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Thoughts on Market Volatility Surrounding Coronavirus

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"The oldest and strongest emotion of mankind is fear, and the oldest and strongest kind of fear is fear of the unknown" - H. P. Lovecraft

A successful investor faces many hurdles, some of which are external and some internal. Monday's dramatic fall on the global markets - the worst in a single day for two years, or four years, depending on which major European or American equity index you wished to cite - could not fail to capture attention. Not that the world's most famous investor - Warren Buffett - was seemingly that impacted, as he observed in one interview at the height of the equity market slide: 'most people are savers, they should want the market to go down. They should want to buy at a lower price'.

Most of us like a bargain at a supermarket or a department store, but with the financial markets it is harder, especially if the fall has already impacted the value of an investment portfolio or pension fund. And whilst Warren Buffett certainly does not need to worry about whether his pension fund will be sufficiently large or not, the point he makes is a reasonable one for anyone with a time horizon beyond a handful of years.

It is usually at this point that a table is introduced or described citing how regular big falls are on the global equity markets and how over the medium or longer-term, even overt 'crashes' are mere pinpricks in a performance chart over time. There is a lot of truth in this, especially when you blend in natural diversification into a mainstream balanced portfolio. You may have seen the sharp rally in fixed income markets which pushed medium duration U.S. Treasury yields close to a record low and saw the entire German bund curve move to negative yields. The fixed income component of an average portfolio, therefore, typically made progress - which sounds like the classic role of a fixed principal investment in a diversified portfolio.

However, Warren Buffett spots a problem, talking about the benchmark ten-year U.S. Treasury he also noted earlier in the week that 'it makes no sense to lend money at 1.4% to the U.S. government, when it's government policy to have 2% per year inflation'. You cannot fault the thrust of his statistical analysis as one of the first lessons you learn as an investor, is that the typically lower volatility levels of a fixed principal investment often comes at the cost of offering no inflation proofing. The enthusiasm by investors for such ownership at such compressed yields reflects both fear in the current challenges to global economic growth levels in the early 2020s and faith that not only will central banks keep on resorting to stimulus measures (many of which involve buying bonds) but they will also not create inflation.

The apparent catalyst for the above-mentioned February market volatility: the COVID-19 epidemic. With notable outbreaks in countries as diverse as South Korea, Iran and Italy over recent days it is easy to see why the World Health Organisation (WHO) is now talking about a 'potential pandemic'. And unsurprisingly, more talk

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about a broader global impact highlights the risk of indirect supply chain exposures, which can impact even if a country (like the U.K. for example, with barely a double-digit number of COVID-19 epidemic patients cumulatively that have been or are currently receiving treatment) that has no need to impose notable travel or movement restrictions. After all, we already know that the pan-European equity markets have approximately double the sales exposure to China compared with U.S. equivalents, with the U.K. and German stock markets even more exposed due to (respectively) high weightings in the basic resources and automotive/other industrial sectors.

All of this rests on how far exactly a 'potential pandemic' goes - such is the nature of the fear of the unknown. Taking official statistics at face value, it does look as if China is starting to get on top of its COVID-19 challenges, especially outside Hubei province, with news that a total of 24 provincial-level regions across the country reported zero new cases, including municipalities with populations of more than fifteen million such as Beijing, Shanghai and Tianjin. And associated with this I am coming across more statistics showing the start of a rebound in Chinese industrial, consumer and general cyclical statistics, i.e. a sign of a step towards a long-awaited return to a semblance of normalcy. This is good news for the global supply chain and ultimately global equity markets, even if it does not fully answer or quantify the disruption elements during the first quarter of this year or beyond.

Overall, my feeling is that the folksy wisdom of Warren Buffett quoted above is about right. I still doubt whether COVID-19 issues are going to dominate markets in the early part of the 2020s. And when some of the areas that naturally do provide some defensive and diversification capabilities to portfolios are also struggling to be justifiable, then maybe tactical fear considerations have gone a little bit too far.

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