

What next for markets?

Publié le 24 mars 2020

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Individuals, economies and indeed financial markets are going through a difficult period with countries around the world on war footing to tackle the coronavirus. Managing risks and uncertainties is challenging for investors in this environment and there are no easy answers. In this blog, we share our thoughts on market volatility and the response from policymakers. We then offer our insights on how investors could position their portfolios to navigate through these times.

A new peak for volatility

The CBOE Volatility Index (VIX), an important barometer for market volatility, has reached new highs exceeding levels attained during the global financial crisis (Figure 1). In the past, such severe spikes in volatility have been short-lived but average volatility levels can be elevated or subdued over prolonged periods. The average level for VIX in 2019 was around 15.

Source: WisdomTree, Macrotrends. Data as at 18/03/2020. VIX Index refers to the Chicago Board Options Exchange's (CBOE) Volatility Index. You cannot invest directly in an index.

Historical performance is not an indication of future performance and any investments may go down in value.

The economic ramifications of closed borders and entire cities in lockdown across the world will become visible in the coming months. What is clear already is that businesses, small or large, are already taking a direct hit. These businesses will need support to bounce back and, even then, not all will survive. Thus, volatility can be expected to remain high in 2020- or at least higher on average compared to 2019.

Response from policymakers

Central banks have rushed in with their usual tools of policy response. The US Federal Reserve and Bank of England have made emergency rate cuts in March and the European Central Bank (ECB) has announced additional bond purchases of €750bn. But with interest rates now close to 0 in many developed markets, policymakers have realised the need to implement additional fiscal stimuli as well.

The US government has indicated it will seek Congress support for an \$850bn fiscal stimulus while the UK government has pledged a £330bn business loan package. We believe we are likely to see more governments announcing fiscal measures to support ailing businesses and help lift the economy during this difficult period.

A time to be defensive

How investors respond to the prevailing market volatility depends on several factors including their risk appetite and their investment time horizon. Some may choose to trade tactically and others may seek attractive entry points for long term investments. In this blog, we will highlight some of our best ideas which could be considered to help build potentially robust strategic portfolios in light of current market conditions. We will draw on various ideas introduced by Pierre Debru in his defensive assets [blog series](#) and emphasise why a defensive approach has become increasingly relevant and important.

Gold gets the top medal

Our top pick among defensive assets is gold which has historically offered effective downside protection. Over the 10 worst quarters for European equities in the last 20 years, gold has had 7 quarters of positive performance¹. Gold is perceived by investors as a real store of wealth making it particularly attractive when financial markets are in turmoil. In our recent [gold blog](#), we discussed how the price weakness in gold in recent days is testimony to its safe haven attributes as investors have turned to gold for liquidity in the wake of stock market declines. Something similar happened during the global financial crisis when gold initially fell in October 2008 due to margin calls and liquidity needs but subsequently rose 170% by August 2011². During bull markets, gold offers a hedge against inflation making it a well-balanced asset and an important tool for strategic asset allocation.

The right kind of duration

In our [fixed income](#) blog from the defensive assets series, Pierre Debru highlights how long duration government bonds offer an attractive balance between downside protection and upside capture. When rates are falling, these assets perform strongly as longer duration gives them more interest rate sensitivity. The upside can be captured by tilting towards enhanced yield approaches which deviate from market cap weighted benchmarks to capture a higher yield.

A haven among currencies

Among currencies, the US dollar is typically a go-to safe haven for investors during times of heightened market volatility. Following an initial blip recently, it appears that the greenback is gaining strength again (Figure 2). The US dollar strengthening despite the Federal Reserve's rate cut is an early indication of it playing to its safe haven characteristics.

Source: WisdomTree, Bloomberg. Data as at 18/03/2020. You cannot invest directly in an index.

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Commodities - the only way is up?

Cyclical commodities have been hit heavily by the market downturn led by oil which is now pricing in significant demand destruction caused by the economic impact of coronavirus globally (Figure 3). It is also pricing in additional supply as the Organisation of the Petroleum Exporting Countries and its partners (OPEC +) were unable to agree on implementing measures to balance the market following their [meetings](#)

earlier in the month. Oil will still be needed in a post coronavirus world and price wars among oil exporting countries, in our opinion, are unsustainable. Thus, risks to oil prices appear skewed to the upside given where we are today.

Source: WisdomTree, Bloomberg. Data as at 18/03/2020.

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Similarly, industrial metals are also pricing in significant weakness in demand. The Bloomberg Industrial Metals Subindex is down nearly 20% year-to-date as of 19 March. If governments make good on their promise of inducing fiscal stimulus and economies bounce back after emerging from a lockdown, industrial metals could experience a boost in demand.

An all-weather approach to equity

Equity markets have had it tough in the last one month. We believe a defensive approach with a **focus on quality** is a robust way to get core equity exposure which serves as an all-weather investment. Our definition of quality focuses on profitability, long term growth and lower leverage. Businesses with these strong fundamentals typically have a better chance of withstanding stress and re-emerging strong on the other side. Thus, an emphasis on quality can potentially provide a good capture ratio, i.e. defensiveness in the downside without giving up too much of the upside.

The coming weeks and months will continue to pose a great deal of uncertainty to the global economy and financial markets. Some of the ideas mentioned may help investors navigate through the volatility.

1,2 Bloomberg as of 18 March 2020

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