Irish Life

CORONAVIRUS FEARS GRIP MARKETS

Having reached new all-time highs in mid-February, equities fell sharply later in the month. Equities plummeted -11.6% over the last seven trading days, as the coronavirus spread beyond China, spawning fears of a significant slowdown in global growth. Eurozone 5-year+ sovereign bonds were modestly higher – the fall in German 10-year yields to -0.61% in the 'risk off' environment was partly offset by a widening in peripheral spreads, as Italy saw a significant rise in the number of coronavirus cases.

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Coronavirus spreads

For most of February, equity markets edged higher, reaching new all-time highs as the number of new daily coronavirus cases in China declined, suggesting authorities were successfully containing the outbreak. The general belief was that the hit to Chinese and global growth would be transitory and that the economy would recover relatively quickly. But this view changed when cluster outbreaks emerged in Italy, South Korea and Iran. Risks of longer-lasting disruptions to global supply chains, the potential imposition of restrictions across developed economies, reduced consumption owing to rising uncertainty and debt-servicing difficulties in companies (given reduced sales) all resulted in a sudden reappraisal of the global growth outlook. Initially, first-quarter growth in China had been expected to fall to an annualised rate of around 4%, with growth in the global economy slowing to around 2.4%. Given the heightened fears following the spread of the virus to new regions and the slower-than-expected resumption of production in China, expectations deteriorated by month-end. First-quarter growth in China is now expected to contract by up to 4% (annualised), while the global economy could also experience a negative growth rate of -0.1%. Fears that the growth slowdown could be deeper and longer than originally expected contributed to the sharp fall in equities, as did profit warnings from bellwether stocks including Apple and Microsoft, related to the virus.

Economic data falters

Economic releases during the month were mixed, with activity data relating to the pre-coronavirus period generally positive. Early in the month, sentiment data was also surprisingly strong, particularly in the US and UK. But purchasing managers' index (PMI) readings showed the first signs of the impact of the virus on corporate sentiment. The US composite PMI fell below 50 (indicating a contraction), while Japan's composite PMI remained well below 50. Meanwhile, the US labour market generally remained strong. Non-farm payrolls rose by 225,000, although job openings declined the most over any two-month period since the survey began in 2001.

CHART OF THE MONTH

Global Equities

Source: ILIM, Bloomberg. Data is accurate as at 1 March 2020

Fed poised to act

The US Federal Reserve (Fed) was initially hawkish, announcing plans to taper the current $60bn per month of Treasury bill purchases from April, while also ruling out an early interest rate cut. The Fed changed its stance in late February, saying that it would act as appropriate to support the economy, given the increasing risks associated with the coronavirus. The Fed subsequently announced an interest rate cut of 50bps in early March.

Democratic candidacy race heats up

In the US, Bernie Sanders has established a lead in the race to become the Democratic US presidential candidate and is expected to win the most delegates, although not necessarily achieve an overall majority by the end of the process. On 'Super Tuesday' Joe Biden won more delegates than previously expected making the nomination race a much closer contest. As a result, the winner might not be determined until the Democratic Convention in July. President Trump, however, remains the favourite to win the November election.

MARKET ROUND-UP

Equities

The MSCI AC World equity index fell -7.6 (-7.2% in euro terms). Japan fell -9.6% (-8.3% in euro terms) as Q4 GDP contracted more than expected at a -6.3% annualised rate. The UK fell -9.1% (-11.1% in euro terms) as the government adopted an aggressive stance in trade discussions with the EU, threatening to pull out of talks unless the terms are to the UK's liking. Emerging markets outperformed, falling only -3.8% (-4.4% in euro terms), as concerns regarding the coronavirus spread to developed markets following the outbreak in Italy. The Pacific Basin ex Japan also outperformed, falling -5.3% (-6.9% in euro terms) as fiscal and monetary stimulus measures were announced to offset the impact of the virus.

Bonds

Eurozone >5-year bonds rose 0.7%. German 10-year yields fell to -0.61% on rising growth concerns. Italian 10-year spreads, however, widened to 171 basis points (bps) as Italy experienced one of the largest outbreaks of the virus outside China. Spanish 10-year spreads also rose to 89 basis points in the 'risk off' environment amid increased concerns around growth.

Currencies and commodities

The euro fell slightly to 1.1026 against the US dollar, having been as low as 1.0792. Initially the dollar benefited from its safe haven status, but it declined towards month-end on rising speculation over possible interest rate cuts by the US Fed. Commodities fell -8.4% (-7.6% in euro terms), as demand expectations fell on the back of rising growth concerns. West Texas Intermediate (WTI) oil fell -13.2%. Gold was relatively stable, falling slightly over the month by -1.0%.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2019 Return (%)
MSCI Ireland	-6.38	-9.37	40.60
MSCI United Kingdom	-11.14	-13.41	23.40
MSCI Europe ex UK	-7.52	-8.25	28.20
MSCI North America	-7.29	-5.94	33.90
MSCI Japan	-8.33	-8.41	22.30
MSCI EM (Emerging Markets)	-4.43	-7.70	21.10
MSCI AC World	-7.22	-7.04	29.60
10-Year Yields	**Yield Last Month (%)**	**2019 Yield (%)**	**2018 Yield (%)**
US	1.15	1.92	2.68
Germany	-0.61	-0.19	0.24
UK	0.44	0.82	1.28
Japan	-0.15	-0.02	0.00
Ireland	-0.16	0.11	0.90
Italy	1.10	1.41	2.74
Greece	1.33	1.43	4.35
Portugal	0.35	0.43	1.71
Spain	0.28	0.46	1.41
FX Rates	**Current**	**2019 Rates**	**2018 Rates**
US Dollar per Euro	1.10	1.12	1.15
British Pounds per Euro	0.86	0.85	0.90
US Dollar per British Pounds	1.28	1.33	1.28
Commodities (USD)	**MTD Return (%)**	**YTD Return (%)**	**2019 Return (%)**
Oil (WTI)	-13.19	-26.70	34.50
Gold (Oz)	-1.02	2.86	18.90
S&P Goldman Sachs Commodity Index	-8.39	-18.31	17.60

Source: ILIM, Bloomberg. Data is accurate as at 1 March 2020

THE ILIM VIEW – LOOKING AHEAD

Following the fall in late February, equity valuations have moved back in line or slightly below long-term averages. Equities are currently trading on a 12-month forward price-to-earnings (P/E) ratio of 14.8 times, compared to a long-term average of 15.5 times. The current dividend yield of 2.66% compares to the long-term average of 2.60%, while on a price-to-book basis, equities are trading at 2.20 times compared to the long-term average of 2.17 times.

The outlook for equity markets over the next 12 months depends on a number of factors, including the evolution of the coronavirus, the level of growth in the global economy, the scale of monetary policy support from global central banks, and the amount of fiscal stimulus provided by governments.

A new threat to the global economy has emerged with the outbreak of the coronavirus. While severe restrictions on travel and general activity appear to have contained the virus in China, its spread to other regions has given rise to renewed fears of a global recession. A rising risk of long-lasting disruptions to global supply chains, potential restrictions in developed economies due to efforts to combat the virus, reduced consumption due to increased uncertainty and rising risk of credit defaults have all resulted in increased risks to global growth. If the virus is successfully contained on a global basis, business and consumer confidence can quickly recover, with any negative impact on global growth relatively short-lived. Our base case is that the virus will be contained over the next few months. As a result, we believe that global economic growth will rebound in the second half of the year after a very weak patch during which the global economy could contract in the first quarter of the year.

THE MONTH AHEAD

Economic data and political events to watch

Economic data releases

2 March	China's Caixin Manufacturing PMI
3 March	Reserve Bank of Australia's interest-rate decision
4 March	Italy's year-on-year final growth rate
6 March	US non-farm payrolls
9 March	Japan's GDP growth rate, fourth quarter 2019
10 March	Euro Area growth rate, 3rd estimate, quarter on quarter
11 March	US core inflation rate (year on year, February) UK balance of trade (January)
17 March	Germany's ZEW economic sentiment index (March) US retail sales (month on month, February)
18 March	US Fed's interest-rate decision
19 March	Japan's inflation rate (year on year, February)
25 March	UK inflation rate (year on year, February)
26 March	Germany's GfK consumer confidence survey (April) Bank of England's interest-rate decision
30 March	Euro Area business confidence (March)
31 March	China's NBS manufacturing PMI (March) Spain's GDP growth rate (quarter on quarter, final)

Source: ILIM, Trading Economics. Data is accurate as at 1 March 2020

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