Commentary
**Markets**

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# What Just Happened?

## Where We Came From... And Where We Might Be Going

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Market moves are so violent now that almost any chart or table is out of date by the time it is published. What we have seen so far this year are market moves with a definite geographic tilt, with Asia now looking the least worst globally and Europe being the most underwater.

In a sense, the spread of the sell-offs has mirrored the spread of the virus itself, with Asia suffering first before recovering in relative terms, next Europe and then the USA falling victim.

If that pattern does indeed play out then we may well still have more weakness to come out of the US equity market.

### Sectors: An Uneven Landscape

Sectors have behaved in a similar way, with defensive sectors such as staples and healthcare — companies that make the things people need right now, such as toilet paper and paracetamol tablets — doing relatively well, and financial companies, like banks and insurers, and particularly energy stocks, suffering the most.

With interest rates now looking likely to remain historically low for a very long time, it's a much tougher environment than it was even six months ago for financials. And, with the oil price being crushed by the staring match between Saudi Arabia and Russia in the short term, it's hard to imagine that sector seeing any respite either.

One more subtle point is that the market reaction to this crisis, in equities at least, has been a continuation of the trends that we saw beforehand, but even more so — defensive sectors and technology outperforming at the expense of cyclicals.

## Factors: Risky Losers, Defensives Stronger

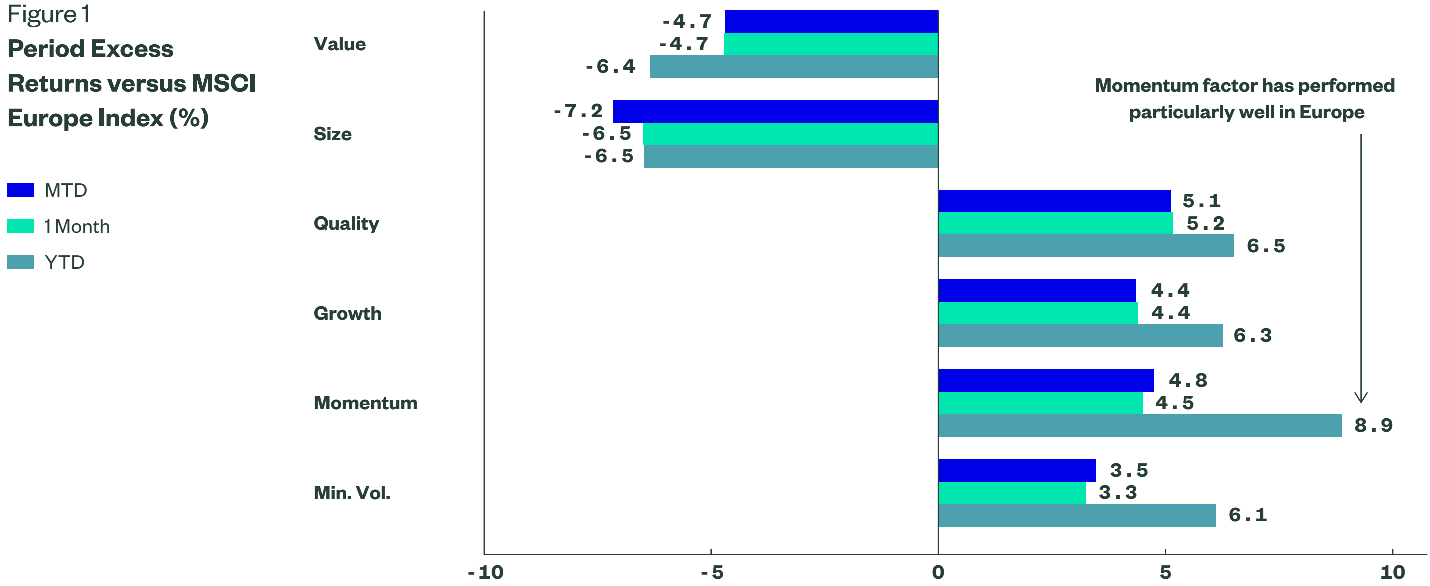
The same is true when we look at factors, which you can think of as the individual themes which drive stock price returns. There, especially in Europe, the Momentum factor has been the strongest year to date, meaning that stocks which were already doing well have continued to do well, and those that were lagging have continued to underperform.

More risky factors such as Value and Small Size, just like the riskier sectors, have continued to suffer in relative and absolute terms across geographies. On the other hand, Low Volatility in particular, as well as Growth and Quality have continued to outperform. In other words, as you might expect, investors have been selling stocks across the board, but selling more of the risky, and less of the defensive stocks.

Once again, given a view that rates will stay lower for longer, it's hard to see the same rebound to risk that we saw after the Global Financial Crisis in March 2009, and we would further venture that the recovery, when it comes, will be more measured and defensive than the junk rally we saw back then.

We hate to keep being the bearer of bad news, but it does not feel like we are out of the woods yet, and that it could get worse before it gets better.

Figure 1
**Period Excess Returns versus MSCI Europe Index (%)**




Source: State Street Global Advisors, Bloomberg Finance, L.P, as of 27 March 2020. **Past performance is not a guarantee of future results.**

## The 3 Waves of Crisis

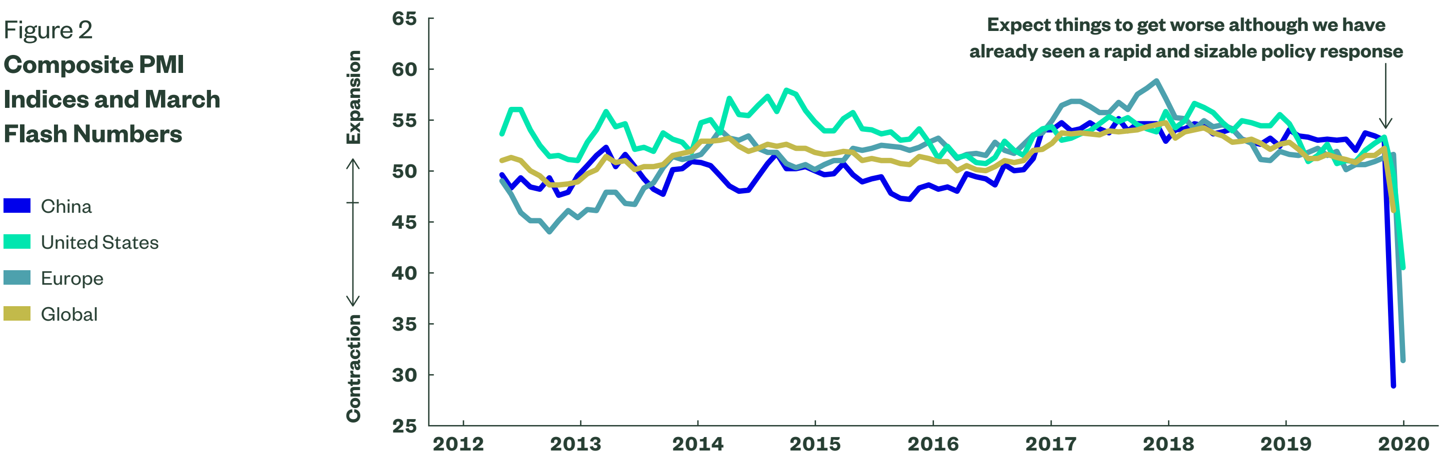
When a crisis like this hits, there are typically 3 waves of bad news:

1. The first wave is when people realise they have a problem and start discounting asset prices based on their changing expectations of how bad the problem could get. This time it started around 20 February, leading to the brutal, broad-based, and volatile sell-off of the following four weeks. The market behaved like a ball bouncing down stairs, falling steadily lower but bouncing off its lows on every step down.

2. The second wave is when economic data starts reflecting the scale of the problem — we have seen some really eye-popping numbers recently in unemployment claims and manufacturing and services activity to name a few. We believe that we are some (but not all) of the way through this second wave.

3. The third, and hopefully final wave, is when corporates start discussing the impact of the crisis on their business models and analysts start incorporating them into their forecasts. We don't believe that we've started this phase yet in any real way.

Figure 2
**Composite PMI Indices and March Flash Numbers**




Source: Bloomberg Finance L.P, Markit and Caixin as of 27 March 2020. **Past performance is not a guarantee of future results.**

## Where Are We Going?

We don't feel we've seen the last of the weakness. This is a medical emergency first and we believe it will take a flattening of the case and mortality curves globally before the market breathes a sigh of relief and moves on to finding value.

However, the silver lining is that once the virus abates, economies should be able to restart strongly, given the coordinated fiscal and monetary stimuli that are in place globally.

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