MARCH 2020
VOLUME 17
ISSUE 3

INTUITION

IN THIS SPECIAL EDITION:

- **The Coronavirus wreaks havoc**

HARVARD HOUSE

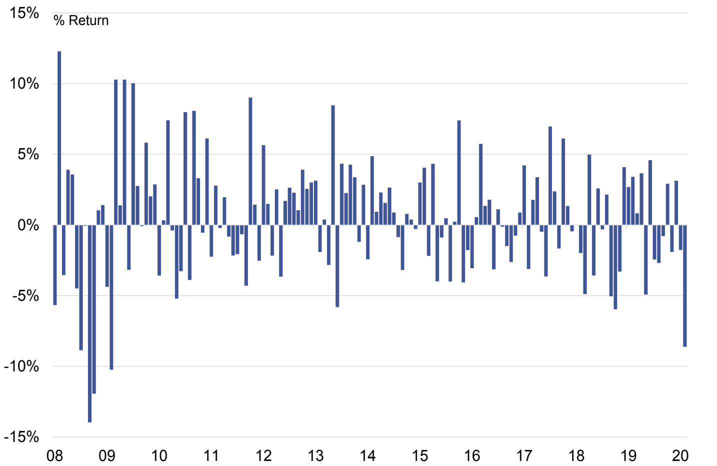
We understand your need for FINANCIAL INTEGRITY

THE CORONAVIRUS WREAKS HAVOC

HH Team

A combination of a very depressed local mood, coupled with panic over the spread of the Coronavirus has resulted in February being the worst month for local equity returns since the Global Financial Crisis. Globally, the trend is similar – US shares have suffered one of their worst weeks ever, and in the UK, the FTSE 100 index has seldom performed this poorly. As always, such extreme volatility is hugely stressful, so this article aims to shed some perspective on the issue.

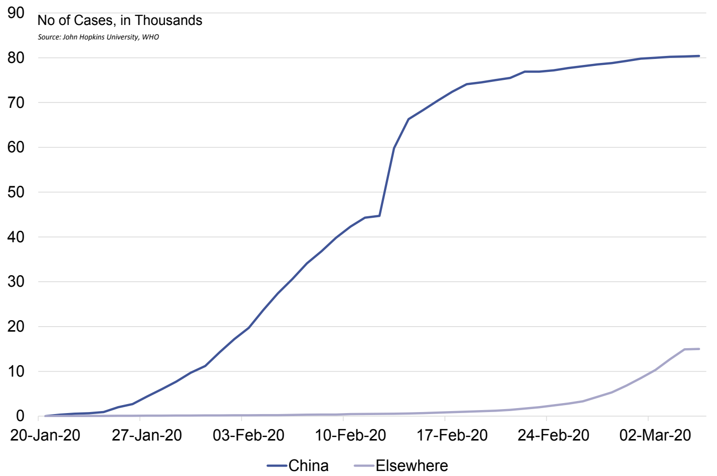
JSE MONTHLY RETURNS



February has been the worst month for local equities since the Global Financial Crisis.

Let us start with the global issue – the spread of the coronavirus. The virus was first detected at the end of December, but first made headlines in late January. Markets did react briefly, but soon recovered when it appeared that the virus had largely been contained within China. A key statistic being watched was the daily rate of new cases – which seemed to rise exponentially at first, but soon started to slow. This provided markets with comfort, and life continued. That was until the 22nd February, when cases outside of China started to rise sharply – led by outbreaks in both Iran and Italy. Over the last week in February, new cases outside of China were rising at a much faster rate than new cases inside China. To give some perspective, when I started this article, the virus had spread to 65 countries, with 88,930 cases being reported, and 3,043 fatalities. Two days later, those same statistics are 77 countries, 95,164 cases and 3,285 deaths respectively. The statistics continue to rise steadily. This caused panic amongst investors – the inference being that economic activity would be severely curtailed in many countries as areas / industries were quarantined.

RATE OF NEW CASES



Whilst the rate of new cases climbed dramatically, most were confined to China. But in the last week of February, new cases surged in other countries, leading to panic over the implications for global growth.

Is this fear justified? In part, yes. There is no doubt that economic activity in China is still well below normal levels post the Lunar New Year holiday period. Statistics ranging from coal use to the number of traffic jams all point to a country that is far from getting back to full throttle, although there has been a definite increase in activity over the past seven to ten days. Given China's pivotal role in global manufacturing, the lack of production is rippling out into the wider world. Other businesses can't get stock or components to make their own products. And hence the ripple effect across the entire world.

In recognition of this, global GDP forecasts have been revised sharply downwards. In china, Q1 GDP is expected to be negative, the first time since modern records began in 1992. However, at this stage, there is expected to be an equally big rebound in Q2, leaving global growth for the year only marginally weaker.

Fear of a sharp slowdown in global growth has not gone unheard. This week, global central banks stepped into

Revision to Global GDP Forecasts since 24 Jan 2020				
	Q1 20	Q2 20	Q3 20	Q4 20
Global Real GDP	-2.7%	2.0%	0.4%	0.0%
China	-10.2%	9.0%	1.7%	0.0%
USA	-0.3%	0.0%	0.0%	0.0%
EU	-1.0%	1.0%	0.0%	0.0%
Japan	-3.2%	1.7%	1.0%	0.0%
Rest of the World	-0.5%	0.4%	0.0%	0.0%

the breach. Leading from the front, the US Federal Reserve didn't wait for their official meeting in the middle of March, but rather decided to act immediately, cutting interest rates by 0.5%. Central banks across Asia have also eased monetary policy. Market reaction to the cuts has been "interesting". Initially, US markets rallied a few percentage points after the cut, but plummeted with 20 minutes – the rationale being that if the Federal Reserve was implementing "emergency cuts" then the situation is far worse than we know. Twenty-four hours later, US markets rallied by over 4%. At the same time, bond yields have fallen to record lows – now just 1% in the US, and in Europe they have slipped further into negative territory.

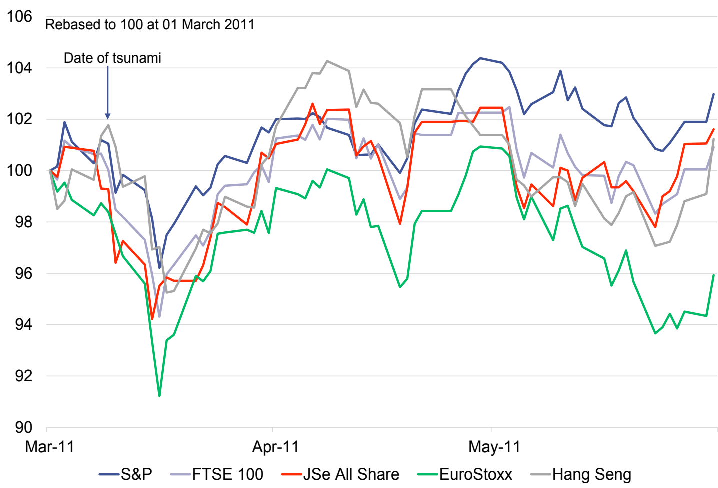
In our opinion, the real issue here is about human behavior. Between the official media, social media, and government reaction, panic has spread through various communities. For example, in Australia, where just 45 cases have been diagnosed, there has been a stampede for basic necessities, as people prepare for weeks of possible restricted movement. In Italy, which has seen the largest outbreak apart from China and Korea, the government is contemplating closing all schools and universities. This type of reaction causes people to become defensive and defer decisions, which can become self-fulfilling.

So, what to do? A few thoughts, in no particular order:

1. As always, our first advice is not to panic. Making decisions in the heat of the moment is seldom the right choice in hindsight.
2. The week of 24th – 28th February was one of the worst weeks for global stocks since the Global Financial Crisis in 2008. Three days later, by close of business on the 4th March, many markets had already staged a partial recovery, as per the table below.
3. US markets have recovered sharply. In part this is due to interest rates being cut. In part, it is due to politics – the rising probability that Joe Biden will succeed as the Democratic Party candidate over Bernie Saunders. Nonetheless, the US still acts as the global barometer, and higher US markets will have a positive effect on other global exchanges.
4. Typically, market reaction to these events can be overdone in the short term. Think back to the Tohoku Earthquake and Tsunami that occurred in March 2011 off the coast of Japan. It was another event that came as a complete surprise, and had the potential to disrupt global trade. As the chart below shows, markets reacted negatively over the few days of the event, but then rallied hard, and were soon back to pre-tsunami levels.

% Movement Across Various Markets		
	% Fall (24 – 28th Feb)	% Move (2nd – 4th Mar)
S&P 500	-11.5%	6.0%
FTSE 100	-11.1%	3.6%
EuroStoxx 50	-12.4%	2.7%
Hang Seng	-4.3%	0.4%
Australia	-9.8%	-1.8%
JSE All Share	-11.0%	3.7%

MARKET REACTION TO JAPANESE TSUNAMI



Markets fell sharply in the aftermath of the Japanese tsunami, but soon recovered their composure.

In this instance, we are concerned about the duration of the "crisis". Furthermore, whilst cuts to interest rates will always support markets, solving this crisis will not be achieved by stimulating spending, but rather by encouraging people to behave normally – something that initially is harder to do, given the tendency for panic and irrational behaviour. Ultimately, life will move on, but in the meantime, there could be a sharp contraction in activity that will never be recovered.

The impact on SA

1. Ironically, whilst markets were battered in February, actions from the SONA and Budget have reaffirmed our view that whilst 2020 will be a tough year for GDP growth, there is a growing probability of a change in sentiment, and with it, far better returns for SA assets over the next few years.
2. Whilst we agree with the Reserve Bank governor that lower interest rates alone will not solve SA problems, we do expect further interest rate cuts – possibly as much as 0.5% over the next few months.
3. Together with a lower oil price due to weaker global demand, lower rates and modest tax cuts will support consumer spending. We do not expect fireworks, but its positive relative to our expectations of just a few weeks ago.
4. In addition, we are hopeful that some of Government's promised infrastructure spend will finally get off the ground.

The question of whether the building blocks are falling into place for an economic recovery in SA is the topic of our next seminar in April, at which time this will be discussed extensively.

What are we doing now?

Importantly, we are not panicking, nor do we believe that radical change to portfolios is necessary. Given the sharp recovery in selected markets:

1. For offshore portfolios, we are using strong markets to take some profits in selected counters where portfolios have become overweight due to strong performance, and to effectively raise cash levels slightly. This will ensure that we have flexibility to take advantage of the expected volatility to invest into high-quality companies that have until recently, been too expensive.
2. Similarly for local portfolios, we will use the recovery in markets to reduce exposure to excessively overweight positions, but within the constraints of meeting income requirements and sticking with our view that portfolios are best served by having a portion in locally-orientated shares in anticipation of better times in SA, and a portion in rand hedges to protect against events such as these.

Harvard House clients will know that we advocate living on income generated by assets rather than by the change of value in those assets. This is particularly applicable to investment markets and events such as these. This is contrary to most of the industry which has a fixation on the change in market value. There is no doubt that clients' portfolios will be down, but in many of the cases we are collecting the same or higher dividends than we did prior to the Crisis. The only exception is property where, in a few cases, distributions have declined. In such cases though, the income yield relative to market value exceeds cash by such a high margin that shareholders will be more than compensated.

Our recent Insight presentation and Intuition article demonstrated clearly that this philosophy works well over the long term and has been a very successful approach relative to alternatives. We remain confident that portfolio clients will be rewarded by viewing these events as another historic moment that will be looked back on as a moment of fear that could have derailed a long-term investor. We caution you not to be one of those who succumb.

It has been a tough start to the year. Rolling loadshedding has soured the mood, and the emergence of the Coronavirus in China is rippling through the world economy. Locally, we have had the SONA and Budget to digest. Our investment thesis for the year acknowledges a tough year for economic growth, but importantly, a turn in sentiment that will start to drive a more virtuous cycle. Our next seminar will examine whether this stance is still valid.

Please RSVP to Clare Mitchell on 033 3302164 or clarem@hhgroup.co.za.

Topic:	**Viruses vs green Shoots; Is our outlook still valid?**

Natal Midlands

Date:	Thursday, 16th April 2020
Venue:	Fernhill Hotel Midmar / Tweedie Road (almost opposite entrance to Midmar
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	Tuesday, 21st April 2020
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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