

The world reels as the Covid-19 virus spreads

February 2019

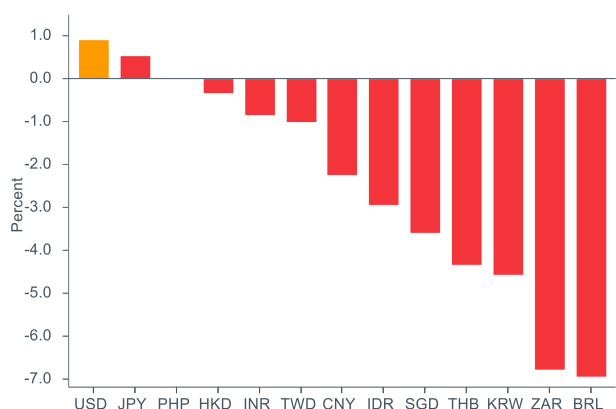
The World in five bullet points

- ▶ The world reeled in reaction to the spread of the **Covid-19 virus** as investors feared the hitherto contained epidemic could become a global pandemic, and trigger a worldwide recession. In the final week, more new patients were recorded outside China versus inside for the first time as Italy and Korea struggled to contain its spread. Equities everywhere sold off aggressively as did bond yields, commodities, and Emerging Market currencies. In contrast, classic safe-haven asset classes performed well with the US dollar, Swiss franc, gold and some defensive sectors either rising in absolute terms or outperforming as investors sought sanctuary as the virus spread.
- ▶ The **impact of the virus on the markets** was felt in developed countries for the first time after hammering Emerging Markets in January. The US saw its MSCI index fall 8.2% with the S&P 500 and Dow Jones indices also seeing their worst week's, and worst month's losses, since the GFC. France fell 8.9% and Germany – perhaps the most exposed eurozone economy to China – falling 9.2%. Emerging Markets also fell but China was a notable outperformer as the number of new virus patients there began to slow and the government introduced a series of monetary and fiscal stimuli.
- ▶ As well as a substantial hit to the equity market (see Equities section below), the **currency markets** had a volatile month, and gave a “double-whammy” for Emerging Market equities as every major EM currency fell against the US dollar (Figure 2). The greenback became a “safe-haven” asset amid the turmoil as investors bet the virus’s spread would impact EM economies first and hardest. At the end of the month, China said its manufacturing PMI for February had fallen to 35 and its Services sector to below 30, pointing to a substantial slowdown in the economy.
- ▶ **Central Banks** began reacting to the likely macroeconomic hit with China lowering its Loan Prime Rate by 10bps, adding to a plethora of smaller-scale stimuli and giving further supportive hints at month end. Indonesia and the Philippines cut by 25bps as did Russia, Brazil and Mexico although Korea's CB did not, against expectations, preferring to adopt a wait-and-see approach. By the end of the month, US Fed Fund Futures were also pencilling in 50bps of cuts with a single half percent cut suggested for March.
- ▶ In news away from the virus, **Malaysia's** prime minister Tun Dr Mahathir resigned then was immediately appointed interim PM by the country's king, giving him time to form a new coalition. However the move seemingly backfired as within days the king promptly appointed a rival, Muhyiddin Yasin, as PM. It was enough time for Dr Mahathir to announce a Rp20bn stimulus package for the economy, but not enough time for its stock market to recover as it hit 11-year lows.

Figure 1. MSCI AC World Index



Figure 2. EM Currencies since 20 January



Equity Markets

- ▶ **Global equity markets** had their worst month since the 2008 Global Financial Crisis on fears the Covid-19 virus could turn into a pandemic, triggering a global recession. Hopes the spread of the virus would be contained to China were dashed as infections spread to Europe then the US, with Wall Street aggressively selling off in the final few days of the month; records broken included the S&P 500 seeing its worst one-day sell off in more than a year.
- ▶ The **MSCI US** index is now almost 8% lower year to date, almost matching the drawdown in Emerging Markets. In February, **US** indices endured their worst week since 2008 on worries the Covid-19 virus would spread to the US, and compounded by weak PMI figures as well as Bernie Sanders' surge in the Democratic Party polls.
- ▶ In **Europe**, Italy's struggles in containing the virus's spread led to worries of recession there as well as in the greater eurozone region which again saw weak economic data for Q4. The MSCI Europe index fell 9.3% with Germany down 9.2% and the UK leading the fallers with a 11.9% drop as the spectre of a no-deal Brexit resurfaced.
- ▶ No region was spared the sell off. The MSCI **Emerging Markets** index lost 5.3%, a modest outperformance versus the MSCI Developed index but only as China outperformed to gain 1.0% after its industrial core started to return

to work and the PBoC introduced monetary and fiscal stimuli. Elsewhere in Asia, markets were hurt again by the strong US dollar (see Currencies below) as well as fears the virus's impact would affect macro economic growth. Worst hit was **Thailand**, down 12.2% to make it -19.7% for the year to date, as weak economic data added to the collapse in Chinese tourist numbers. **Indonesia** lost 11.9%, **Malaysia** (-6.4%) and **Korea** (-7.4%) with the latter driven down by a sudden jump in the number of infections and as the won depreciated on weak macro data. **Hong Kong** outperformed modestly and fell just 1%.

- ▶ The virus's impact was also felt in countries that have, to date, not seen an infection or recorded very low numbers. **Latin America** saw its MSCI index fall 12% with Brazil and Chile taking the brunt of the losses, and Mexico losing 10%. The **EMEA** region fell 12%, with losses moderate until the final day of trading when Turkey fell sharply to end the month 14.8% down after the conflict with Syria boiled over again. Russia felt the effects of a lower oil price to lose 14.4%.
- ▶ In other markets, **Australia** lost its safe-haven status by losing 11% with metal prices coming off sharply (see Commodities section), and **Japan** also suffered with a 9.1% loss after the yen also depreciated against the dollar for a time before recovering. **Greece** took the wooden spoon with a 22.1% fall.

Figure 3. Regional Equity Indices

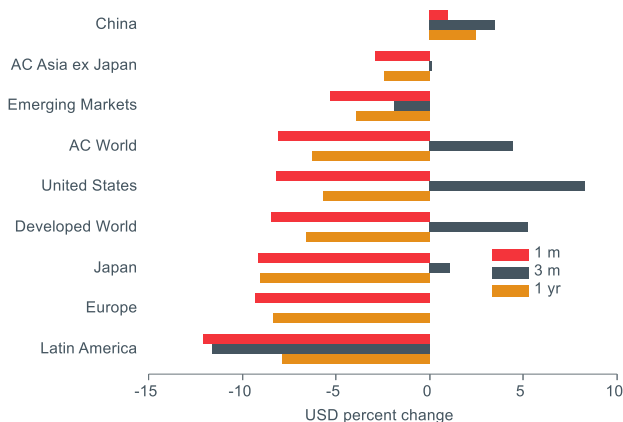
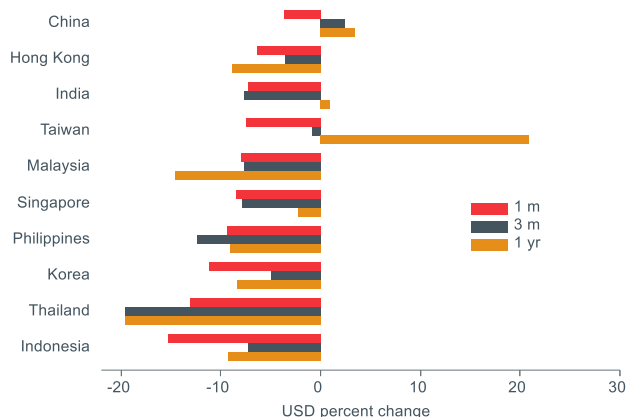


Figure 4. Asia Equity Indices



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 28 February 2020. For representative indices and acronym details please refer to notes in the appendix. Quoted returns are MSCI, US dollar denominated total returns.

Fixed Income

- ▶ **US Treasury yields** rose in the first few weeks of the month as upbeat economic data, including the unexpected expansion in US manufacturing activity, the pick-up in services-sector activity and a strong private-sector jobs report, pointed to a still-resilient US economy. But risk appetite waned as the Covid-19 virus spread, steering investors towards the perceived safety of government debt as the month progressed.
- ▶ By month end, yields were sharply lower, with the **benchmark 10-year yield** falling 25 bps to a record low of 1.26%. Expectations that inflation would remain benign also boosted demand for longer-dated paper and flattening the yield curve. The 30-year Treasury yield fell 24 bps to also end at an all-time low of 1.76%. The fall in Treasury yields came despite the Fed Reserve downplaying hopes of a resumption in the rate-cut cycle with Futures pointing to at least two cuts this year.
- ▶ Fed chair Jay Powell said in his twice-a-year update to Congress that the **US economy was still stable** and the current policy environment remained appropriate. Separately, minutes of the February meeting revealed Fed officials were unanimous in keeping rates stable in their late-January vote, with officials citing lessening trade tensions and loose financial conditions for their decision however futures contracts are now showing a rate cut as soon as March.
- ▶ **In Asia**, local government bond yields were also lower. In the face of the Covid-19 threat and downgrades to economic outlooks, a number of central banks took pre-emptive steps and cut rates to boost growth, including Thailand, Indonesia and the Philippines.
- ▶ **China** also acted to alleviate the disruption to economic recovery. The central bank trimmed its benchmark prime lending rates, as well as the interest rates on short and medium-term funding. It also injected Rmb 1.2tn into money markets through reverse repurchase agreements. While local rates mostly fell, Asian bond market total returns were trimmed by generally weaker regional currencies on the back of the stronger USD.
- ▶ **In Emerging Market USD bonds**, credit spreads widened over the month. Initial hopes that the impact of the coronavirus outbreak would be transient were doused by subsequent fears over the rising number of infected cases outside of China. The main laggard was the Middle Eastern USD credit market, where sentiment was hampered by the worsening health crisis in Iran – by month end, the country had the highest death toll from the virus outside China. Conversely, Asian USD credit markets outperformed, with lower US risk-free rates compensating for the wider credit spreads. However, given the fragile risk sentiment Asian high-yield credits underperformed investment-grade debt.

Figure 5. Bond Indices Performance in USD

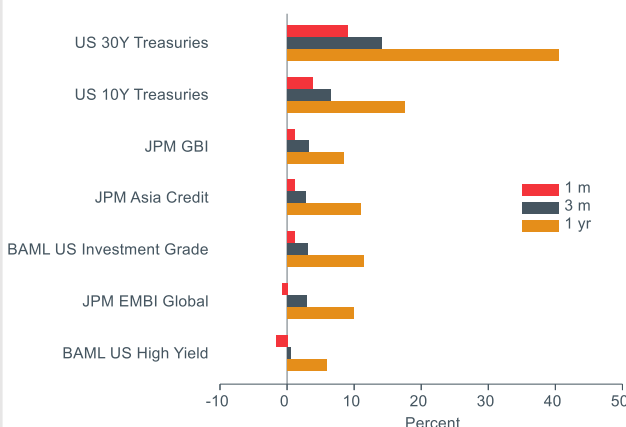
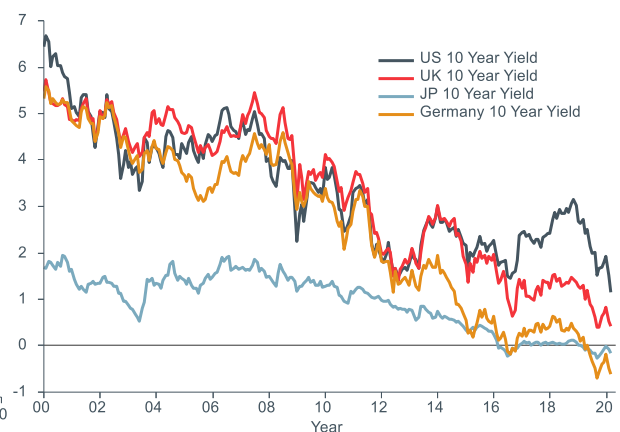


Figure 6. Key Bond Yields (%)



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of as of 28 February 2020. For representative indices and acronym details please refer to notes in the appendix. For representative indices and acronym details please refer to notes in the appendix.

Currencies

- ▶ The **US dollar Index (DXY)** endured a volatile February – up 2.5% at its peak, before dropping 2% to end the month only 50bps higher. As the virus outbreak grew in countries outside of China, investors flocked to the traditional safe-haven assets, including the US dollar and gold.
- ▶ The **Japanese yen**, usually considered a safe haven currency, failed to rally along with other safe assets, lending strength to the broad dollar index. That did not last however as the yen regained its strength to end the month 40bps higher, causing the US dollar to give back some of its gains although the DXY is still up 1.55% year to date. All G10 currencies depreciated against the dollar except the Swedish krona and yen, both of which modestly rallied 20-40bps. The New Zealand and Australian dollars, and the UK pound sold off the most among the G10 currencies – over 2.5% - extending their declines in January.
- ▶ Most **Emerging Markets’** currencies weakened as investors began to price in chances of a global recession if Covid-19 were to spread. The Indonesian rupiah and Russian ruble were among the worst performers in the month, dropping by nearly 4.5%. The rupiah gave back all of its gains and depreciated beyond the 14,000 mark after its central bank cut policy rates to support growth, and despite central bank intervention. Weaker commodity prices also weighed.
- ▶ Similarly, the ruble depreciated in line with lower oil prices, with the impact intensifying following the escalation of indirect conflict with Turkey in Syria. Other high beta currencies, including the Brazilian real, Turkey’s lira, the Mexican peso and South Africa’s rand all depreciated around 4% in February.
- ▶ **In Asia**, the Philippine peso, Taiwan’s dollar and the Hong Kong dollar all fell by around 50bps, outperforming other EM currencies and defying a sharp risk-off move. On the flip side, the Thai baht and Singapore dollar witnessed a sharp depreciation in the early part of the month as investors priced in negative spillover effects of weaker Chinese tourism and activity onto these relatively export-oriented economies. The SGD, which is managed by the central bank within a currency band, depreciated towards the lower end of the band after the Monetary Authority of Singapore highlighted it may be willing to ease policy in order to support domestic growth amid Covid-19.
- ▶ The **Malaysian ringgit** was the second worst performing currency in Asia, depreciating by 2.8% after Prime Minister Mahathir resigned unexpectedly on 24 February. The Chinese yuan remained relatively steady at around 7.0/1USD as new Covid-19 cases gradually moderated in the country, and factories/offices began to return to work.

Figure 7. Currencies Performance vs USD

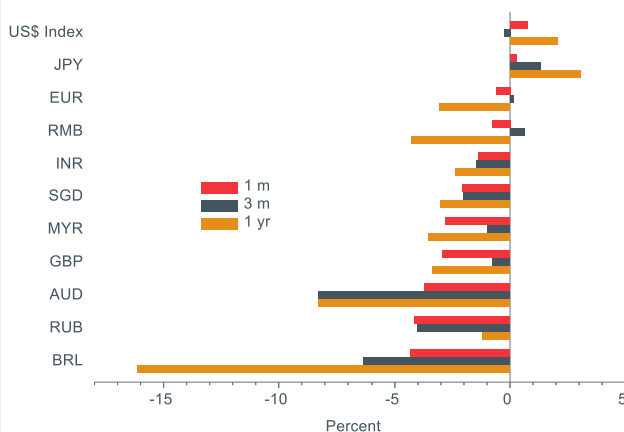
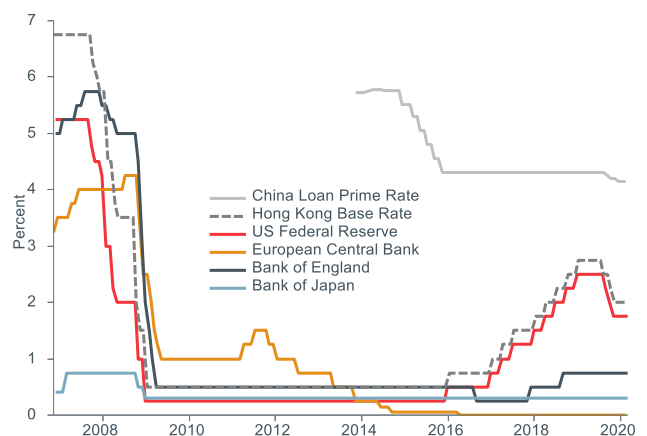


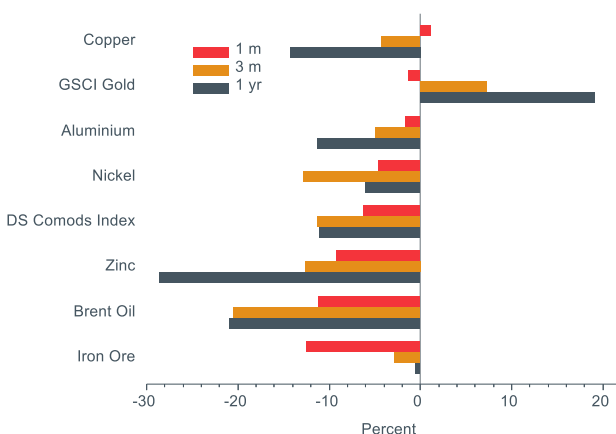
Figure 8. Central Banks Interest Rates



Commodities

- ▶ **Oil** prices were again volatile in February but finished the month at lows not seen since September on concerns the spread of the Covid-19 virus would slow the global economy. Weighing on prices was news that China's refineries had cut output by 1.5m barrels per day but supporting prices somewhat was backwardation in Brent crude, signalling that supply may also be tightening. **Oil tanker charter rates** plunged 80% while the Baltic Dry Index also touched record lows.
- ▶ **Gold** prices rose to fresh seven-year highs, as equity prices fell and the US dollar rose on news the Covid-19 virus was spreading at pace outside China. The spread of the virus to Europe triggered hopes of an interest rate cut by central banks including the US which saw its dollar rise, supporting gold further.
- ▶ **Copper** continued its recent trend lower despite a modest rally that started in late January when it seemed the Covid-19 virus had been contained and that China would work to stimulate its economy. But the metal soon reversed course and ended lower, weighed further by inventories that surged to three-month highs. **Zinc** prices fell to three-year lows as stockpiles rose in the face of weakening demand from Asia.
- ▶ Despite some supply disruptions, **Iron ore** prices fell more than 10%, with much of the drop in the final week amid fears of a more prolonged economic slowdown globally.

Figure 9. Commodities Performance in USD



Economics

- ▶ Minutes from the **US** Fed meeting at the end of January indicated it would not cut rates but Fed Fund Futures are now starting to price in two cuts this year. However, data continued to point to a robust economy: housing starts rose to 14-year highs and New Home sales rose in January. Retail Sales and Consumer confidence also rose albeit before the surge in Covid-19 cases globally.
- ▶ **Europe's** data showed continued weakness as industrial output in eurozone fell and German GDP was flat in Q4. In the **UK**, growth accelerated in December but the resignation of the country's Finance Minister and apparent difficult start to talks with the EU over a trade deal tempered hopes for Q1.
- ▶ **Japan's** GDP data showed a 6.3% QoQ fall in Q4 likely reflecting the effects of a typhoon as well as a fall in consumption. **Hong Kong's** GDP fell further in Q4 contracting 1.2% yoy. Taiwan's Manufacturing PMI rose in January but does not reflect the slowdown in the supply chain evident since January.
- ▶ **Mexico** and **Russia** both cut their policy rates by 25bps to 7.0% and 6.0% respectively; **Brazil** also cut its rates by 25bps to 4.25%, a new historical low and possibly the final one in this cycle. **Korea** did not raise rates as expected but did lower its economic forecasts for the full year. **Australia** and **New Zealand** were among many countries warning the virus could negatively affect growth this year.

Figure 10: Commodity Prices, 2019-20



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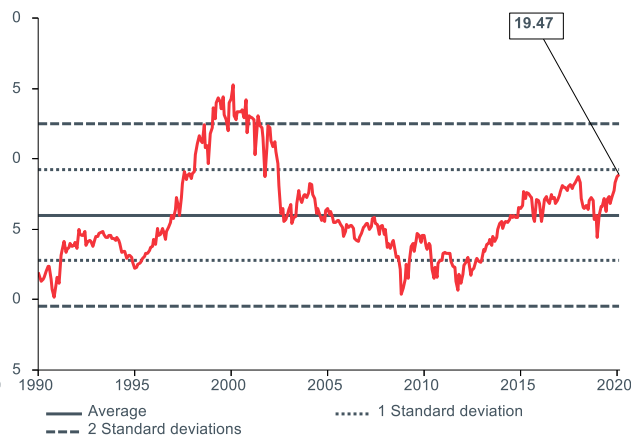


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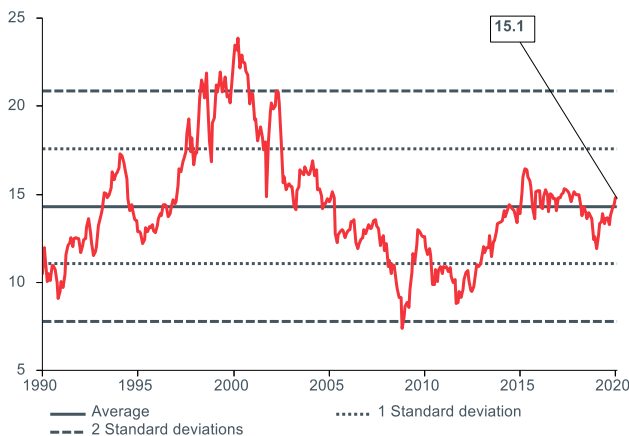
MSCI AC World 12M Forward PE



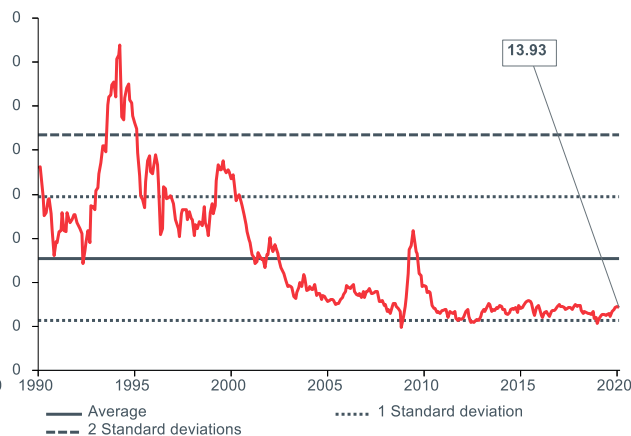
MSCI USA 12M Forward PE



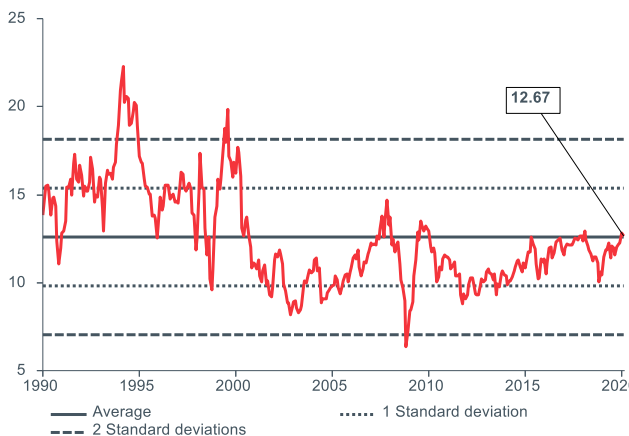
MSCI Europe 12M Forward PE



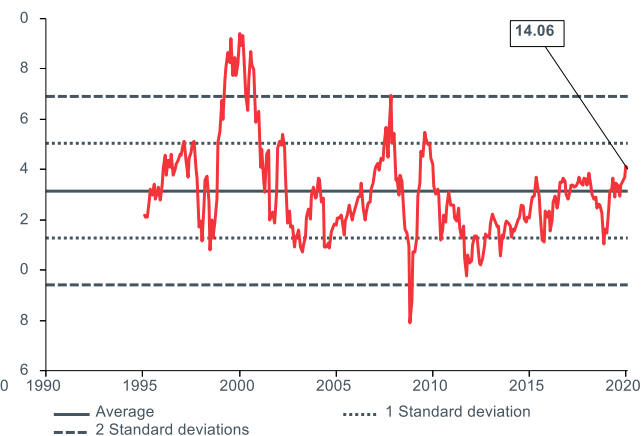
MSCI Japan 12m Forward PE



MSCI Emerging Markets 12M Forward PE



MSCI Asia Pac ex Japan 12M Forward PE



Source: Eastspring Investments. Chart data using IBES estimates from Refinitiv Datastream as of 28 February 2020.

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MSCI monthly, quarterly and year-to-date data

	Feb-20	Jan-20	Dec-19	YTD	Q4 19	Q3 19	2019	2018
World	-8.0	-1.1	3.6	-9.0	9.1	0.1	12.3	-8.9
Developed World	-8.4	-0.6	3.0	-8.9	8.7	0.7	12.6	-8.2
United States	-8.2	0.2	2.9	-8.0	9.1	1.6	13.9	-4.5
Europe	-9.3	-2.5	3.9	-11.5	8.9	-1.8	11.0	-14.3
Japan	-9.1	-1.4	2.1	-10.4	7.7	3.3	6.8	-12.6
Emerging Markets	-5.3	-4.7	7.5	-9.7	11.9	-4.1	10.0	-14.2
Asia Pac Ex Japan	-4.2	-3.7	5.8	-7.8	10.6	-3.9	11.5	-13.7
Asia Ex Japan	-2.9	-4.4	6.7	-7.2	11.8	-4.4	11.4	-14.1
Latin America	-12.0	-5.6	10.4	-17.0	10.6	-5.6	7.9	-6.2
Brazil	-13.0	-7.5	12.5	-19.5	14.4	-4.5	8.2	-0.2
EMEA	-12.0	-4.8	7.1	-16.2	10.0	-6.8	5.6	-15.5

	Feb-20	Jan-20	Dec-19	YTD	Q4 19	Q3 19	2019	2018
Australia	-11.0	0.1	1.5	-10.9	4.4	-1.4	11.4	-11.8
New Zealand	-5.1	-0.7	5.2	-5.8	17.5	-2.8	16.9	-3.5
Hong Kong	-1.4	-4.5	4.0	-5.8	7.3	-11.9	15.6	-7.8
China	1.0	-4.8	8.3	-3.9	14.7	-4.7	17.7	-18.7
Korea	-7.4	-5.3	10.4	-12.3	13.7	-4.5	5.0	-20.5
Taiwan	-1.9	-4.7	7.5	-6.5	18.0	5.9	9.0	-8.2
Thailand	-12.2	-8.6	0.9	-19.7	-0.8	-5.9	7.5	-5.3
Malaysia	-6.4	-3.9	4.0	-10.0	3.1	-6.3	0.3	-6.0
Singapore	-7.1	-3.5	3.2	-10.3	7.5	-5.8	6.2	-9.4
Indonesia	-11.9	-2.7	7.1	-14.3	7.0	-5.2	4.3	-8.7
India	-7.3	-0.8	1.5	-8.0	5.3	-5.2	7.2	-7.3
Philippines	-5.9	-8.0	1.6	-13.4	3.0	-4.6	8.0	-16.1

	Feb-20	Jan-20	Dec-19	YTD	Q4 19	Q3 19	2019	2018
Mexico	-10.0	1.4	4.8	-8.8	6.3	-1.6	5.6	-15.3
Chile	-12.3	-7.6	10.9	-19.0	-8.8	-7.3	4.4	-18.9
Hungary	-7.0	-10.7	9.7	-17.0	22.2	-3.9	6.0	-6.1
Poland	-15.7	-5.9	2.7	-20.6	4.1	-11.7	-0.6	-12.5
Czech Republic	-11.9	-3.7	5.8	-15.1	9.2	-9.5	3.8	-2.2
Russia	-14.4	-3.0	8.4	-17.0	17.1	-0.9	12.2	0.5
Turkey	-14.8	1.5	1.9	-13.6	0.0	11.7	-3.0	-41.1
South Africa	-12.9	-8.8	9.7	-20.6	13.2	-12.4	4.6	-24.3
Qatar	-6.7	-0.5	4.3	-7.2	2.2	-0.2	-3.5	29.8
Saudi Arabia	-8.1	-3.0	6.1	-10.9	3.3	-9.3	14.9	19.2
United Kingdom	-11.9	-3.8	5.2	-15.3	10.0	-2.5	11.9	-14.1
Germany	-9.2	-3.1	1.9	-12.0	9.9	-4.0	7.0	-21.6
France	-8.9	-3.4	3.0	-11.9	8.6	-1.6	10.8	-11.9
Netherlands	-7.9	-3.0	3.7	-10.7	7.4	2.5	13.6	-12.8
Austria	-10.2	-4.5	3.6	-14.2	9.1	-3.0	8.6	-23.2
Italy	-6.7	-2.1	2.7	-8.6	8.1	0.1	14.7	-17.0
Spain	-7.3	-2.7	4.2	-9.8	6.2	-3.8	7.1	-15.7
Greece	-22.1	-4.9	2.9	-25.9	12.7	-3.0	12.8	-36.7
Portugal	-6.8	4.7	4.8	-2.4	8.7	1.8	10.2	-10.1
Switzerland	-7.9	0.8	4.4	-7.2	7.6	0.3	13.5	-8.2

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