

# Multi-Asset

## Beware of being “Hooked on a feeling”

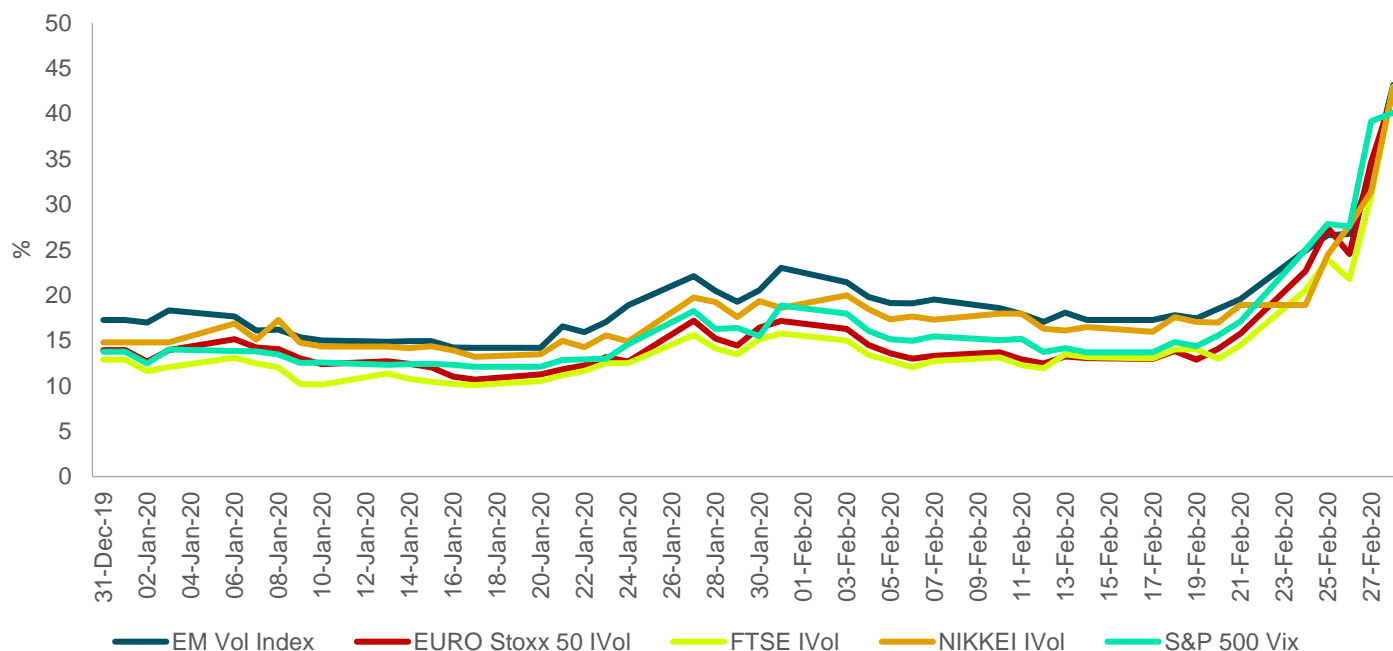
- February sees global equity markets turn sharply negative as cases of coronavirus continue to increase
- February saw the worst risk sell-off across assets and regions since the global financial crisis
- Market risks are high and fear is driving markets, investors should be flexible as opportunities might arise



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February saw equity market volatility increase sharply with implied volatilities breaching 40 having been sub 20 until the recent spike.

Figure 1: Implied Equity Market Volatility

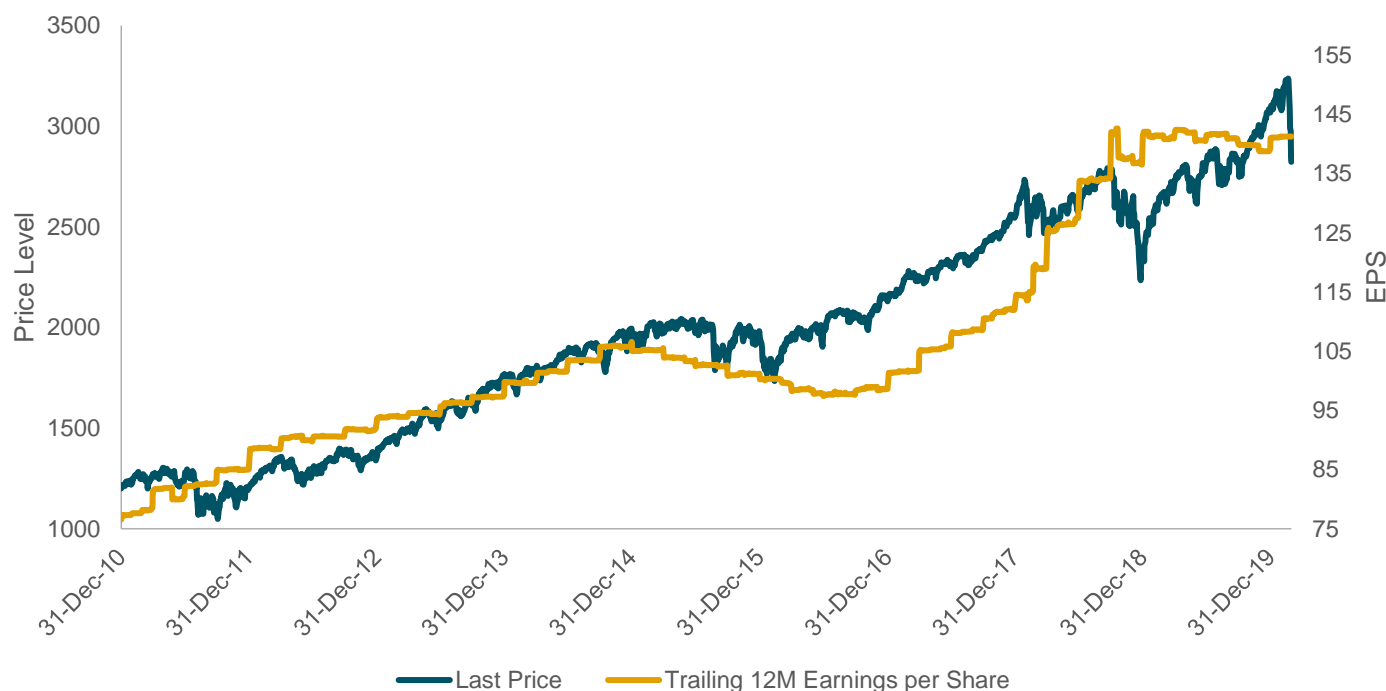


Source: Bloomberg Finance L.P., as at 28 February 2020. Past performance is not a reliable indicator of future performance.

With investor sentiment turning extremely fearful, markets quickly sold off at the end of February. February saw the worst risk sell-off across assets and regions since the global financial crisis (GFC) but there could be worse around the corner. With the current backdrop of increased number of cases of coronavirus being reported globally, it's difficult to see where equity market resilience will come from. Before the coronavirus took hold of market sentiments, prices had been ahead of earnings and strong earnings growth this year would have been

required to sustain equity markets. The recent pull back has brought market prices back in line with trailing earnings but forward looking earnings look likely to be dented. With earnings trailing off, market prices may drop and markets are likely to fall further.

Figure 2: MSCI USA Index



Source: Bloomberg Finance L.P., as at 29 February 2020. Past performance is not a reliable indicator of future performance. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

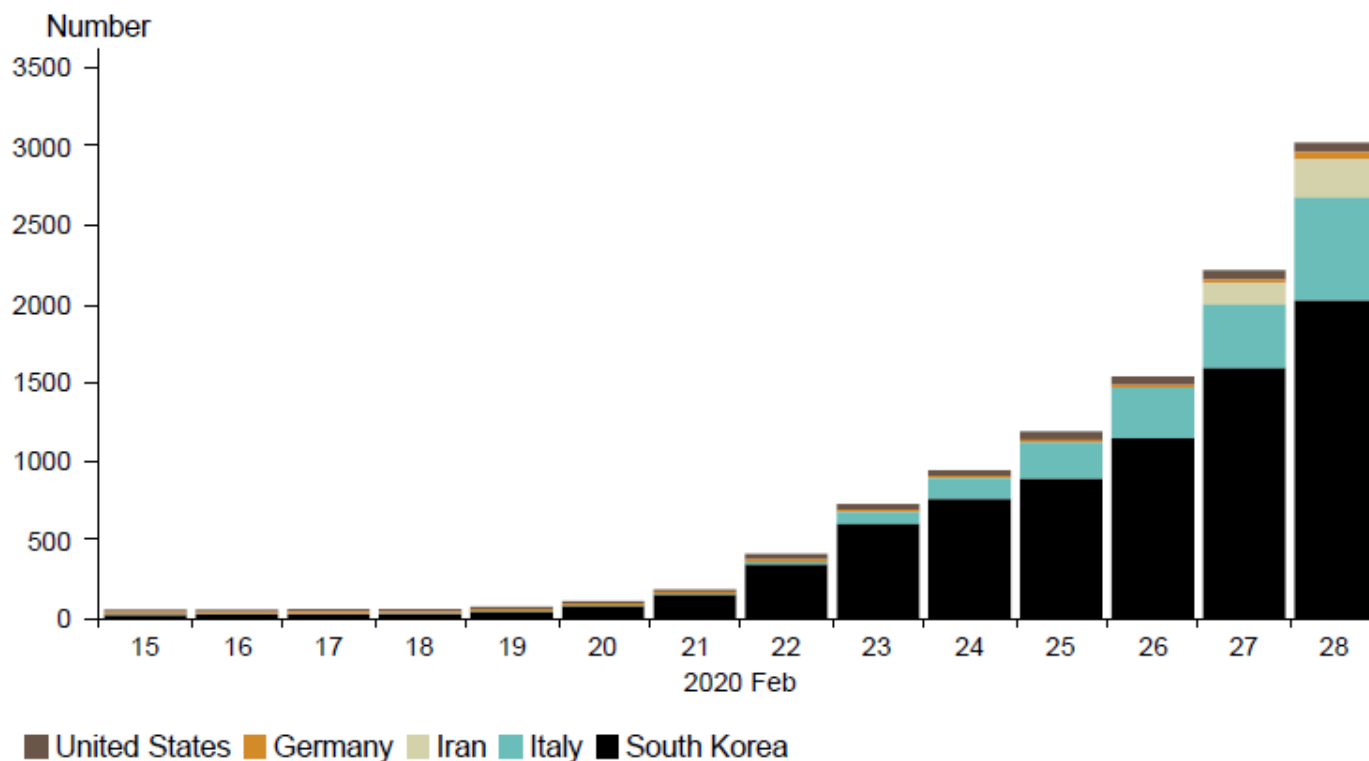
## How are Markets Reacting?

Markets are now quickly repricing news flows and the coordinated central bank policy response is only providing a temporary relief. Larry Summer is right when he tweeted, “Interest rates don’t cure the #coronavirus and interest rates don’t repair supply chains.”

Previously expectations were for a Q1 deterioration to global growth with the recovery coming in Q2. Now, global growth is more likely to be lower for the year and possibly half of previous expectations depending on how things evolve. When markets see through the central bank action and start pricing in the expected true extent and impact on growth, we might see markets move from correction into bear market territory.

Going forward, markets will likely be trading news. We continue to expect more volatility and choppy markets. What is concerning is the aggressive spread being seen outside of China. In China the virus has been relatively contained with the number of new cases on the decline. However the rate of the spread in Italy has been alarming. Italy had a 50% surge in new coronavirus cases and more new cases are now being reported outside China than within<sup>1</sup>. Initial cases are starting to be reported in the US where identification across states may be challenging.

<sup>1</sup> As at 11 March 2020. Sourced from: <https://gisanddata.maps.arcgis.com/apps/opsdashboard/index.html#/bda7594740fd40299423467b48e9ecf6>

**Figure 3: Novotel Coronavirus (COVID-19), Confirmed Cases**

Source: Macrobond, European Centre for Disease Prevention & Control

The overall market trend may still be downwards until there is more clarity around a cure and containment of the virus. Until then we will continue to see the negative re-pricing of global growth. Earnings will also be disrupted although how much is already priced in by markets is difficult to say with so many unknowns. China, the single largest contributor to global GDP has seen Purchasing Managers' Index (PMI) collapse to below GFC levels.

**Figure 4: China Manufacturing PMI SA Index**

Source: Bloomberg Finance L.P., as at 29 February 2020. Past performance is not a reliable indicator of future performance.

Factories are only just re-opening in China but the government has staggered their re-opening. Restoration of the supply chain will take time as they work through the built up inventories that had been pre-ordered prior to the Chinese new year.

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## How do you position for these kinds of environments?

These kinds of environments are evocative for many investors during the GFC and retail investors especially could be driven by feelings of great loss that they incurred at the time and so could be tempted to move to cash. That may protect them from further downside, and the next question they may have is how and when to get back in. Timing the bottom is fraught with risks and investors are equally at risk of being out of the market when sentiment rebounds.

Through the GFC, investors faced this exact scenario, selling on the way to the bottom and not having a mechanism to get them back in as markets rebounded. Investor sentiment, although not always reflective of investor positioning, can be one indicator that helps navigate these kinds of market environments. For our portfolios, we continue to monitor investor sentiment as well as the macro landscape and market fundamentals that drive our portfolio positioning and adjust allocations accordingly.

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## Portfolio positioning and performance<sup>2</sup>

In February, the main driver of markets and the cause that saw global equity markets turn sharply negative was increasing concerns surrounding coronavirus. It's impact cancelling out any optimism that was present on the back of an improving global economic profile. Previous expectations that the coronavirus impact would be short lived and the global economy would bounce back quickly evaporated with the market pricing in a more prolonged malaise.

During the month, global equity markets were negative with Europe (MSCI Europe Net total return local index) down -8.0%, Japan (MSCI Japan Net total return local index) down -9.6% whilst the US (MSCI US Net total return local index) was down -8.2%. Emerging markets (MSCI EM Index Net total return local index) had a negative month returning -3.8% outperforming developed markets on a relative basis. Australia was no exception with local equity markets (S&P/ASX 200 Net total return index) down -7.7%. Local based fixed income returns saw marginally positive monthly returns in February with Australian corporate bonds up +0.6% for the month after yields moved lower over the month.

Our investments in Emerging markets bonds was also positive for the month benefiting from a weaker Australian dollar. We also saw negative returns from our exposure to Commodities with the global economic impact from coronavirus being priced into demand expectations for the asset class.

Going into February, with markets not yet pricing in the extended impact of the coronavirus situation we maintained a healthy exposure to growth assets. Over the first three weeks of the month markets rallied before sentiment quickly turned as more cases of the disease began to be reported outside of China. Along with the deterioration in market risk sentiment, for the State Street Multi-Asset Builder Fund we de-risked the portfolio, reducing the growth asset exposure from around 62% to 45% through the last week of the month. Performance wise, our diversified exposures across equities, fixed income and alternatives saw the fund deliver a negative return in February as risk assets experienced a broad market sell off.

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<sup>2</sup>Bloomberg Finance, L.P. SSGA as at 28 February 2020. Past performance is not a reliable indicator of future performance. This information should not be considered a recommendation to buy or sell any security or sector shown. It is not known whether the securities or sectors shown will be profitable in the future. Characteristics are as of the date indicated, subject to change, and should not be relied upon as current thereafter. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

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