SEB

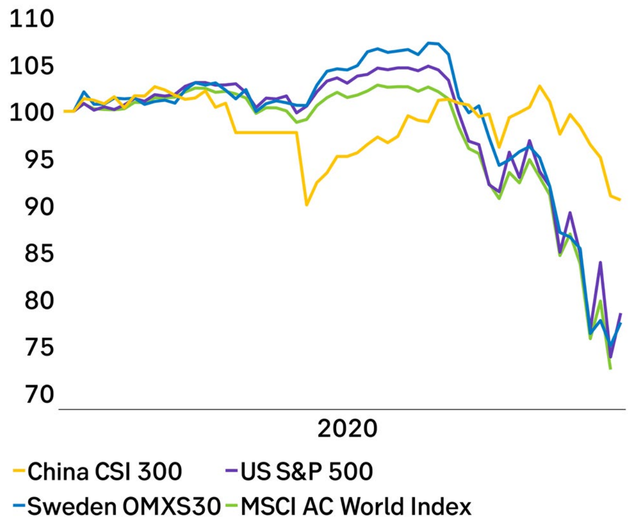
Extra Market Commentary

Massive global actions

The spread of the coronavirus and its effects are continuing to impact the world's financial markets. Massive responses by governments and central banks have so far failed to create calm. Market turmoil will probably last for another while, and there is a great risk of continued sharp fluctuations in both the stock market and the fixed income market. Yet for long-term investors, we still see good reasons to wait out the turmoil.

While fewer people are being infected by the COVID-19 coronavirus in China, the number of infected people is still increasing in the rest of the world. In addition to the human suffering that this creates, financial markets are greatly affected. In the United States, the stock market has plummeted by about 25% over the past three weeks – the fastest-ever decline of this magnitude. Other markets, for example in Europe, have also been severely affected. One factor that is fuelling further market worries is the recent sharp drop in international oil prices, which are now at levels similar to those of 2016, when the price also collapsed. Among other things, this is creating problems for the US oil industry, which needs far higher oil prices in order to be profitable. This has contributed to further stock market declines and turbulence in parts of the fixed income market.

Stock market performance so far this year



Source: Bloomberg/Macrobond

Massive stimulus packages and movement restrictions
In order to limit the spread of the virus, massive measures are being implemented on a global basis to influence the course of the disease, but also to soften its economic consequences. Many countries have chosen to follow China's example by shutting down large portions of their economic activities. They have banned large gatherings in theatres, restaurants, schools and other venues. People are being encouraged to work at home as much as possible and to avoid travel. Many countries in Europe and elsewhere have also closed their borders to non-residents.

Economic policymakers are also responding vigorously to the pandemic on an unprecedented scale. They are taking major steps to help sustain businesses and avoid accelerating unemployment and lay-offs. Central banks are cutting key interest rates and ensuring liquidity in financial markets. Governments are launching enormous stimulus packages. The list of official responses to the pandemic is long. Both central banks and governments have also announced that they are prepared to do more.

So why does the market remain so volatile? First, we are not yet seeing a stabilisation in the number of new COVID-19 infections in many countries. Many observers agree that there will be an endpoint to the spread of the epidemic, but as long as we don't see it, uncertainty will maintain its grip on markets. Second, there is concern that all the actions that have been taken are not sufficient, or even that the cure – official interventions that constrain many people's everyday lives – may be worse than the disease itself. But at present, the speed and scope of COVID-19's spread are the main factors governing the markets.

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The economy and stock market performance

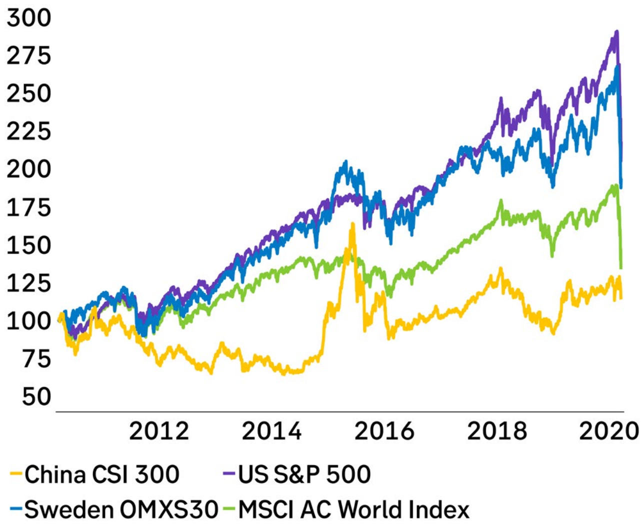
However, bright spots are visible. In China, there are signs that the number of infected people is decreasing. The country has started to re-open its business operations and factories. This means that there is hope that production in China will be back to a fairly normal level within a month or so. Positive signals are also coming from South Korea, which was hit early by the virus, and where we are now seeing a slowdown in its spread. Time is a critical factor in this context. If the rest of the world follows roughly the same scenario as China and South Korea, we still face a difficult period ahead of us, but then there will be potential for stabilisation. Our main scenario is a U-shaped economic trend – a rapid fall, followed by a delayed economic recovery. The robust measures being taken, and experience from China, nonetheless provide hope that an overly unpleasant scenario can be avoided.

The coronavirus will have a clear impact on the world economy, but if the rest of the world can follow the example of China relatively soon, the economy and production have good potential to recover towards the end of this year. A slowdown during the first half of 2020 may very well be followed by an acceleration again, driven by a pent-up need to recoup lost production and consumption – and fuelled by lower interest rates and the other stimulus measures that have been implemented and that will remain in place for some time. Prospects may then actually look brighter in terms of growth and corporate earnings than before the virus outbreak. In such a scenario, stock markets would probably be well above current levels a few quarters from now.

Conclusion

In the short term, there is still a risk of major stock market volatility. Today's turmoil in financial markets will probably persist until the rate of new infections slows. Governments and central banks are prepared to take further steps to curb the spread of the virus and support their economies as needed. Strong stock market declines may be triggered for a variety of reasons and are thus difficult to predict. However, past experience indicates that long-term investors will be rewarded for waiting out the turmoil we are now seeing.

Stock market performance over the past 10 years



Source: Bloomberg/Macrobond

We have a risk exposure of around neutral in the portfolios we manage. Naturally, we are prepared to modify this if the market picture changes. At present – because of the already large downturns – we consider it more likely that we are approaching a buying opportunity, even though today's market turmoil calls for short-term caution. If you are uncomfortable with the market situation and uncertainty, it may be wise to review the risk in your portfolio. Because of short-term uncertainty, cautious investors may want to hold off on risky new investments for a while.

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