 115bps.

Currencies

Despite the Fed cutting interest rates by 150bps and announcing an open-ended asset-purchase programme, the euro fell against the US dollar to 1.0971 by quarter-end as the dollar benefited from its safe-haven status in the 'risk off' environment.

Commodities

Commodities fell -42.3% (-41.0% in euro terms), given the fall in demand following the shutdowns evident across many economies. West Texas Intermediate (WTI) oil fell -66.5% as OPEC and Russia failed to agree new production quotas and the previous arrangement collapsed. Instead, Saudi Arabia increased production of oil as the demand backdrop deteriorated, which also contributed to the sharp fall in the oil price.

MARKET SNAPSHOT

Market returns

Equity indices (€)	QTD Return (%)	YTD Return (%)	2019 Return (%)
MSCI Ireland	-23.81	-23.81	40.60
MSCI United Kingdom	-27.15	-27.15	23.40
MSCI Europe ex UK	-20.84	-20.84	28.20
MSCI North America	-18.20	-18.20	33.90
MSCI Japan	-14.71	-14.71	22.30
MSCI EM (Emerging Markets)	-21.81	-21.81	21.10
MSCI AC World	-19.44	-19.44	29.60
10-year sovereign bond yields (€)	**Yield last month**	**2019 Yield (%)**	**2018 Yield(%)**
US	0.67	1.92	2.68
Germany	-0.47	-0.19	0.24
UK	0.36	0.82	1.28
Japan	0.02	-0.02	0.00
Ireland	0.07	0.11	0.90
Italy	1.52	1.41	2.74
Greece	1.68	1.43	4.35
Portugal	0.87	0.43	1.71
Spain	0.68	0.46	1.41
Commodities ($)	**QTD Return (%)**	**YTD Return (%)**	**2019 Return (%)**
Oil (WTI)	-66.46	-66.46	34.50
Gold (Oz)	3.96	3.96	18.90
S&P Goldman Sachs Commodity Index	-42.34	-42.34	17.60
FX rates	**Current**	**2019**	**2018**
U.S. dollar per euro	1.10	1.12	1.15
British pounds per euro	0.88	0.85	0.90
U.S. dollar per British pounds	1.24	1.33	1.28

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2020.

POLITICAL HIGHLIGHTS

The year began with fears over a potential military conflict between the US and Iran, when tensions rose following the killing of a senior Iranian military official by the US. But the risk of an escalation into a full military conflict eased; Iran indicated that its attack on two US bases was appropriate retribution, and both sides managed to defuse the situation.

In the US, President Trump was acquitted in the Senate impeachment trial. In the race for the Democratic presidential nomination, the moderate candidate Joe Biden has become the clear frontrunner following success in some key primaries in March. This was positive for equity markets, given the more unconventional nature of some of the policy proposals of his main rival, Bernie Sanders.

The UK officially left the EU on 31 January. Trade negotiations between the UK and EU began in March, but commentary suggested a mixed start, with serious differences identified between both sides. The economic dislocation associated with the coronavirus outbreak could result in the UK seeking an extension of the transition period beyond the end of 2020, something it previously had indicated it would not do. Were this to happen, it would avoid the risk of another 'no deal' exit at the end of the year.

ECONOMIC OUTLOOK

The outlook for the global economy looked promising at the beginning of the year, after progress on global trade and Brexit removed most of the overhangs on growth that had been evident in 2019. Meanwhile, economic releases in January suggested that growth was even stronger than initially expected, as purchasing managers' indices (PMIs) rose to levels consistent with global growth of 2.7%.

But the growth outlook changed quickly, as restrictions were put in place to contain the spread of the coronavirus. Limited hard data has been published covering the period since the virus began to have an impact on growth. The few data points available, however, suggest a severe slowdown has already taken place, with global growth possibly contracting by up to a 10%+ annualised rate in the first half of the year. In the US, a record 3.3m people (2% of the labour force) made unemployment claims in the last week of the quarter. Data points in China suggest the economy contracted by up to 40–45% in the first quarter. Growth is forecast to contract across Europe and the US by up to 30–35% on an annualised basis in the coming months. This represents the largest hit to the global economy since World War II.

There is the potential for a relatively quick rebound in growth – if the spread of the virus can be contained. High-frequency data points in China suggest the economy was already operating at around 85–90% of normal activity levels at the end of March. Having hit record lows in February, Chinese PMIs rebounded above 50 in March, with the composite PMI rising to 53.0.

EQUITY OUTLOOK

The outlook for equity markets over the next 12 months depends on a number of factors, including the evolution of the coronavirus, the timing of the recovery from the first-half recession, and the level of growth achieved in the second half of the year.

A major threat to the global economy has emerged in the form of the coronavirus pandemic. The measures taken to contain the virus have brought much of the global economy to a standstill, which has resulted in the sudden onset of a recession. Our base case is that after a very severe but short recession, the global economy will rebound in the second half of the year.

Given the ongoing uncertainty associated with the coronavirus and lack of visibility around when case numbers will peak and economic activity will begin to recover, any short-term rebound in equity markets could be limited. Upside in markets will depend on greater clarity regarding the potential containment of the virus and subsequent recovery in economic growth and earnings expectations. Our base case is that the virus will be contained in the coming months and that global growth will recover in the second half, supported by the implementation of recent fiscal and monetary stimulus measures. Assuming an economic recovery is evident later this year, there is potential upside in equities of double digits from current levels over the next 12 months. Relative valuations for equities are very attractive, given the low yields currently available in other assets (such as bonds and cash).

Equity markets continue to face a number of challenges beyond those posed by the coronavirus. These include ongoing trade disputes and uncertainties related to key political events in 2020, such as the US presidential election and tensions in the Middle East and North Korea. These could result in additional bouts of volatility in the market.

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2020.

THE MONTH AHEAD

Economic data and events to watch

1 April	China's Caixin Manufacturing PMI (March)
3 April	US non-farm payrolls (March)
5 April	UK's GfK consumer confidence (March)
9 April	Germany's balance of trade (February)
10 April	China's inflation rate (year on year, March)
15 April	US retail sales month on month (March)
17 April	China's GDP growth rate, quarter one
21 April	Germany's ZEW economic sentiment index (April) UK claimant count change (March)
22 April	UK inflation rate, year on year (March)
24 April	Germany's Ifo business climate (April)
29 April	Euro Area business confidence (April) US Fed's interest-rate decision US quarter-on-quarter GDP growth rate (Q1; advance)
30 April	Euro Area GDP growth rate (flash, quarter on quarter)

Political events

7 April	Eurogroup meeting
9 April	OPEC+ meeting

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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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