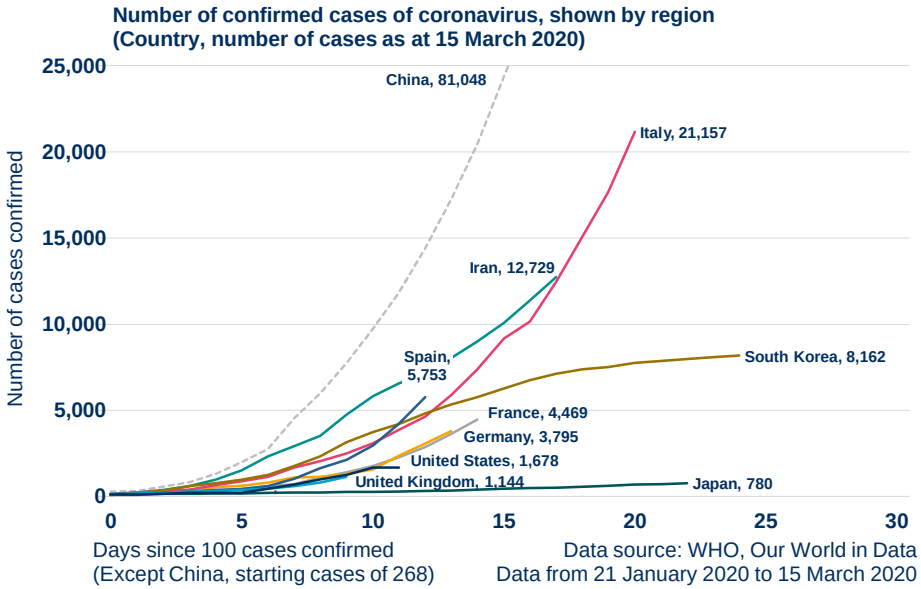
Coronavirus – update

16 March 2020

Since its initial appearance in Wuhan, China, the Coronavirus has since spread rapidly.



The majority of those affected experience only mild to moderate symptoms, but the disease can cause acute respiratory problems and, in some cases, death, with older age groups appearing to be at most risk.

The World Health Organisation (WHO) has declared a pandemic[1], with its director general stating: "This is not just a public health crisis, it is a crisis that will touch every sector". Many countries have resorted to extraordinary measures to slow the spread of the virus. Europe and the US are fast approaching lockdown, with bars and restaurants shuttered, flights grounded or turned back mid-air and national borders closed.

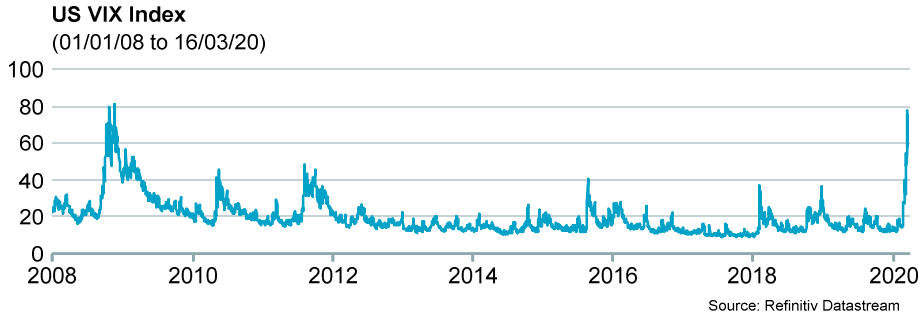
While first and foremost a tragic global healthcare crisis, the pandemic also has significant economic implications. It is both a supply shock – goods and services are not being made / provided – as well as demand shock – companies and individuals are not consuming as they normally would. In this note, we provide a summary of the impact on the global economy and financial markets so far, cover the response from policymakers and consider what this may mean for investors.

Impact on global economy and financial markets

Although China has to date been most severely impacted, the country's seemingly draconian response to the crisis has dramatically curbed the number of new infections. This has though come at significant economic cost.

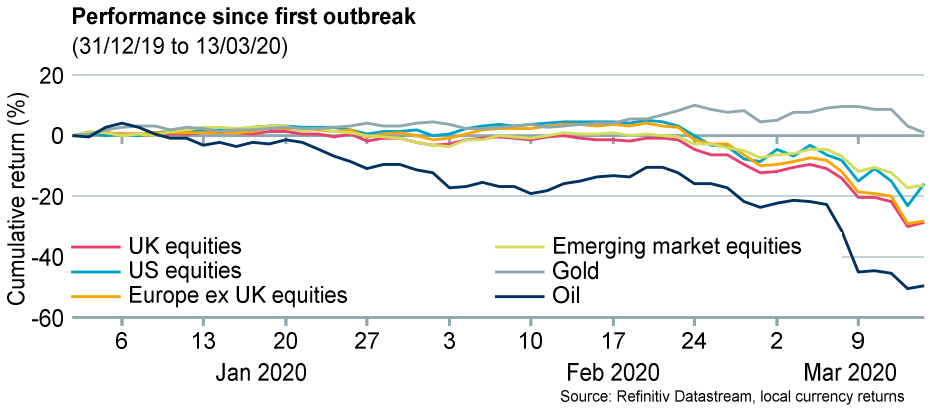
As the virus and the countermeasures against its spread have taken hold elsewhere, there has been an inevitable slowdown in economic activity. Consequently, the OECD has lowered its 2020 global growth forecast from 2.9% to 2.4%, below the 2.5% recessionary threshold often seen as the minimum needed to keep pace with growth in the global workforce. A "longer-lasting and more intensive coronavirus outbreak" could halve global growth in 2020 to 1.5%.

While policymakers scramble to mitigate the outbreak's effects (more detail overleaf), the uncertainty surrounding its economic impact has panicked investors. Early March 2020 saw the VIX index[2] (a widely followed measure of volatility – and fear) rise to around 80, experiencing its biggest five-day rise since the collapse of Lehman Brothers in 2008.

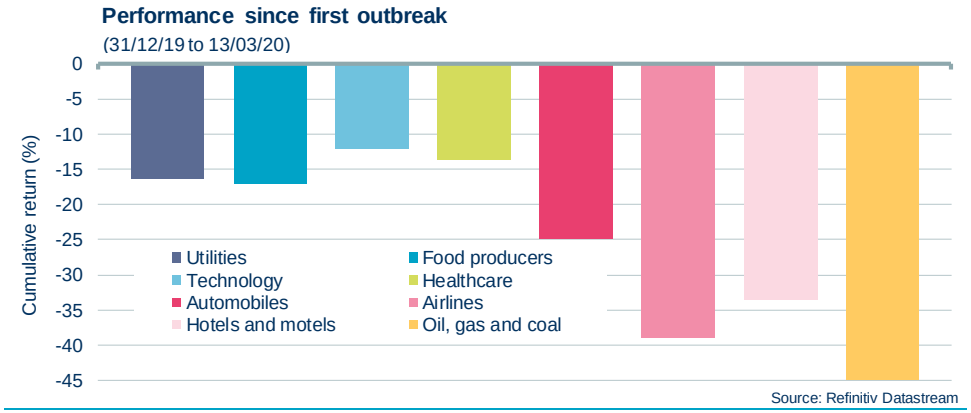


[1]According to the WHO, a pandemic is declared when a new disease for which people do not have immunity spreads around the world beyond expectations.

[2]The VIX index is a gauge that uses derivative prices to measure investors' expectations of swings in the S&P 500 index over the next 30 days.

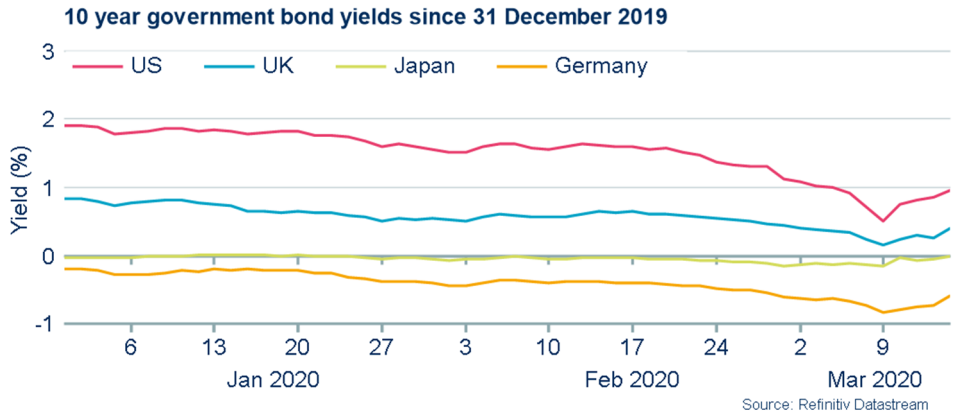


Major equity indices such as the Dow Jones and the pan-European Stoxx 600 have fallen by 30% or more (well into "bear" market territory) as has the FTSE which suffered its second worst day on record on 12 March 2020, closing down c11%.



At a sectoral level, travel-related industries such as airlines and hotels remain amongst the hardest hit. Flybe, which operated c40% of UK domestic flights, entered administration, on 5 March 2020, while major airlines are calling for immediate and significant government support in the face of what the industry sees as an existential crisis. Energy producers already faced a Coronavirus-induced demand slump. Things have got worse however, with attempts at a coordinated reduction in supply collapsing following a Russia / Saudi Arabia bust-up. The resulting oil pumping free for all has led to a huge drop in oil prices – and in oil company shares, with BP down by more than 40% since the start of the year. No major sector has fared well although Technology is down "only" around 12%.

Traditional boltholes have been the main beneficiaries of investors' risk-off mind set, most notably government bonds and gold. The flight to safety briefly pushed UK gilt yields below 0% at shorter maturities, whilst the 30-year gilt yield reached 0.5% in early March 2020.



What about the response from policy makers?

Simultaneous health, supply and demand crises have created unprecedented challenges for policymakers. In these circumstances, cash or cashflow is king. It is encouraging to see that many of the measures being implemented globally seem to recognise the real and immediate danger that otherwise sound enterprises could go to the wall unless money is made easily available to address temporary shortfalls.

Central banks have injected huge quantities of liquidity into markets, recognising the dangers to normal market functioning created by volatile conditions. The US Federal Reserve (the "Fed") has announced a $1.5trillion liquidity boost given 'highly unusual disruptions' to markets. Elsewhere, the ECB has also committed

to a €120bn increase in its quantitative easing programme this year, on top of existing arrangements to buy €20bn of bonds per month.

Liquidity is not only being made more accessible, it is also being made cheaper. On 11 March, the Bank of England reduced base rates by 0.5% to just 0.25%, the lowest level in history. This followed the Fed's 0.5% rate cut (to 1.0% to 1.25%), a rate which has been cut further by 1% (to 0% to 0.25%) over the weekend in what seems like a coordinated attempt by several central banks, including those of Japan, New Zealand and China – to calm market jitters – via a mix of interest rate cuts, liquidity injection and asset purchases.

In a budget speech that seems an age ago, UK Chancellor Rishi Sunak promised to do "whatever it takes" to support households and businesses, unleashing a £30bn fiscal stimulus package. The measures announced include statutory sick pay for those advised to self-isolate and a temporary coronavirus business interruption loan scheme (whereby banks can offer loans of up to £1.2m to support small and medium sized businesses).

Meanwhile, the European Commission has stepped up its efforts, announcing the creation of a €25bn fund to battle the crisis, German finance minister Olaf Scholz has pledged "unlimited" support for businesses while Italy's government has committed to a spending splurge. In the US, President Trump has proposed a "major" relief package in the form of a payroll tax cut, providing ~$1bn worth of support.

As noted, given the vital importance of providing cheap liquidity to both markets and companies, it is encouraging to see many of the measures that have been brought in by central banks and policy makers are focussed on that. One of the key challenges will be to ensure that it reaches those firms and individuals that need it – while lenders have the liquidity (and capital strength) to lend very cheaply, can central authorities convince them that doing so would not be throwing good money after bad?

It is clear that the virus is going to have a more serious and longer lasting effect on individuals, companies and economies than first thought. What is not at all clear is the speed with which things will develop and their specific impacts since that depends upon the response of individuals, companies and policymakers.

Key investment questions we are encouraging our clients to consider

Markets remain volatile and fast-moving. We recommend that investors focus on their own longer-term objectives and strategy. For most schemes, few major changes will be needed as allocations will have been sized appropriately and investments well-diversified.

However, there are some key practical questions that you may need to consider, such as:

- Should I rebalance my strategy (eg rebalance back into equities)? And, if so, how and when?
- Should I review my current hedging strategy and collateral position? Should I retain higher cash buffers or look to put money to work now as credit spreads are wider?
- Should I carry on de-risking (eg in line with existing de-risking policies), or should it be paused / slowed down? Should it be accelerated?
- Should I consider re-risking my allocation and looking to buy equities at the now reduced levels?
- Do I have sufficient liquidity for cashflow purposes – if I need to sell assets, do I need to review what I am selling?
- Should I proceed with any planned asset transfers, given the level of market volatility?
- Should I continue with any planned allocations to less liquid assets (eg private credit)? And, should I bring forward sales of any less liquid assets (eg property)?
- What opportunities have been (or will be) created by the market disruption, and how can I position to best respond?

It is certainly worth getting in touch with your consultant to discuss these questions, or any others that you may have, specifically for your scheme.

Paul Gibney
Investment Partner

+44 (0)20 7432 6653
paul.gibney@lcp.uk.com

Natalie Brain
Senior Investment Consultant

+44 (0)20 7432 7756
natalie.brain@lcp.uk.com