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Global Strategy Bulletin

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COVID-19, Investing and the Economy: Observations. Market Views and Recommended Actions

TO BE READ IN CONJUNCTION WITH: COVID-19, Investing and the Economy: 20 Questions and Answers

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Observations

- COVID-19 is expressing itself as a pandemic. The shock to the global economy due to the economic, social and health impacts of COVID-19 are significantly impacting markets globally. World equity markets have quickly fallen into “correction territory” and US bond yields have fallen to record lows.
- We believe for the next 2-4 months, given the speed of disease and information transmission, disruptions to the economy will be severe, as people and businesses act to minimize infection and ensure continuity of business. The primary source of negative economic impacts result from travel restrictions, supply chain interruptions, absenteeism, government interventions and other behavioral changes aimed at preventing infections.
- Our US and Global EPS estimates have been revised downward for 2020. We now expect year over year declines in EPS in 2020 of 4%. We expect US and global GDP growth to fall to 1-2% in 2020 with rolling impact in the first half before a rebound begins in the second half.
- If the 2020 Chinese and Asian experience are a guide, European and US credit and payment transactions volumes could drop by +/- 10%, as retail sales, business to business transactions and slower supply chains all create a “one time” slowdown in these economies.
- COVID-19 will not cause a global recession, in our view. Instead, COVID-19 likely represents a severe, one time global disruption to economic activity that forces economies off their usual, positive growth path temporarily. In the case of an exogenous shock, we expect the longer-term buying intent of consumers and business to remain intact. The health of consumers, business and bank balance sheets prior to the health crisis gives us confidence that this is more likely than not.
- We expect that in addition to Central Bank monetary easing (which will have longer term benefits), like the US Fed’s 50 basis point emergency action, governments will undertake fiscal actions in the form of tax relief, payments to small/medium sized businesses and other programs to mitigate damage to businesses and individuals from the sharp, short-term drop in their receipts.

Market Views

- Our base case sees a higher than average probability for another “leg down” in markets. We would view a correction closer to 20% overall as compensating for the significant COVID-19 shock and uncertainty.
- While one can argue that global equities have fallen in line with our EPS estimates, there can be an overshoot given the significant uncertainties. Many western market participants have not seen the actual impacts to their daily lives and

businesses reach their shores. There are likely to be temporary shortages of medicines, food and some consumer goods. There are also likely to be visible strains on the health care systems of deeply impacted cities and communities.

- Looking out 12 to 18 months we see the potential for a significant rebound in share prices and positive turning points for other asset classes. It is far easier for major economies to rebound at higher-than-usual growth rates from exogenous events than from recessions (please see our full report for examples).

Recommended Actions

- Leaving Core Portfolios intact is our strongest recommendation at this time. Citi Private Bank believes -- and our extensive analysis confirms -- that long term investing creates the best investment results for investors. Market timing can be especially damaging to long terms returns in periods of instability like this. Strategic asset allocation is the first line of defense for long-term investors to an unanticipated shock.

- Global health crises have had a short term negative impact on markets, followed by a substantial rebound six months later. (**See Figure 1**) We expect the same pattern to be true here. However, the COVID-19 crisis will be a global pandemic and of greater impact that any of the listed prior health crises. As such, we expect this to be a U-Shaped and not a V-shaped recovery. The bottom of the "U" is likely to be a period of 3-4 months when the economic impacts will roll across the globe from Asia to Europe to the US and the Americas.

Figure 1: Market Performance In Past Viral Epidemics

Illness				S&P 500		MSCI AC World Ex-US	
	Start		End	Worst Period	Six months Later	Worst Period	Six months Later
SARS	15-Jan-03	to	11-Mar-03	-12.8%	27.8%	-12.9%	32.8%
Avian Flu	23-Jan-04	to	12-Aug-04	-6.9%	12.6%	-6.8%	20.7%
MERS	1-Sep-12	to	15-Nov-12	-3.8%	22.0%	0.8%	15.6%
EBOLA	31-Dec-13	to	3-Feb-14	-5.8%	11.3%	-5.5%	7.8%
Zika	6-Nov-15	to	11-Feb-16	-12.9%	19.5%	-14.7%	18.0%
Coronavirus	20-Jan-20	to	3-Feb-20	-12.8%		-12.0%	

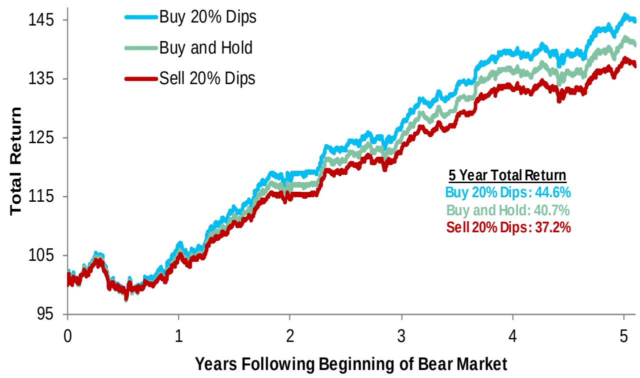
Source: Bloomberg, FactSet, Haver Analytics, March 6, 2020. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only. Past performance is no guarantee of future returns. Real results may vary.

- For new money, our best advice is to step into markets now, with one-third of capital to be invested with additional capital deployed over the next few months. In the event of another "leg down" in global equity markets – an event we believe is likely – we would invest all of the remaining amounts. Given our view that the COVID-19 situation is a large, unexpected shock, we understand investors may be wary to step in. That is why we advise investing when markets are being sold broadly and indiscriminatingly. Our fixed income exposures will be underweight overall, with an overweight to US fixed income for now**.**

- For Opportunistic Investors, this window for investment will create specific opportunities to buy dividend growth shares, "unstoppable trend" baskets and emerging market opportunities at attractive prices. Among our 2019 Unstoppable Trends list, weakness in healthcare shares seems irrational given the industry's lack of economic sensitivity. Cybersecurity software provider equities have weakened somewhat, as have fintech shares. Finally, after the 2019 trade war impact and the trade deal with the US, it is not hard to understand why Chinese equities have been outperforming. In the event of a pullback in prices, Asia shares can be accumulated.

- As discussed in our report It Is Better to be a Buyer Tomorrow Than a Seller Today, even when we do not know the full extent of an oncoming shock, 1-, 2- and 5-year forward returns improve systematically after reallocating a greater weight to equities following broad drops in equity prices of 20% (**See Figure 2**) This insight is based on the experience of US equities over the past 55 years including the systemic crisis of 2008-2009 and other far worse periods for the economy than we are experiencing presently.

Figure 2: Impact on 5-Year Returns from Buying/Selling after 20% S&P 500 Decline



Source: FactSet as of March 6, 2020.

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[1] According to the US's National Bureau of Economic Research Business Cycle Dating Committee, recession is a "significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.

Malcolm Spittler, Joe Kaplan, Maya Issa and Joe Fiorica contributed to this report.