Intermediate report after Black Monday (09.03.2020)

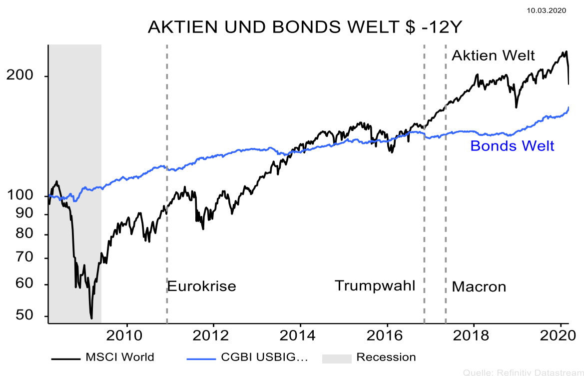
Prof. Dr. Josef Marbacher
Chief Economist

Shock and psychological factors rule the field

The financial markets went out of control on Monday 9 March. Wall Street had to interrupt trading a few minutes after it opened. Yields on investment grade bonds reached new lows. What happened? What comes next?

The rapid spread of the novel coronavirus outside of China has been causing market unrest for days. Volatility indices have reached values last seen during the financial crisis of a decade ago. In particular, the massive mobility restrictions extended across the country by the Italian government over the weekend up to 9 March have raised fears that other countries may face similar problems.

The rapid spread of the novel coronavirus outside of China has been causing market unrest for days. Volatility indices have reached values last seen during the financial crisis of a decade ago. In particular, the massive mobility restrictions extended across the country by the Italian government over the weekend up to 9 March have raised fears that other countries may face similar problems.



Reaction to this supply shock was violent. Already this year, stocks have lost over 20% of their value. In addition, there are currency losses for CHF and Euro investors. On top of this, risk premiums for all low-credit-rating investments have risen.

On a percentage basis, the losses are comparable with the stock market crash in the 4th quarter of 2018. At that time, markets recovered within a few days and the spectre had passed within a month. Can we count on similar developments at the current moment? There is reason for doubt. Let us take a somewhat closer look at the opportunities and risks ahead.

A range of factors could lead to a positive change:

- The oil price could practically be raised by a simple telephone call: a talk between Russia and Saudi Arabia would suffice. History shows, however, that this kind of price war can stretch out for months, not least because both parties are following the shared goal of driving troublesome competitors in the fracking industry out of business.
- Some calm could return to the markets if medical tests achieve a breakthrough against the coronavirus. Results cannot be expected before the end of April, however. In addition, it will be months before sufficient production capacity has been built up.
- The reports from China are also promising. The number of new cases there has markedly reduced. In addition, production capacities have increased in stages. International supply chains are being reconstructed. From this we can conclude that at least the OECD states should succeed in bringing the spread of the virus under control in time. However, the Italian example leaves some cause for doubt. The death rate in Italy is nearly twice that in China.
- A positive effect will also be had by the political measures that are currently being prepared worldwide. These include massive support for SMEs, which have fallen into liquidity difficulties due to the fall in demand. This is intended to slow down a wave of bankruptcies and redundancies with cumulative effects along the line.
- Monetary policy also has little leeway. We assume that the USA will lower interest rates before the summer holidays to below one per cent. The effect of these interest rate cuts cannot, however, be compared with the interest rate manoeuvre of the FED in January 2019, which gave an immediate boost to the stock market.

A series of negative factors stands against it:

- In the near future, we will be confronted by lower GDP forecasts
- The coming reporting period of the company will be characterised by downward revisions of earnings
- Consumer sentiment and investment readiness could also come under pressure
- Particular problems could arise if the USA is more seriously affected by the corona crisis than it has been so far. As is well known, the supply of test devices has been massively delayed. A dramatic leap in the number of cases would have serious effects in that the health system would be designated as off limits to a large proportion of the population. This is a situation that could rapidly find its expression in high death rates. Panic among the population and drastic mobility restrictions could be the result. This would in any case bring a sudden end to the longest global economic upturn in history

How can these factors be weighted?

Over the short term, we consider the downside risks – regarding the collective depression of the global economy – for more important. In the medium term, however, positive factors will win through.

In terms of investment policy, this means that caution is advised. Because of equity correction, the share quota is around 20% below the neutral position. This underweighting will be maintained until situation changes in favour of the positive factors. At best, this could take place before the next regular situation report by mid-April.

Strategic and tactical Asset Allocation for the 1st Quarter 2020

	Reference Currency CHF			Reference Currency EUR		
	Investment strategy Balanced			Investment strategy Balanced		
	SA	IC	C	SA	IC	C
Investment categories						
Money market	**5**	**6**	**+2**	**5**	**6**	**+2**
Bonds	**40**	**38**	**-2**	**40**	**38**	**-2**
Home Country	24	23	-1	23	22	-1
Rest of Europe	8	7	-1	5	4	-1
USA	4	4		8	8	
Rest of World	4	4		4	4	
Stocks and shares	**45**	**45**		**45**	**45**	
Home Country	9	8		15	13	
Rest of Europe	11	9		6	5	
USA	12	13	-1	15	13	-1
Rest of World	13	15	+1	9	14	+1
Alternative investments	**10**	**11**		**10**	**11**	
Commodities	4	4		4	4	
Various	6	7		6	7	
Total	**100**	**100**		**100**	**100**	

SA = Strategic Asset Allocation IC= Investment Committee C = Change