Coronavirus sends equity markets plummeting

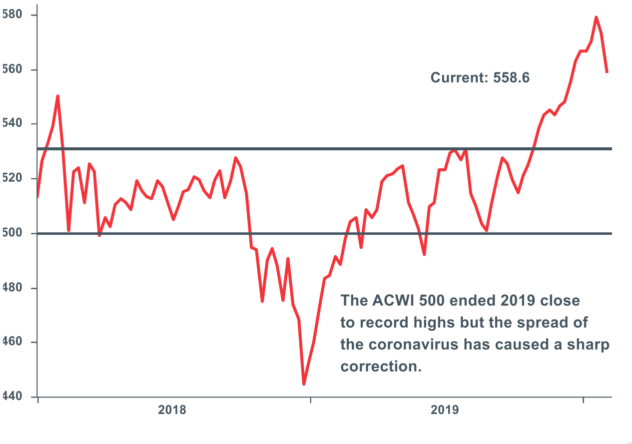
January 2019

The World in five bullet points

- Global equity markets were pulled lower in January by the outbreak of the **coronavirus in China**. The rapid spread of the virus and its deadly effects caused the China government to isolate the city of Wuhan in Hubei province, curtail domestic travel during lunar new year celebrations, and then begin cancelling international flights. The holiday season was also extended by several days and some industrial zones postponed their restart by a week, likely denting economic recovery in the country and consequently sending equities in Hong Kong and Shanghai lower in a broad-based sell off.
- The **impact of the virus on the markets** was immediately apparent with safe haven assets such as the US dollar, the Japanese yen and Swiss franc all appreciating (see Currencies below), while gold also gained (also detailed further below). Those that fell included the traditional vulnerable assets such as oil, metals and emerging market currencies which largely reversed gains seen at the back end of 2019. Government bond yields also fell with the US 30- and ten-year briefly re-inverting and eurozone yields also dipping (Figure 6).
- The markets had already briefly sold off at the beginning of the month when the **US killed a top Iranian army general** in a drone strike in Baghdad. Qasem Solemani was head of the army's elite Quds Force and his death sparked a limited retaliatory missile strike from Iran on a military base hosting US forces but there were no causalities and both sides quickly de-escalated the rhetoric in the following days. During the heightened tensions Iran accidently shot down a Ukrainian airline, killing all on board. Initially, equity markets sold off and oil prices rose 5% on the news of the drone strike, but these were quickly reversed as it became apparent both sides did not want an escalation.
- The **Impeachment trial of President Trump** began in the US Senate. Almost immediately, it became a partisan division with Democrats calling for witnesses to testify against the President, and Republicans resisting and moving instead toward a rapid dismissal of the charges. The trial had no detectable impact on the global financial markets as it is widely expected the President will defeat the charges given a two-thirds majority is required in the Senate for him to be found guilty.
- **Bushfires** engulfed the eastern coast of Australia, killing 33 people and as many as a billion animals, burning 2,500 homes and destroying an area roughly the size of Greece in its path. The fires were exacerbated by an extreme dry spell that is seeing rainfall at 1-in-100 year lows in New South Wales, with the natural water table levels now so low that it is beginning to hit production at coal and gold mines as dust levels reach untenable levels.

Figure 1. China and Hong Kong sell off sharply

Figure 2. MSCI AC World Index



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of as of 31 January 2020.

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Equity Markets

- **Global** equity markets ended 1.1% lower in January with almost every major MSCI index falling as the coronavirus took hold in China, offsetting encouraging economic data and corporate results. The exception was the US, which gained 0.2% despite a sharp sell off in the final week on the virus news. However, this was not enough to stop the **Developed World** index from falling 0.6%, with Europe weighing heavily and falling 2.5%.
- The MSCI **Emerging Markets** index lost 4.7% and, while the **China** and **Hong Kong** indices technically fell just 4.8 and 4.5% respectively over the month, the Shanghai markets remained closed for almost two weeks. Stocks opened sharply lower on the first day of trading on 3 February.
- Elsewhere in Asia, **Taiwan** gave up 4.7% with investors taking advantage of the virus crisis to take profits from the strong gains made in 2019. **Korea** also gave back some of its gains from late in 2019 to close 5.3% lower as the weaker won also impacted stocks there with supportive corporate news from several of the large technology stocks failing to offset fears over the spread of the coronavirus.
- **South East Asia** stocks were mixed although all ended in the red. The Philippines lost 8.0% on a weaker local currency while Malaysia (-3.9%) and Indonesia (-2.7% performed relatively well, along with their respective currencies. But on the negative side, **Thailand** was one of the weakest markets anywhere in the world with stocks there losing 8.6% after the baht fell sharply on fears of falling tourist numbers from China.
- Other Emerging Markets also fell as the US dollar regained some of its losses it made in December**. Latin America** fell 5.6% as weaker commodity prices sent currencies here plummeting. The MSCI Brazil index was down 7.5% and Chile reversed most of December's gains with a 7.6% fall, reflecting the depreciation of their currencies against the dollar. Mexico went some way to offsetting these losses with a 1.4% gain after the peso gained against the dollar.
- The **EMEA** region was also affected by the sell off with the MSCI index there down 4.8% with some support from Turkey, which rose 1.5%, and a relative outperformance from Russia, which fell just 3.0%. Elsewhere, there was notable underperformances from Hungary, Poland and South Africa, the latter of which lost ground as the rand came under severe pressure (see Currencies below).
- **Australia** outperformed and ended almost flat as yields on its government bonds slid and its currency fell sharply. **Japan** also outperformed and finished just 1.4% lower as the yen appreciated against the dollar, reaffirming its safe-haven status. **India** was also a standout albeit with a 0.8% loss as the country benefits from a lower oil price.

Figure 3. Regional Equity Indices

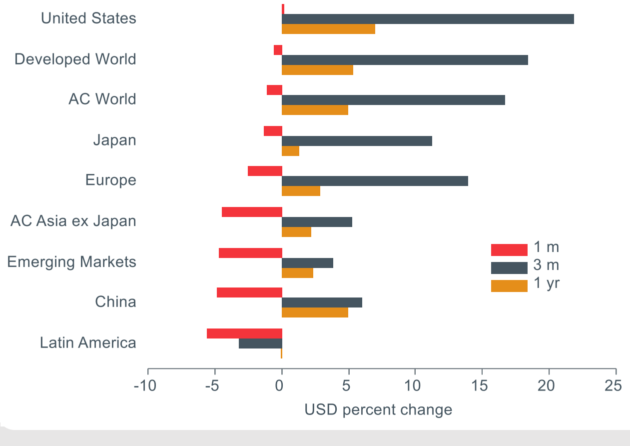
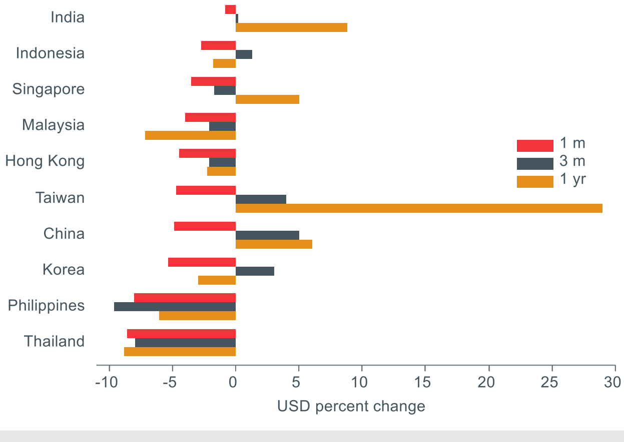


Figure 4. Asia Equity Indices



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 31 January 2020. For representative indices and acronym details please refer to notes in the appendix. Quoted returns are MSCI, US dollar denominated total returns.

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Fixed Income

- Core government bond yields declined in January on the back of waning risk appetite in global markets. US Treasury Yields (UST) were broadly lower, with the 10-year UST rate down 41bps at 1.5%. German bunds and UK gilts also fell over the month.
- Investors fled to safety during a month that saw Middle East tensions escalate with the killing of a top Iranian military commander in a US drone strike that sparked swift retaliation from Iran. Later, risk sentiment deteriorated further amid mounting concerns over the spread of the deadly Wuhan coronavirus and the impact this may have on economic recovery. These two events overshadowed positive developments on the trade front somewhat which saw investors reversing some of the early-month yield decline with the 15 January signing of the China-US Phase 1 trade deal.
- In Asia, local rates markets also benefited from a still-benign policy environment, with Indonesian and Malaysian local government bonds outperforming the rest of the region on a total-return basis. Malaysia's central bank unexpectedly cut its key interest rate by 25 bps to 2.75%, as it looked to spur private spending and economic growth. The last time Malaysia lowered rates was in May 2019. Meanwhile, China trimmed the amount of cash that domestic lenders must hold in reserve. Beijing also signalled additional policy action in 2020 to bring down borrowing costs for companies.
- Emerging-market USD bonds posted positive returns in January, with lower US rates offsetting the widening in credit spreads. In Asia, spreads tightened at first on hopes that dissipating tensions after the signing of the Phase 1 trade deal would encourage corporates to resume capex spending. However, the virus outbreak subsequently dampened risk sentiment, as analysts started downgrading their outlook on economic growth and stocks. In Asia, high-yield credit spreads widened by more than investment-grade ones.

Figure 5. Bond Indices Performance in USD

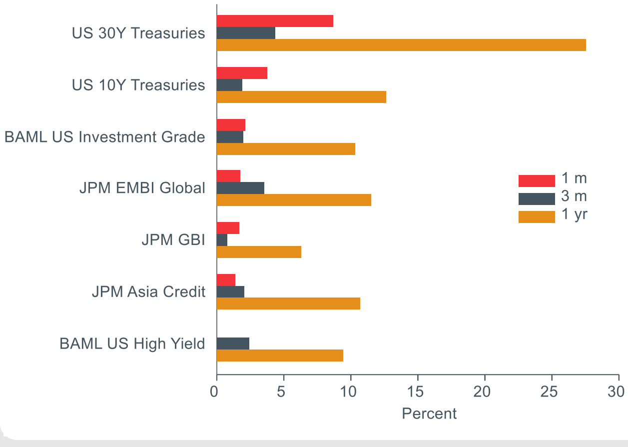
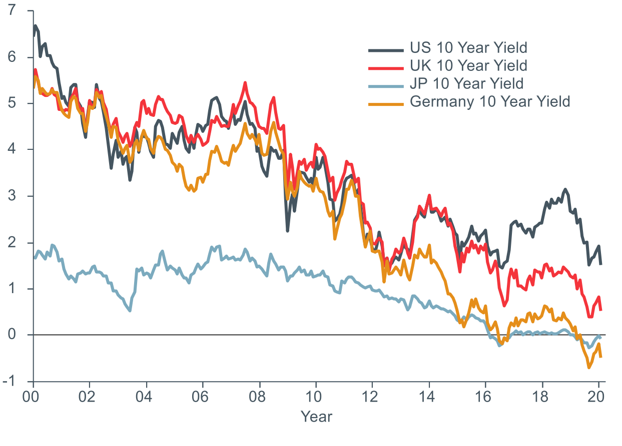


Figure 6. Key Bond Yields (%)



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of as of 31 January 2020. For representative indices and acronym details please refer to notes in the appendix. For representative indices and acronym details please refer to notes in the appendix.

Currencies

- The US dollar Index (DXY) rallied strongly in January (+90bps), largely reversing its sell off in December. While the greenback drifted higher in the first half of the month, it found additional support after the coronavirus outbreak which escalated ahead of the Lunar New Year holidays. As investors assessed the impact of the potential pandemic on global activity, they scrambled to hide within safe havens, shunning equities and buying bonds, gold and the US dollar.
- All G10 currencies depreciated against the USD, except the Swiss franc and Japanese yen, both of which modestly rallied 20-30bps owing to their "risk-off" nature. The AUD, NOK and NZD sold off the most among the G10 currencies, down more than 4%, more than reversing their rally in December. The Australian dollar was among the worst performers, losing 4.7% against USD, dropping to its lowest in over a decade. The sell-off was likely driven by a number of factors, including the bushfire crisis, and the economy's significant exposure to commodity exports and Chinese demand.
- Most emerging markets' currencies weakened against the US dollar in January following the risk-off sentiment. The South African rand, Chilean peso, and Brazilian real were the main underperformers, depreciating around 6% each. The South Africa rand, which had rallied late last year after Moody's gave the government three months to sort out its finances, gave up all of its gains made since November. The Chilean peso too, gave up its gains from December despite central bank intervention. Meanwhile, the Brazilian real, which has been under pressure throughout 2019, weakened to all-time lows. Among the Latin American currencies, the Mexican peso defied any risk-off move and appreciated by 40bps against the USD.
- In Asia, the Thai baht and Korean won depreciated the most. The Thai baht was impacted by expectations of weaker tourism activity following the spreading of the virus, particularly as it is one of countries' most-exposed to Chinese tourism. The Chinese yuan depreciated past the 7.0 mark once again when the market opened on 3 February after the Chinese New Year break.
- Several economists have downgraded Q1 growth expectations for China and the region, with expectations that a rebound is likely to occur in Q2/Q3. Interestingly, the Indonesian rupiah appreciated by 1.5% against the USD in January, led by better global data and bond inflows in the first half of the month. During the risk-off move from 23 January, the IDR did not depreciate in line with its peers, largely due to its relatively domestically-oriented economy, coupled with central bank intervention.

Figure 7. Currencies Performance vs USD

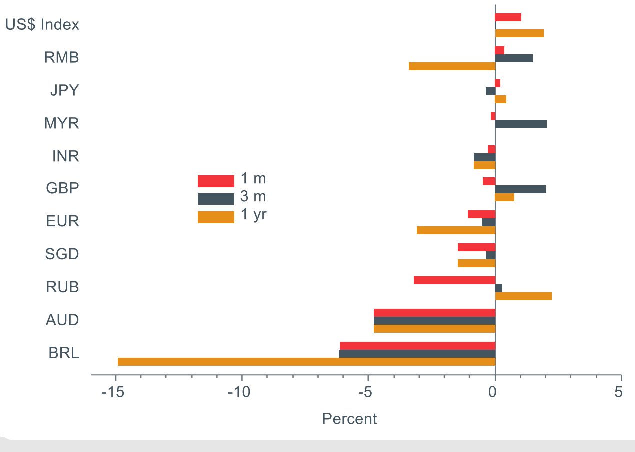
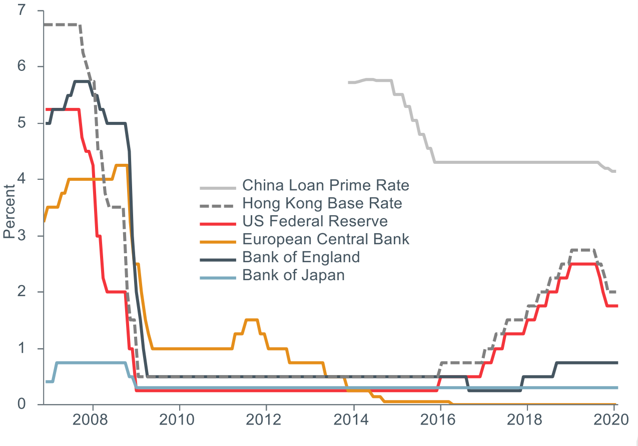


Figure 8. Central Banks Interest Rates



Source: Eastspring Investments. Chart data from Thomson Reuters Data stream as of 31 October 2019. For representative indices and acronym details please refer to notes in the appendix. For representative indices and acronym details please refer to notes in the appendix.

Commodities

- **Oil** prices were volatile over the month as first news of the Iranian general's killing caused a sharp spike in prices, particularly Brent, before settling back to its starting point. Then as news of the spread of the coronavirus accelerated, prices fell further on worries that the subsequent likely slowdown in the China economy would dent demand for crude.
- **Gold** prices rose to seven-year highs, somewhat defying other metal prices that mostly fell amid the twin pressures of middle east tension and the coronavirus. But the gains were modest as speculators drove up the price as a safe-haven bet, and shrugging off the hit to retail sales in China of gold, which are likely to fall as shoppers stayed at home during lunar new year celebrations.
- **Copper** hit five month lows with prices falling more than 10% as inventories jumped in London and Shanghai, and despite imminent closures in several African mines. Concerns over the impact of the coronavirus on economic growth also weighed heavily on prices in the final two weeks (Figure 10).
- **Iron ore** prices defied the metals slowdown and rose with indications that exports to China from Australia rose last year but aside this, it was a weak month for most metals. **Rodium**, a precious metal used to lower emissions in vehicles, surged more than 40% in the first three weeks on surging demand and amid an uncertain supply outlook.

Economics

- The **US** Fed kept rates on hold as expected and gave no indication of any imminent change ahead either, in line with market expectations. Fed Chair Powell did say it would start to scale back its bond purchases in Q2 once banking reserves were adequate. The US economy grew 2.3% in 2019, its slowest annual growth in three years but was inline with expectations.
- **Europe's** economic sentiment surged as confidence among manufacturers rose and unemployment fell again. The UK's consumer confidence survey hit the highest level in over a year and PMI data also improved as the post-election boom continued. The Bank of England kept rates on hold although said rates could still be cut if the confidence surveys didn't turn into stronger output data in the months ahead.
- **China's** factory activity measured by PMI slowed in January as exports fell and the coronavirus outbreak added to the lunar new year holidays to slow production. The index fell to 50.0 from 50.2 in December. Industrial production rose 0.6% in December while Retail Sales growth remained at 8%.
- **Argentina** cut its benchmark rate for the fifth time in two months, although it is still at an eye-watering 48%. **Mexico's** economy contracted for the first time in ten years with GDP falling 0.1% largely a result of lower investment levels.

Figure 9. Commodities Performance in USD

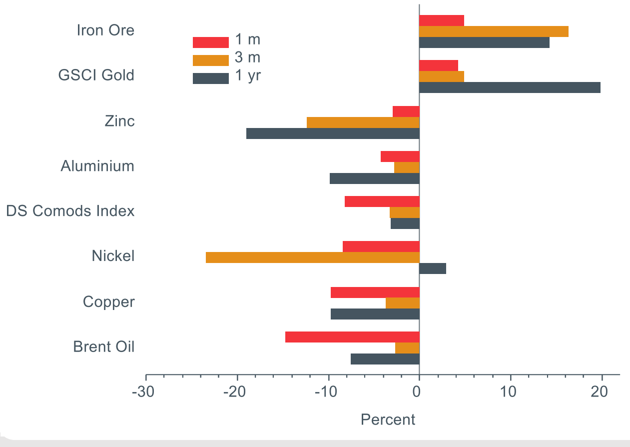
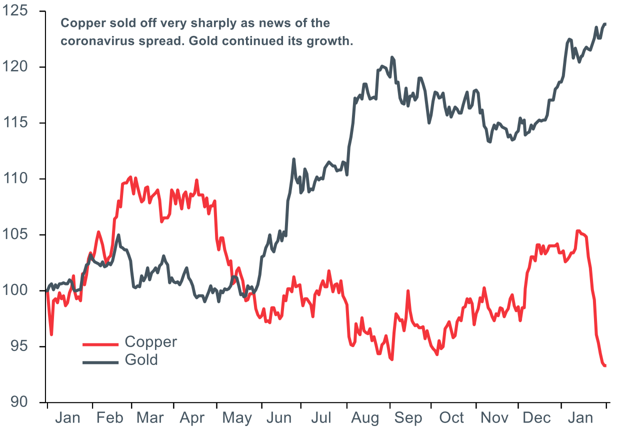


Figure 10: Commodity Prices, 2019-20



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 31 January 2020.

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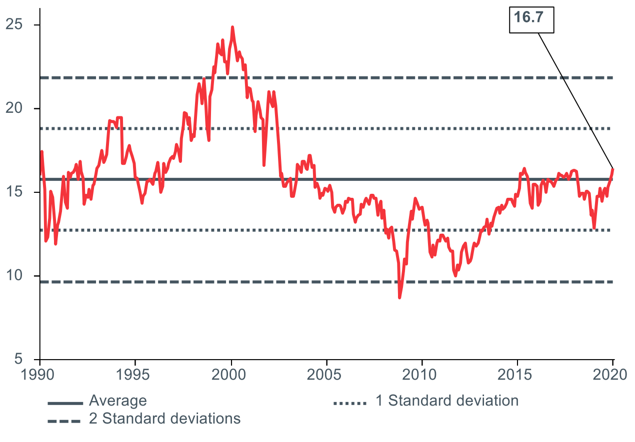
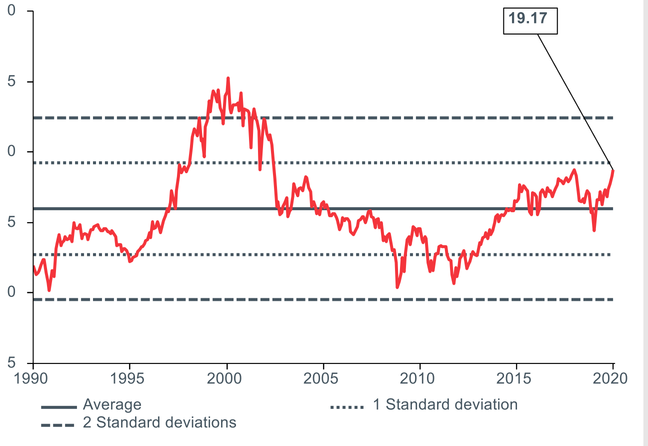
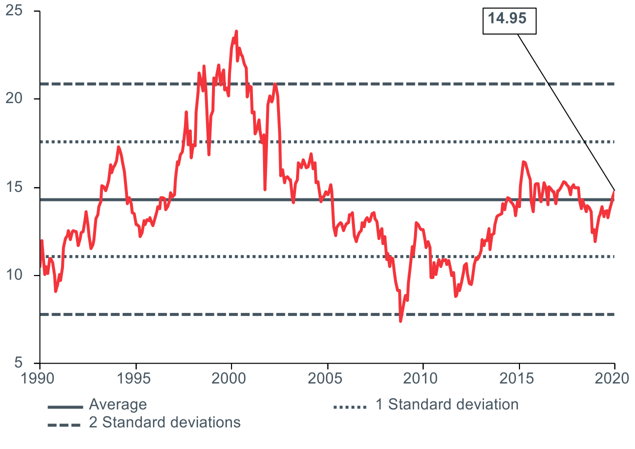
MSCI AC World 12M Forward PE



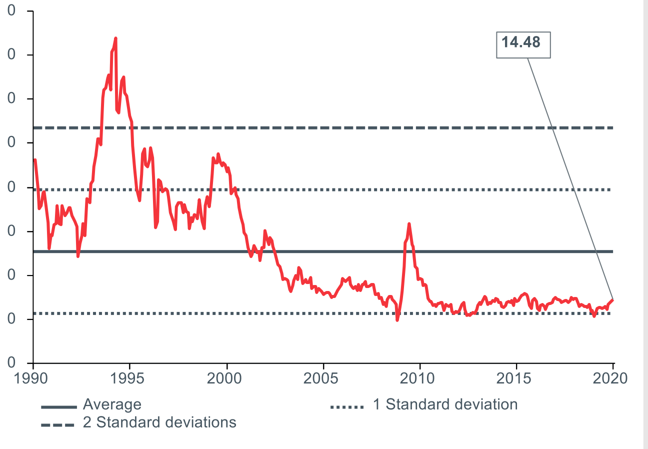
MSCI USA 12M Forward PE



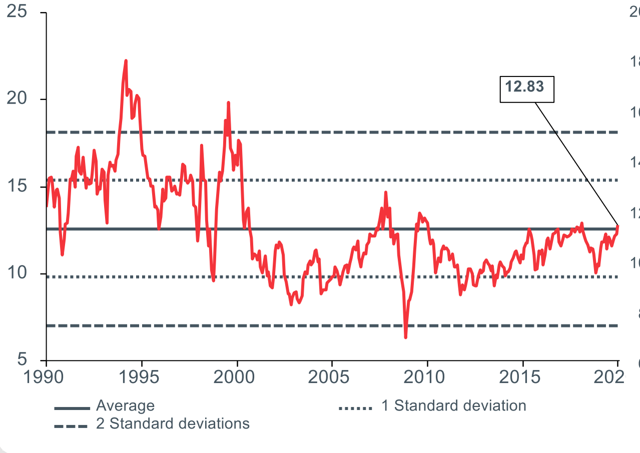
MSCI Europe 12M Forward PE



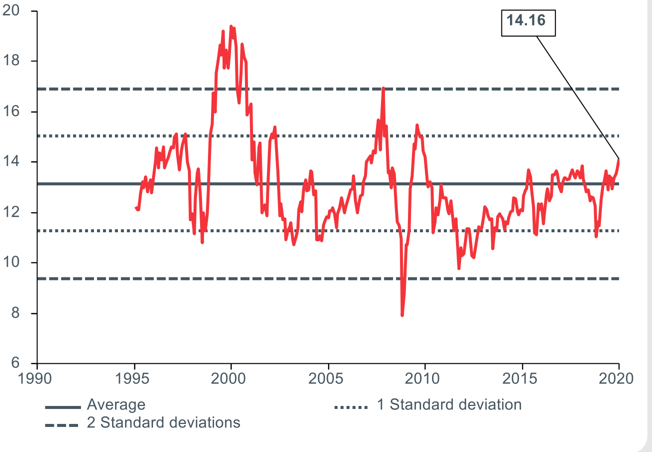
MSCI Japan 12m Forward PE



MSCI Emerging Markets 12M Forward PE



MSCI Asia Pac ex Japan 12M Forward PE



Source: Eastspring Investments. Chart data using IBES estimates from Refinitiv Datastream as of 31 January 2020.

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MSCI monthly, quarterly and year-to-date data

	Jan-20	Dec-19	Q4 19	Q3 19	Q2 19	Q1 19	2019	2018
World	-1.1	3.6	9.1	0.1	3.8	12.3	-1.1	-8.9
Developed World	-0.6	3.0	8.7	0.7	4.2	12.6	-0.6	-8.2
United States	0.2	2.9	9.1	1.6	4.3	13.9	0.2	-4.5
Europe	-2.5	3.9	8.9	-1.8	4.9	11.0	-2.5	-14.3
Japan	-1.4	2.1	7.7	3.3	1.0	6.8	-1.4	-12.6
Emerging Markets	-4.7	7.5	11.9	-4.1	0.7	10.0	-4.7	-14.2
Asia Pac Ex Japan	-3.7	5.8	10.6	-3.9	0.8	11.5	-3.7	-13.7
Asia Ex Japan	-4.4	6.7	11.8	-4.4	-0.6	11.4	-4.4	-14.1
Latin America	-5.6	10.4	10.6	-5.6	4.6	7.9	-5.6	-6.2
Brazil	-7.5	12.5	14.4	-4.5	7.2	8.2	-7.5	-0.2
EMEA	-4.8	7.1	10.0	-6.8	7.4	5.6	-4.8	-15.5

	Jan-20	Dec-19	Q4 19	Q3 19	Q2 19	Q1 19	2019	2018
Australia	0.1	1.5	4.4	-1.4	7.4	11.4	0.1	-11.8
New Zealand	-0.7	5.2	17.5	-2.8	4.0	16.9	-0.7	-3.5
Hong Kong	-4.5	4.0	7.3	-11.9	1.0	15.6	-4.5	-7.8
China	-4.8	8.3	14.7	-4.7	-3.9	17.7	-4.8	-18.7
Korea	-5.3	10.4	13.7	-4.5	-0.9	5.0	-5.3	-20.5
Taiwan	-4.7	7.5	18.0	5.9	1.1	9.0	-4.7	-8.2
Thailand	-8.6	0.9	-0.8	-5.9	9.4	7.5	-8.6	-5.3
Malaysia	-3.9	4.0	3.1	-6.3	1.2	0.3	-3.9	-6.0
Singapore	-3.5	3.2	7.5	-5.8	7.0	6.2	-3.5	-9.4
Indonesia	-2.7	7.1	7.0	-5.2	3.7	4.3	-2.7	-8.7
India	-0.8	1.5	5.3	-5.2	0.5	7.2	-0.8	-7.3
Philippines	-8.0	1.6	3.0	-4.6	4.6	8.0	-8.0	-16.1

	Jan-20	Dec-19	Q4 19	Q3 19	Q2 19	Q1 19	2019	2018
Mexico	1.4	4.8	6.3	-1.6	1.3	5.6	1.4	-15.3
Chile	-7.6	10.9	-8.8	-7.3	-4.9	4.4	-7.6	-18.9
Hungary	-10.7	9.7	22.2	-3.9	-4.1	6.0	-10.7	-6.1
Poland	-5.9	2.7	4.1	-11.7	3.6	-0.6	-5.9	-12.5
Czech Republic	-3.7	5.8	9.2	-9.5	3.9	3.8	-3.7	-2.2
Russia	-3.0	8.4	17.1	-0.9	17.3	12.2	-3.0	0.5
Turkey	1.5	1.9	0.0	11.7	3.1	-3.0	1.5	-41.1
South Africa	-8.8	9.7	13.2	-12.4	6.8	4.6	-8.8	-24.3
Qatar	-0.5	4.3	2.2	-0.2	0.6	-3.5	-0.5	29.8
Saudi Arabia	-3.0	6.1	3.3	-9.3	1.4	14.9	-3.0	19.2
United Kingdom	-3.8	5.2	10.0	-2.5	0.9	11.9	-3.8	-14.1
Germany	-3.1	1.9	9.9	-4.0	7.8	7.0	-3.1	-21.6
France	-3.4	3.0	8.6	-1.6	7.3	10.8	-3.4	-11.9
Netherlands	-3.0	3.7	7.4	2.5	6.1	13.6	-3.0	-12.8
Austria	-4.5	3.6	9.1	-3.0	3.1	8.6	-4.5	-23.2
Italy	-2.1	2.7	8.1	0.1	3.6	14.7	-2.1	-17.0
Spain	-2.7	4.2	6.2	-3.8	2.9	7.1	-2.7	-15.7
Greece	-4.9	2.9	12.7	-3.0	16.4	12.8	-4.9	-36.7
Portugal	4.7	4.8	8.7	1.8	2.6	10.2	4.7	-10.1
Switzerland	0.8	4.4	7.6	0.3	9.0	13.5	0.8	-8.2

Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 31 January 2020. Data and commentary prepared by Peter Bennett.

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