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Market Ethos

The latest market insights from the Richardson GMP team

RICHARDSON GMP

Lessons from afar

Craig Basinger, Chris Kerlow, Derek Benedet, Alexander Tjiang

Everyone has become keenly aware that combatting the COVID-19 pandemic is dramatically changing our lives, our livelihoods and the economy. Social distancing, working remotely, no more sports have become the norm – and for good reason. Based on success in some countries, this social isolation is a key ingredient in limiting the spread and ultimately moving past this pandemic. Faster, easier and more testing is also key. Relaxing social liberties helps too. As a planet, we are not there yet but with more and more countries / jurisdictions adopting this approach, the world is mobilizing.

The more vigilant we can all be individually, the better off our society as a whole will be. Stay healthy.

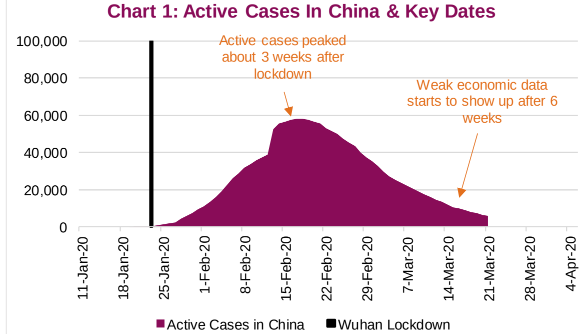
COVID-19

The unknowns and uncertainties remain numerous and unsettling. Confirmed cases of COVID-19 continue to rise at a dramatic pace in many countries including Italy, Spain, Germany, France and the U.S. As testing continues to improve, this rising trend is sure to continue. However, a number of lessons have been garnered from other countries that contain some optimism.

China: Clearly this was not handled well at the epicenter of the pandemic as it would appear the authorities ignored, supressed and then embarked mostly on marketing their response rather than taking meaningful steps. However, this changed on January 23 when Wuhan was locked down.

This is important because about three weeks later, the number of cases plateaued, and active cases started to decline shortly thereafter.

Chart 1: Active Cases In China & Key Dates



South Korea: It learned a lot from MERS, which hit the country pretty hard a few years ago. This changed how South Korea reacted and behaved when COVID-19 started to make its way onto the peninsula. Testing was free, plentiful and fast (5 hours). Technology was used, in the form of credit card usage and phone GPS tracking, to understand where infected citizens had been and at what times. This information was made public so you could see

Past reports
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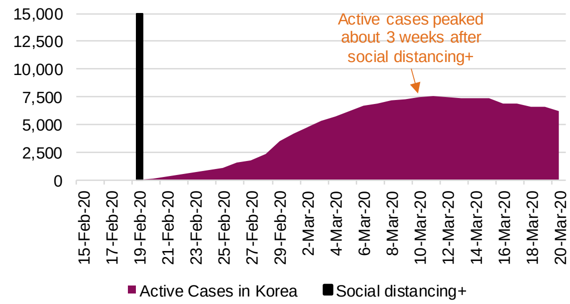
where there may be added risk of catching the virus. Local citizens were also highly responsive to government demands to practice social distancing and work from home.

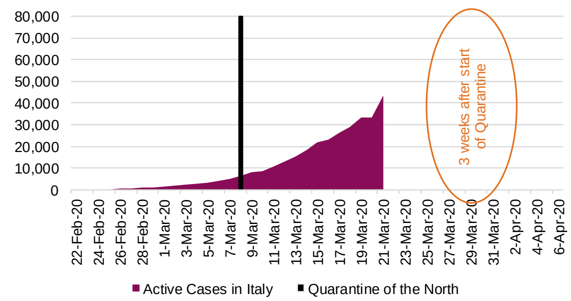
Chart 2: South Korea: How to handle a pandemic



In South Korea, social distancing started in mid to late February and active cases peaked about three weeks later. And now they are on the decline.

Italy: Every country is different. Italy did not respond quickly and when they did, there was significant confusion prompting even greater mistrust towards authorities among many local citizens (OK, that mindset may have existed before COVID-19!). The country is also demographically older with a stressed health care infrastructure, leading to many more deaths. As a result, the plateau after quarantine, which has typically taken around three weeks, may take longer. We will find out as the three-week mark is mid week for Italy. Given the current pace of confirmed cases, any plateau is likely farther off.

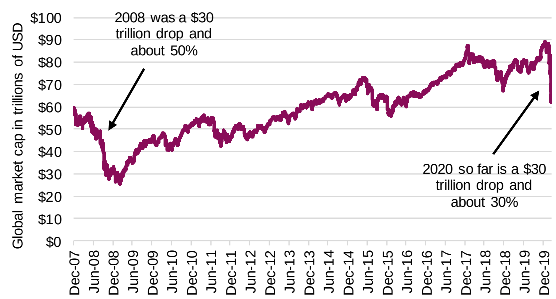
Chart 3: Italy Active Cases and Responses



U.S.: The Trump administration initially allowed the problem to escalate with limited response but, more recently, increasingly aggressive measures have been taken. Sadly, this initiative has been led mainly by states as opposed to centralized government. At least testing is becoming more readily available. They have only now started isolation practices in some states, which could mean their peak is still weeks away.

Canada: Our own federal government spearheaded widescale social isolation measures about a week ago, around the same time as many European countries. Some countries will be better, some will be worse, but if this three-week trend repeats, the markets will react very positively as it will provide a window into how this plays out. Time and our individual vigilance will tell.

Chart 4: $30 trillion of global market cap is gone



The economy

We are in a recession – at least, that is what the markets are pricing in. The global stock market has dropped from about U.S.$88 trillion to U.S.$63 trillion in the past month. That represents a 29% decline. Even if the first $5-10 trillion was coming off an elevated level, this is still pricing in a global recession.

Sticking with our timeline approach, China locked down much of its people in late January and a softening in economic data has become evident in the past week (March 16-20). This amounts to a delay of six weeks. That means February data for other countries should be mostly fine, but March data will likely reflect dramatically weaker numbers.

In addition to the scope, the actual speed of the drop will be unprecedented. By some estimates, initial jobless claims for the U.S. measured via a weekly report, are expected to spike from around 200,000 into the multi millions. Clearly, this reflects the abrupt and pervasive halt to all social and economic activity in a bid to fight this pandemic. For economists, in particular, this will be historic.

The question is, what is on the other side. Does economic activity snap back quickly (V shaped) or remain lower for longer (U shaped) or will we see the old flipped radical (shaped)? Yes, we created that last one – a big drop and then a partial economic bounce but not back anywhere near previous levels.

China may offer some further insight here too. While the data has turned south for China, economic activity is coming back strong. Anecdotal evidence is suggesting that China supply chains are back to almost normal. As a harbinger of social activity within major urban centres for instance, Starbucks has started opening stores again. Perhaps one of the best insights came from Tencent, the Chinese internet company that includes gaming services. It said there was a huge spike in active users during the pandemic, but these have since dropped off with people returning to work. Playing "vids" to stop a pandemic – well, it sure is one way to keep people on their couches.

Portfolio thoughts

The situation remains very tense and markets will likely react negatively again this week on the back of rising active cases of COVID-19 and/or in response to the data that is starting to turn. Last week had more monetary and fiscal stimulus announcements than perhaps any other week, and markets declined. Policy can help keep markets functioning but not materially alter the path.

What will change this trend? More evidence that the spread of the virus is slowing in individual countries that have enacted a similar action plan would certainly help. Evidence of how other countries, such as China, are returning to normal could change the negative trendline and give us guidance to the path forward. A medical breakthrough for a better treatment or vaccine would do it too (although this is unlikely any time soon given the time needed to test and manufacture the solution). From a market perspective, the negative trend could change when the motivated sellers become exhausted and the opportunistic buyers begin to outnumber them. There are many quality companies with limited debt that can survive an economic shutdown for a month or more, trading at amazing prices. However, the truth is, they were more expensive last week, and they too may become cheaper.

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Source: All charts are sourced to Bloomberg L.P. and Richardson GMP unless otherwise stated.