SIMEKA

member of Sanlam group

Investment Notes

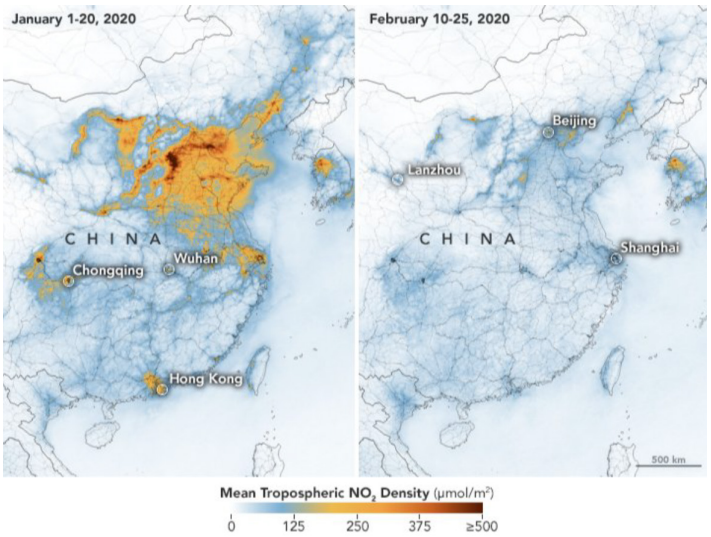
1/2020

Corona virus and its effect on financial markets

The Corona Virus (now referred to as COVID-19 virus), is likely to be a game changer in 2020.

It is likely that the COVID-19 virus is also going to influence our lives for some time and negatively affect financial markets due to reduced economic activity.

Airborne NO_2 pollution



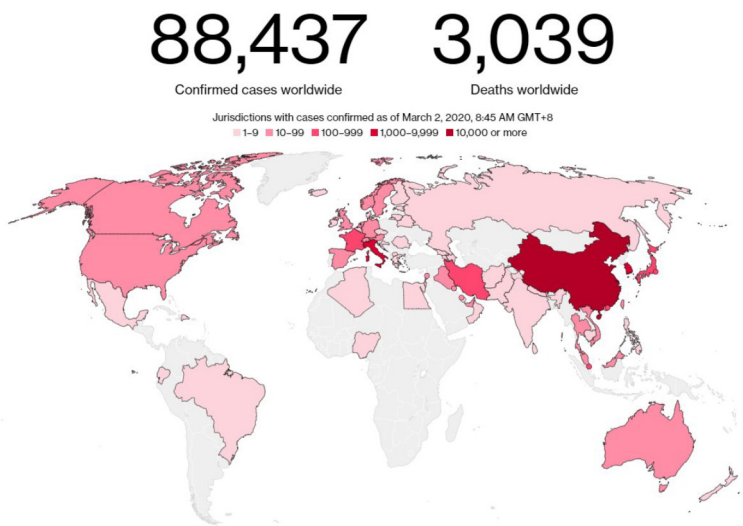
Source: earthobservatory.nasa.gov

Already global trade is slowing at an unprecedented rate because of reduced production and consumption in Asia. This is evident from images captured by pollution monitoring satellites that shows that airborne nitrogen dioxide emission over China has plummeted.

Even though the contagion is centred currently in China, Iran, Japan and Italy, it can be expected to spread quickly to other countries in Asia, Europe, Australia and North America. As of 2 March 2020, Bloomberg reports more than 3000 deaths worldwide. This death rate is concentrated amongst the older ages and medically vulnerable.

One can only guess what the impact of a slowdown in the Chinese economy will have on the rest of the world. Anecdotal evidence leads one to expect that it will affect our lives extensively and in areas not anticipated.

Confirmed cases and deaths of COVID-19 virus by 2 March 2020



Source: Bloomberg

In countries such as South Africa, where the public health system is untested in coping with large-scale challenges of this nature, the ability to cope with an outbreak of COVID-19 remains uncertain.

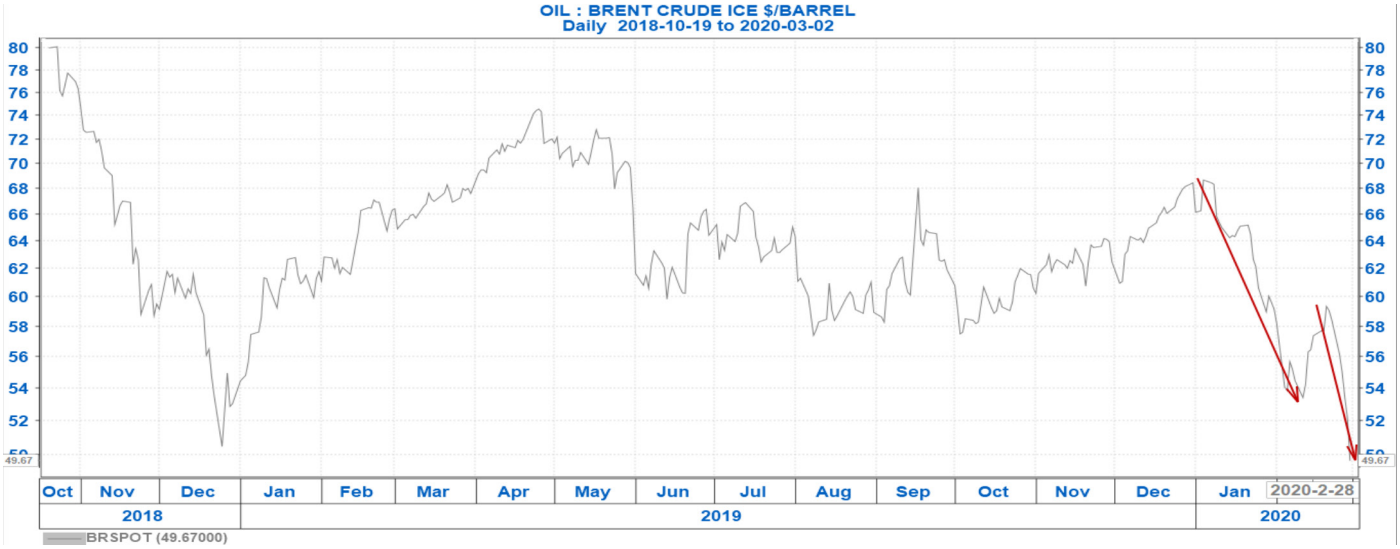
The rate of contagion of the COVID-19 virus seems to be much faster than previous strains of similar viruses.

With no vaccine available at the moment, countries have resorted to a strategy of containment by e.g. isolation, quarantine and contact tracking. This clampdown on human movement is one of the main reasons for the economic downturn currently experienced.

We categorise the effect of the COVID-19 virus into the following phases:

1. the initial outbreak on 1 December 2019 in Wuhan, China;
2. financial markets react cautiously late in January 2020 to the uncertainty of the outbreak contained in China (we call it the first downward market wave);
3. in February 2020, the impact on the real economy starts to become evident as factories close, people are asked to remain at home (second downward market wave);
4. spread of the virus to other geographies, e.g. Iran, Japan, Italy and the realisation that outbreak of the COVID-19 virus is likely to be of truly global proportions; and
5. local outbreak of COVID-19 in largely unprepared geographies, e.g. Southern Africa;
6. this is likely to give rise to a third downward market wave, premised on decreases (albeit short-term) in global productivity.

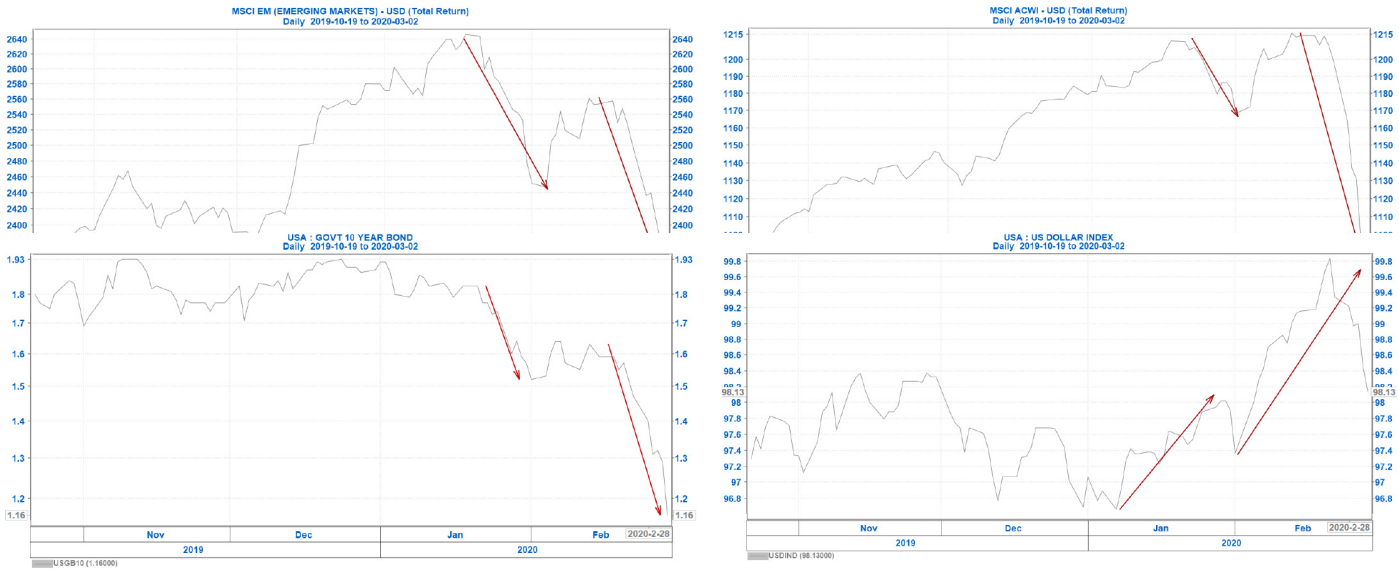
The oil price is used as a proxy for commodities used in production – it moved down in two waves as demand for oil declined in China.



Source: IRESS

Financial markets

In financial markets, the performance of assets considered risk-bearing, were bared to the world. Emerging market exposure was sold off in two waves, share exposure was sold off indiscriminately in two waves, while bond yields were bought down in two waves and the US dollar strengthened in two waves, but consolidated after the second wave.



Source: IRESS

It is important to note the significant pull-back to the exchange rate of the US after the second wave of dollar strength. This seems to suggest that there may be a consolidation phase after the indiscriminate sell-off of risky assets during the second wave in February 2020.

Retirement savings

Saving for retirement is a long-term initiative that involves many risks and uncertainty. The impact of the COVID-19 on retirement investments is one more such a risk. It is not clear that the impact of COVID-19 on investment markets will extend beyond the short to medium-term. The best way to deal with uncertainty is through proper planning and adherence to a long-term investment strategy. Making “knee-jerk” changes to a long-term investment strategy, without any clear evidence, would be premature. Any such premature changes may result in more harm than good.

Presently we see no evidence that calls for change to the fundamental principles of long-term investing and therefore we do not recommend any changes to long-term investment strategies in general. Volatility in investment markets does afford skilful active asset managers an increased opportunity to outperform the general market.