Frozen and falling: Global Markets slide under the weight of Covid-19

March 2020

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The Covid-19 virus impact in six bullet points

- The **impact on global assets** of the Covid-19 virus was laid bare in March when almost every major asset class bar gold fell acutely. Major foreign exchange, credit and bond markets also froze for a time in a series of dramatic market events that resulted in equity markets everywhere plunging and the US dollar appreciating unexpectedly as it became the safe-haven asset class of choice.
- The world's financial markets were effectively **hit by three shocks simultaneously**, any one of which would have proved to be a major burden but which combined to create conditions for the worst monthly sell off in financial assets since the Global Financial Crisis with some records stretching back to the 1930s also comfortably broken. **First** was the increasing likelihood of a deep global recession with some economists predicting a slowdown anywhere between 3% and 7% for developed countries. The **second** was a liquidity shock which saw the debt and foreign exchange markets see a large increase in the bid-ask spread, indicative of the withdrawal of liquidity. This extended into bonds, equities and even to commodities when gold prices fell as equity margin calls required cash settlement. The **third** was an oil-price shock which cut crude prices by two-thirds in a matter of days after the Saudis and Russians failed to agree on an extension of their production supply agreement.
- **Central Banks and governments around the world reacted** to the acceleration of the economic slowdown with massive monetary and fiscal stimulus programmes prompting a 14% bear market rally (see Equities section). In fact, the US Federal Reserve took more action in March than during the entire Global Financial Crisis while the ECB also loosened criteria for its own quantitative easing programme that will effectively give direct support to Italy and Spain, the two worst hit countries on the continent. In Emerging Markets, China continued to ease monetary conditions and introduce new fiscal stimuli despite signs the country's economy was restarting, while EM central banks cut interest rates, at times substantially (see Economics section).
- The third week of the month was perhaps the worst for markets as the pandemic spread at high speed in Europe then the US. Some governments appeared hamstrung by the pandemic and delayed introducing social distancing and/or lockdowns, resulting in a rapid spread of the virus, growing uncertainty and a very sharp and negative reaction in the markets. The US and European markets were badly affected in this respect while China and Japan's equity markets both outperformed as the virus spread was contained and the economic impact became clearer.
- By month end, a **third of the world's population was on complete lockdown** in a bid to contain the virus's spread. Several countries hit early by the virus and which had introduced early quarantine and testing programmes had seen the number of cases and deaths substantially reduced. **China, South Korea, Japan** and **Singapore** appeared to have at least capped the acceleration of the spread. Even Italy, one of the worst hit countries, was showing signs that its lockdown was having an affect at controlling the spread. But others were still struggling with the virus's acceleration, a shortage of medical equipment and overflowing hospitals. **The US became the pandemic's epicentre** as New York in particular struggled to cope with patients while there were worrying signs in the US states of Louisiana and California that the virus was far from contained there.
- In a third major shock to the world's markets, the **oil production deal** between Russia and Saudi Arabia-led OPEC, known as OPEC+, fell apart. Saudi Arabia immediately said it would begin pumping more oil at reduced prices into a global economy already showing signs of slackening demand amid economic weakness, with the result that crude fell to just over $20 per barrel from nearly $60 at the beginning of the month. Together with the freezing of the high-yield debt markets, this sent energy stock prices into freefall with the smaller companies taking the brunt of the selling and even the majors taking substantive hits.

Source: Eastspring Investments.

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Equity Markets

Figure 1. MSCI AC World Index

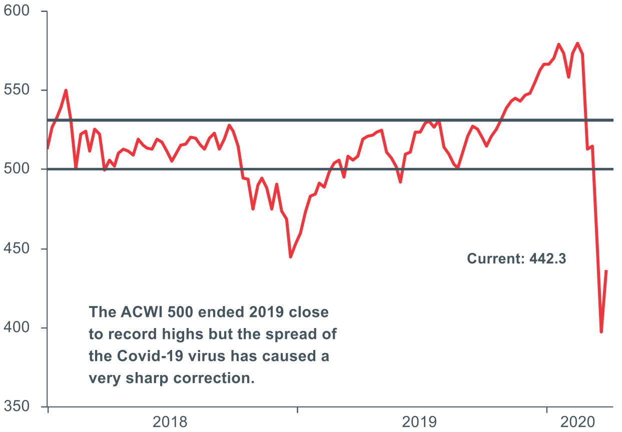


Figure 2: PMI Data for March

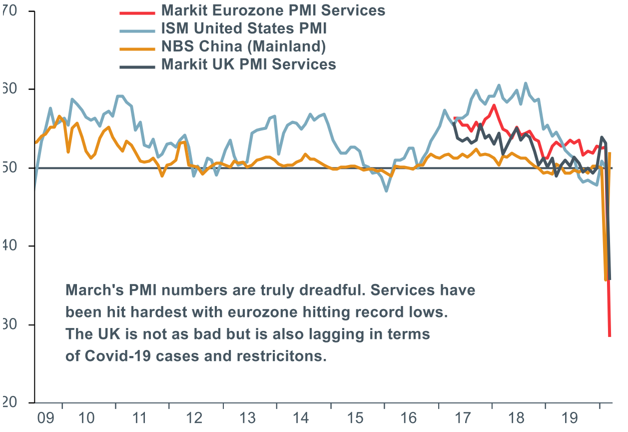


Figure 3. Regional Equity Indices

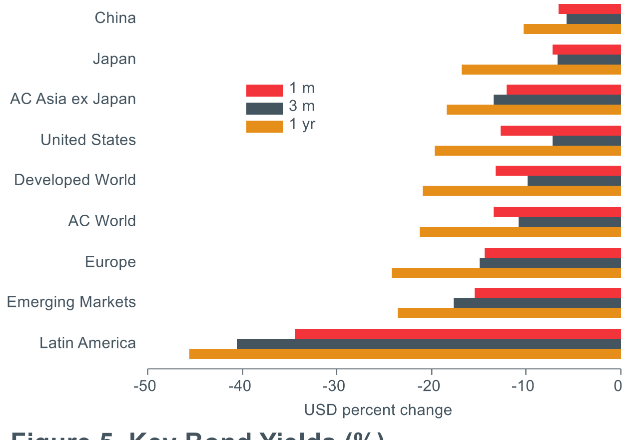


Figure 4. Asia Equity Indices

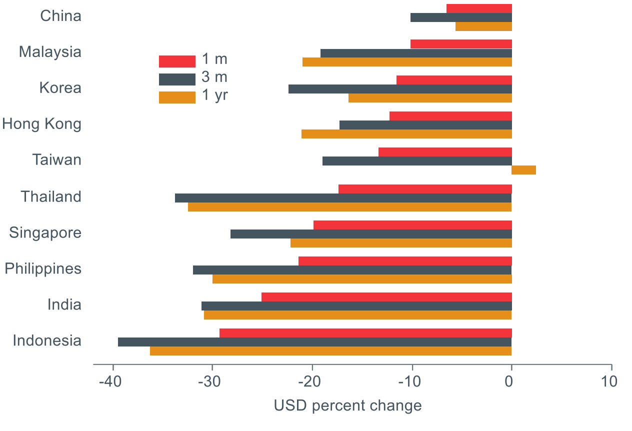


Figure 5. Key Bond Yields (%)

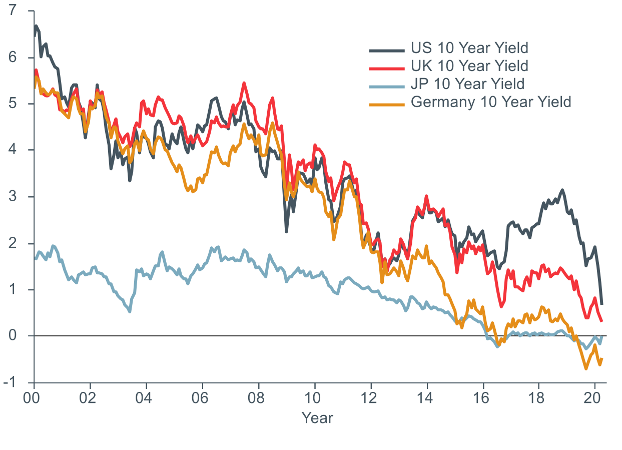
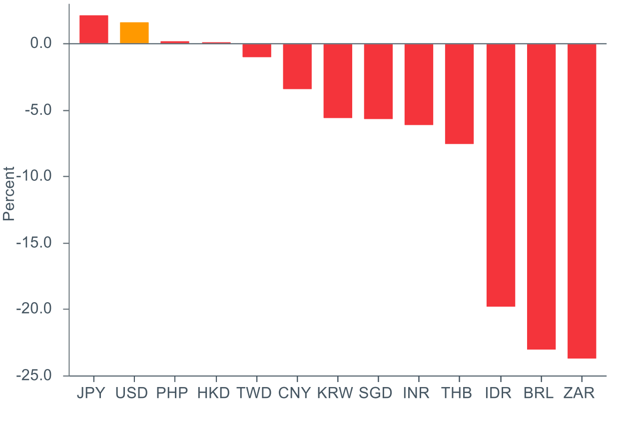


Figure 6. EM Currencies since 20 January



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 31 March 2020. For representative indices and acronym details please refer to notes in the appendix. Quoted returns are MSCI, US dollar denominated total returns.

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Equity Markets

- **Global equity markets** sold off aggressively for the second month in a row in March as the MSCI World index finished the first three months of the year with the worst quarterly performance since 2008. By region, Latin America fell the most, down 34.5% as its commodity-dependent economies and currencies were sold down substantially while EMEA (-21.1%) also saw heavy losses with South Africa particularly weak after a ratings downgrade pulled the rand to record lows.
- In **Developed Markets**, the **US** modestly outperformed to see its MSCI index drop 13.2% against Europe's -14.4% return. The Federal Reserve and government stimulus programmes gave enough support to support a rally in the S&P 500 which combined to give the index its best three-day rally since 1933. But prior to this, a freeze up in the credit and FX markets, and a drop in US bond yields saw a "dash for cash" and equities sell off. By month end, the MSCI US index was 12.7% lower, and is 19.6% lower YTD.
- **Europe** also saw a series of huge stimulus packages launched by the ECB and all of its regional governments. But they were far from enough to save the region's indices from double-digit losses. Spain (down 22.1%) and Italy (-22.5%) underperformed although a handful of positive days post the monetary and fiscal policy moves gave some support. The large industrial markets of France and Germany both dropped around 17% each and the UK fell 16% as its large-cap dollar earners gave support and despite PM Johnson and three of his cabinet catching the virus.
- **Asia** also recorded a weak month although was spared the worst of it by an outperformance in **China's** markets which saw the MSCI China H index down just 6.6% and it's A index down 7.1% mainly as the virus spread showed signs of weakening and the economy restarted. The Asia Pacific ex Japan index was 14% lower for the month and is down 23.9% since its peak on 17 January. As well as China, Taiwan outperformed as its tech-heavy index provided some support although was still down a hefty 13.4% for March. Korea fell 11.5% with the index finding support from a reboot of the China economy although it too saw its currency weaken during the month.
- **South East Asian markets** underperformed by some distance as several governments in the region struggled to implement virus containment measures and, as in the case of Indonesia, struggled with fewer instruments to stimulate a quickly deteriorating economic picture and saw a wave of Fund withdrawals. Jakarta saw four 'circuit breakers' triggered in six sessions while Manila witnessed its worst one-day performance ever after closing its market for two days at the height of the storm. The MSCI **Indonesia** index fell 29.3% and the **Philippines** 21.4%.
- In other markets, **Australia** (-25.1%) was one of the weaker markets anywhere as its mining stocks tumbled and its banking shares took another hit from central bank interest rate cuts. **Singapore** dropped 19.9% despite the country launching its largest ever stimulus package but **Japan** outperformed comfortably with a fall of just 7.0% as the yen again proved to be a relatively solid safe haven. India fell 25.1% as the country entered a full lockdown and despite support from falling oil.
- **For the quarter**, every major MSCI index in the world fell, some substantially, as the reality of the economic slowdown began to bite. Vulnerable currency countries suffered the most with Indonesia (-39.4%), Brazil (-50.2%) and Thailand (-33.7%) among those at the bottom of the table. The bright spots were in Asia where China fell just 10.2% despite being the epicentre of the pandemic for much of the period, and Japan, which lost 16.6% as it retained its safe-haven status.

Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 31 March 2020. For representative indices and acronym details please refer to notes in the appendix. Quoted returns are MSCI, US dollar denominated total returns.

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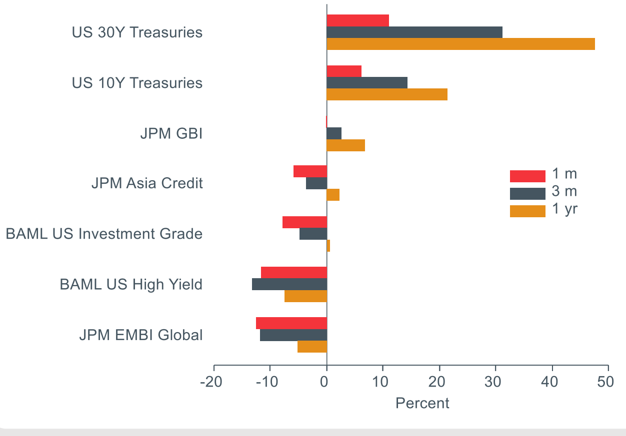
Fixed Income

- **Global government bonds** were not spared the market volatility inflicted upon risk assets. Core bond markets witnessed extreme gyrations as investors grew increasingly alarmed by the spread of the virus and the mounting death toll outside China. Early in the month, the benchmark 10-year US Treasury (UST) yield dropped below 1% for the first time ever and on 9 March, it touched a historical low of 0.32% as virus-related fears were exacerbated by the sharp fall in oil prices caused by the production spat between Saudi Arabia and Russia.
- As lockdown measures in several countries intensified and raised the prospect of a global recession, major central banks embarked on a wave of aggressive policy easing (see Economics section for details). The Federal Reserve led the way with its two emergency rate cuts totalling 150 bps, as well as a US$700bn asset-purchase programme. The Bank of England and the European Central Bank also loosened policy considerably.
- Governments everywhere pledged billions in stimulus to cushion the global economy against the inevitable slowdown, with the US announcing a US$2trn relief package. But all this provided little respite for risk assets as global equity markets suffered sharp declines. After rebounding from its record low, the 10-year UST yield ended at 0.67%, down 48 bps in March and 125 bps over the quarter.

Figure 7. Bond Indices Performance in USD



- In Asia, several central banks cut interest rates in lockstep, while Singapore returned the SGD to a neutral stance by re-centering the policy band and easing the pace at which the currency can strengthen. However, performance in regional local-currency government bonds was mixed in March. Total returns in China, Hong Kong and India were bolstered by lower domestic rates but other markets underperformed as bond yields increased. A notable laggard was Indonesia, which saw the 10-year government bond yield rise 96 bps, reflecting the domestic market's vulnerability to emerging market fund outflows in a risk-averse environment. This was underscored by the IDR's 12% fall, which further amplified on the bond market's decline.
- In credit markets, spreads widened sharply in March as liquidity conditions deteriorated. In the US, fears over defaults in high-yield credits escalated, while investment-grade bonds also started trading at distressed levels. In an attempt to boost lending to businesses, the Fed pledged to backstop high-quality debt.
- In Asia, USD credit spreads also widened markedly over the month, dragging total returns lower, particularly for high-yield sovereign bonds. Asian investment-grade bonds were also lower but more resilient, sheltered by the rally in US Treasuries. Regional primary market activity dried up as risk appetite waned, with total new issues in March reported at around US$6bn, down 67% yoy. However, Asian US dollar credits still outperformed the double-digit decline seen in the broader emerging-market USD sovereign bond market.

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Currencies

- It was yet another volatile month for the US dollar Index (DXY) in March – up 5% month-to-date at its peak, before dropping around 4%, to end the month only 100bps higher. As more countries around the world entered a lockdown to contain the spread of Covid-19, safe-haven assets including DXY continued to remain well bid in the early part of the month.
- Significant spikes in corporate credit spreads amplified the nervousness across markets as investors feared the potential for the economic downturn to turn into a broader financial crisis as companies struggle to meet debt obligations amid weaker earnings.
- However, the trend was soon reversed when the Federal Reserve announced a slew of measures (including the purchase of corporate bonds), and expectations of a $2trillion fiscal stimulus package in the US gathered pace (see Economics section). Investors appeared to believe the dual monetary and fiscal policy stimuli would mitigate the economic impact from the virus, driving risk assets higher and quickly reversing the US dollar gains.
- Within G10 currencies, safe-haven currencies such as Swiss franc and Japanese yen were the only ones that appreciated against the US dollar in March, albeit modestly. All others, particularly commodity-linked currencies like Norwegian krone, Australian dollar and Canadian dollar, depreciated between 5-10% against the dollar following the oil price collapse. The Norwegian krone depreciated the most by nearly 10%, taking the currency to its all-time lows.
- Emerging Markets currencies faced a volatile month in March as risk-off sentiment, the drying up of liquidity, and concerns of prolonged economic weakness combined to weigh heavily on currencies. Latam currencies suffered the most, with the Mexican peso, Brazilian real, and the Colombian peso all down between 12-17%. The Russian ruble dropped nearly 15% following oil price trends. Within Asia, the Indonesian rupiah, which has been relatively stable over the past few months, spiked beyond 16,000 to all-time lows, as foreign investors withdrew from its bond market.
- The top three relative outperformers in Emerging Markets continue to remain in Asia: the Philippine peso, the Taiwanese dollar and the Hong Kong dollar with all following similar patterns to February. All three appreciated modestly, defying a sharp risk off move.

Figure 8. Central Banks Interest Rates

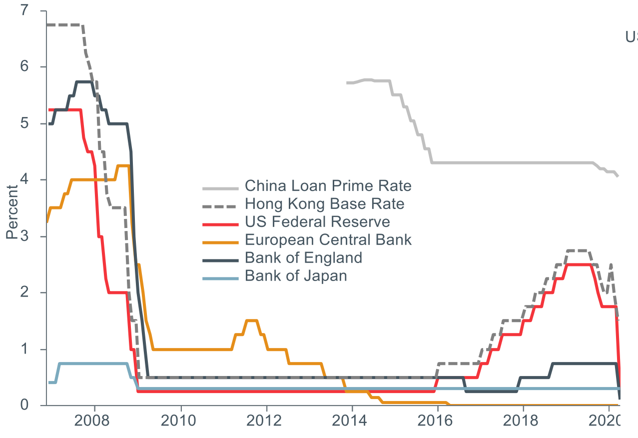
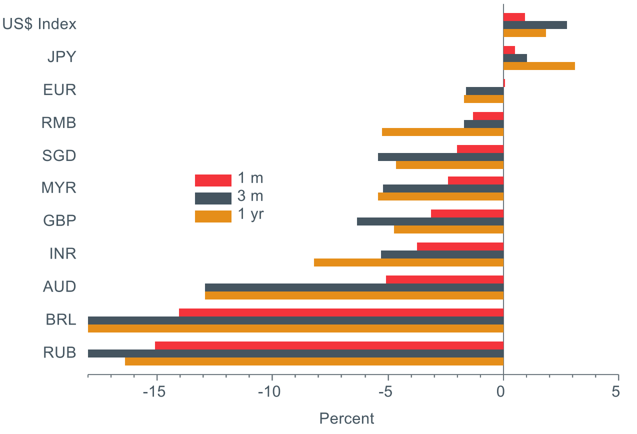


Figure 9. Currencies Performance vs USD



Source: Eastspring Investments, Refinitiv Datastream as of 31 March 2020.

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Commodities

- **Oil** prices collapsed in March after Saudi Arabia said it would hike oil output above 10m barrels per day in April after the OPEC supply cut agreement with Russia, known as OPEC+, fell apart. The Saudis then slashed their own prices in retaliation for Russia's reluctance to extend and deepen a deal to curb production. The glut of supply comes just as demand for crude globally began to show signs of shrinking as the economic impact of Covid-19 began to bite, and as storage facilities, particularly in the US, began to reach capacity. Both Brent and WTI fell around 75% over the month with WTI now just over $20 per barrel.
- **Gold** prices rose over the month as a rush to safe-haven assets gathered pace however it also saw a strong sell off in the third week as equity prices collapsed and investors faced margin calls for cash. Prices rebounded again into the close after the Fed launched its huge stimulus package, halting the rush to cash and a return to safe haven assets. Silver prices also accelerated rapidly over the month.
- **Copper** sold off sharply as risks to the global economy increased and unlike some other metals did not recover post the launch of stimulus plans around the world. Prices dipped to 11-year lows at one point before a modest rally. **Iron ore** prices held up although were still 10% lower by month end, with prices supported by restocking in China, as the country began to resume work. **Aluminium, platinum** and **nickel** were among the metals to show large losses despite some curtailment of supply.

Economics

- The **US Fed** cut interest rates to 0.25% in two steps, 50bps on 3 March and 100bps on 15 March in order to mitigate the economic fallout from the Covid-19 spread, and thereby taking borrowing rates close to zero.
- Along with the rate cuts, the Fed also announced additional monetary measures including a US$700bn **Quantitative Easing** (QE) programme in which Treasuries and mortgage-backed securities would be bought. The desired effect would be to keep lending rates for major purchases lower for longer and importantly is open-ended. A second measure was opening the **'discount window'** in which banks could borrow at a special low rate and for as long as 90-days.

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Figure 10. Commodities Performance in USD

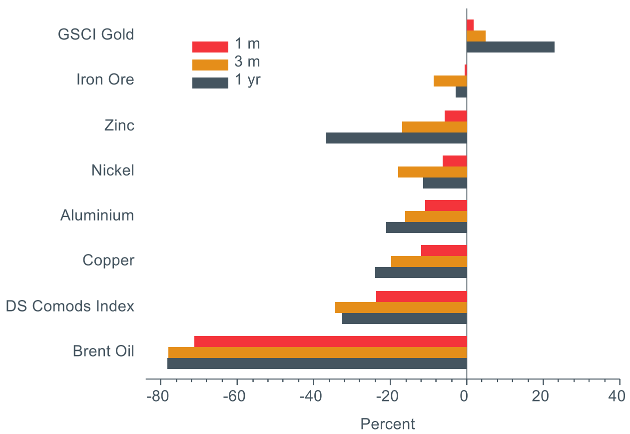
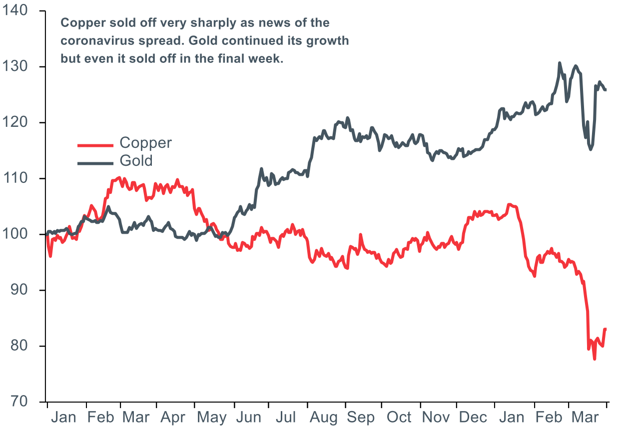


Figure 11: Commodity Prices, 2019-20



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 31 March 2020.

Economics

- The Fed opened **swap lines** with the world's major central banks to help US dollar funding which had frozen during the "dash for cash", allowing the Fed to provide dollars to overseas banks and increase the timing of transactions to daily from weekly. Canada, the UK, Eurozone, Japan, Switzerland and Korea were included in the plan.
- Other measures included a **Commercial Paper Funding Facility** to get cash to businesses who are large employers. It also established the **Primary Market Corporate Credit Facility** for new bond and loan issuance and the **Secondary Market Corporate Credit Facility** to provide liquidity for outstanding corporate bonds. A **Money Market Mutual Fund Liquidity Facility** will effectively support the flow of credit to households and businesses, and finally **a Term Asset-Backed Securities Loan Facility** to support such institutions as auto finance companies.
- Fiscal measures announced included a US$8.3bn spending bill for development of a **Covid-19 vaccine** and to help state governments' responses. A total of US$100bn of low-interest loans for impacted businesses was pledged as well as a $100bn fiscal package to provide sick leave and childcare for affected workers. A stimulus package of US$2tn was passed by Congress to help households and businesses including USD500bn in direct payments to US citizens.
- In **Europe**, the ECB had less scope to lower rates but introduced cheap loans to banks via its long-term refinancing operation (LTRO) to bridge funding gaps. A quantitative easing (QE) programme of €120bn was also launched along with a €750bn Pandemic Emergency Purchase Programme (PEPP). It was also looking at allowing eurozone countries to borrow up to 2% of GDP via an Enhanced Conditions Credit Line.
- Among the fiscal programmes, the **European Commission** set up a €25bn fund for direct responses with Italy announcing a further €25bn package, France a €45bn programme, and Germany was examining a €350bn fiscal package. Another €100bn is marked for purchasing equity stakes in firms and it also passed a supplementary budget of €156bn.
- In the **UK** the BoE cut rates to 0.1% in two steps and announced QE of £200bn along with a Covid Corporate Financing Facility to provide aid to firms so they may to bridge Covid 19-related disruption to cashflow. The 2020 UK Budget included a £30bn stimulus plan along with £20bn in tax cuts and grants. The Finance Minister also said he was earmarking £70bn to mitigate unemployment.
- In **Japan** the BoJ stepped up its purchases of ETFs and J-REITs, increased purchases of corporate bonds, and set up a special lending facility to facilitate corporate financing at 0%. A ¥15tn fiscal package including loan programs is also under consideration.
- **China** pushed through several measures to counter the slowdown in the economy. It cut a variety of rates including the Loan Prime Rate, its **Medium Term Lending Facility** by 5-10bps, its RRR by 50-100bps, and its 7-day reverse repo rate by 20bps. It also asked banks to cap interest rates on loans to selected firms. On the fiscal side, Beijing also pre-approved a higher quota of local government special bonds while cutting taxes and fees for badly affected sectors. It will also embark on meaningful fiscal expansion, including wider fiscal deficit by issuing special central government bonds and a higher local government special bond quota.

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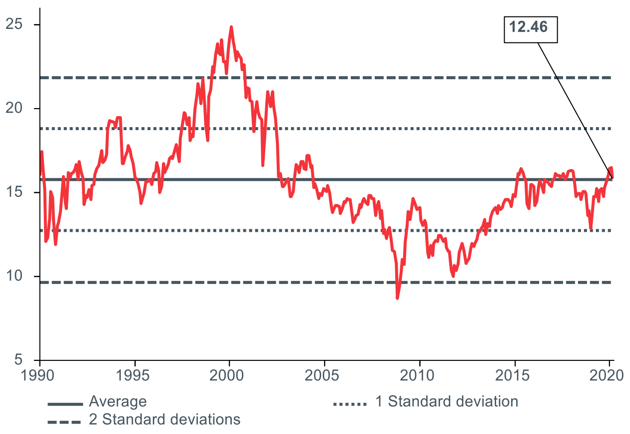
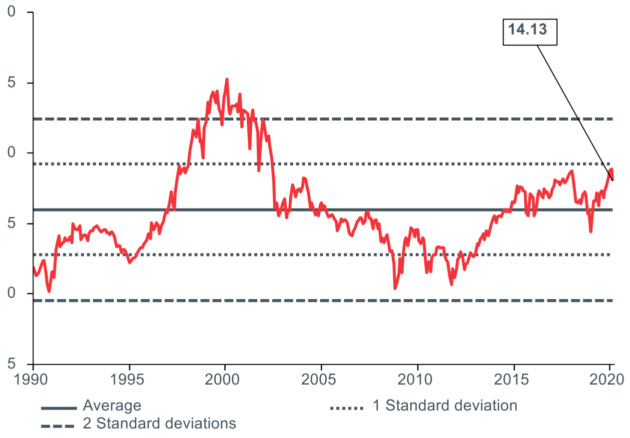
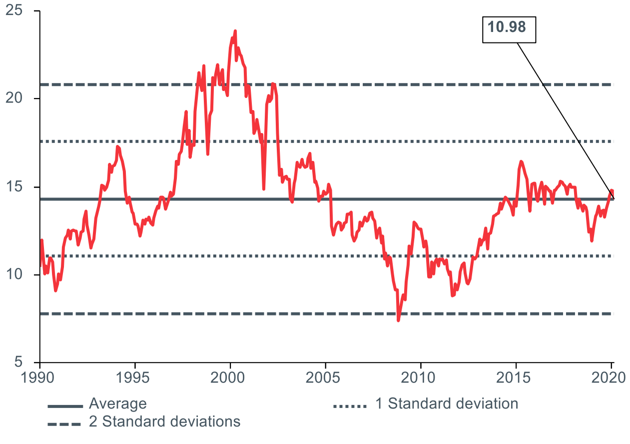
MSCI AC World 12M Forward PE



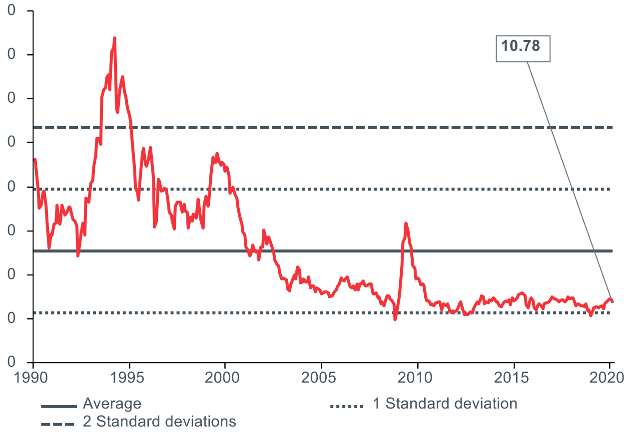
MSCI USA 12M Forward PE



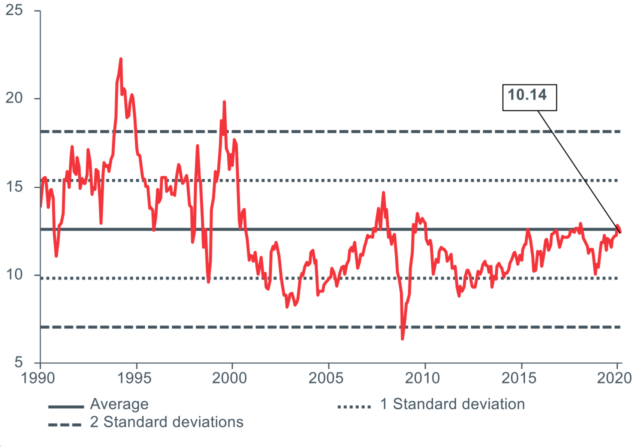
MSCI Europe 12M Forward PE



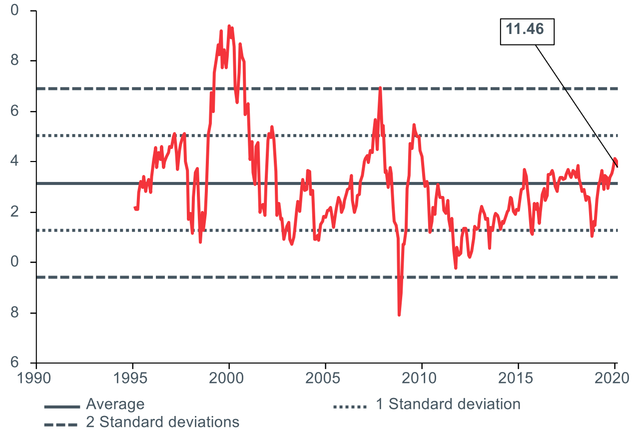
MSCI Japan 12m Forward PE



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 31 March 2020.

MSCI monthly, quarterly and year-to-date data

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	Mar-20	Feb-20	Jan-20	YTD	Q4 19	12M	2019	2018
World	-13.4	-8.0	-1.1	-21.3	9.1	-10.8	0.1	-8.9
Developed World	-13.2	-8.4	-0.6	-20.9	8.7	-9.9	0.7	-8.2
United States	-12.7	-8.2	0.2	-19.6	9.1	-7.1	1.6	-4.5
Europe	-14.4	-9.3	-2.5	-24.2	8.9	-14.9	-1.8	-14.3
Japan	-7.0	-9.1	-1.4	-16.6	7.7	-6.3	3.3	-12.6
Emerging Markets	-15.4	-5.3	-4.7	-23.6	11.9	-17.4	-4.1	-14.2
Asia Pac Ex Japan	-14.0	-4.2	-3.7	-20.7	10.6	-15.0	-3.9	-13.7
Asia Ex Japan	-12.0	-2.9	-4.4	-18.4	11.8	-13.2	-4.4	-14.1
Latin America	-34.5	-12.0	-5.6	-45.6	10.6	-40.6	-5.6	-6.2
Brazil	-38.2	-13.0	-7.5	-50.2	14.4	-41.7	-4.5	-0.2
EMEA	-21.1	-12.0	-4.8	-33.9	10.0	-27.2	-6.8	-15.5

	Mar-20	Feb-20	Jan-20	YTD	Q4 19	12M	2019	2018
Australia	-25.1	-11.0	0.1	-33.2	4.4	-26.2	-1.4	-11.8
New Zealand	-11.2	-5.1	-0.7	-16.3	17.5	-0.6	-2.8	-3.5
Hong Kong	-12.2	-1.4	-4.5	-17.3	7.3	-21.1	-11.9	-7.8
China	-6.6	1.0	-4.8	-10.2	14.7	-5.7	-4.7	-18.7
Korea	-11.5	-7.4	-5.3	-22.4	13.7	-16.4	-4.5	-20.5
Taiwan	-13.4	-1.9	-4.7	-19.0	18.0	2.3	5.9	-8.2
Thailand	-17.4	-12.2	-8.6	-33.7	-0.8	-32.3	-5.9	-5.3
Malaysia	-10.2	-6.4	-3.9	-19.2	3.1	-21.1	-6.3	-6.0
Singapore	-19.9	-7.1	-3.5	-28.2	7.5	-22.2	-5.8	-9.4
Indonesia	-29.3	-11.9	-2.7	-39.4	7.0	-36.3	-5.2	-8.7
India	-25.1	-7.3	-0.8	-31.1	5.3	-30.9	-5.2	-7.3
Philippines	-21.4	-5.9	-8.0	-32.0	3.0	-30.1	-4.6	-16.1

	Mar-20	Feb-20	Jan-20	YTD	Q4 19	12M	2019	2018
Mexico	-29.2	-10.0	1.4	-35.4	6.3	-31.6	-1.6	-15.3
Chile	-17.8	-12.3	-7.6	-33.4	-8.8	-46.4	-7.3	-18.9
Hungary	-26.5	-7.0	-10.7	-39.0	22.2	-31.3	-3.9	-6.1
Poland	-19.9	-15.7	-5.9	-36.5	4.1	-39.5	-11.7	-12.5
Czech Republic	-27.5	-11.9	-3.7	-38.5	9.2	-36.9	-9.5	-2.2
Russia	-23.3	-14.4	-3.0	-36.3	17.1	-13.4	-0.9	0.5
Turkey	-19.0	-14.8	1.5	-30.0	0.0	-19.5	11.7	-41.1
South Africa	-24.8	-12.9	-8.8	-40.3	13.2	-36.8	-12.4	-24.3
Saudi Arabia	-13.7	-8.1	-3.0	-23.1	3.3	-27.0	-9.3	19.2
United Kingdom	-16.0	-11.9	-3.8	-28.8	10.0	-22.9	-2.5	-14.1
Germany	-17.0	-9.2	-3.1	-27.0	9.9	-16.9	-4.0	-21.6
France	-17.6	-8.9	-3.4	-27.5	8.6	-16.9	-1.6	-11.9
Netherlands	-11.2	-7.9	-3.0	-20.6	7.4	-7.3	2.5	-12.8
Austria	-28.0	-10.2	-4.5	-38.2	9.1	-32.6	-3.0	-23.2
Italy	-22.5	-6.7	-2.1	-29.2	8.1	-20.6	0.1	-17.0
Spain	-22.1	-7.3	-2.7	-29.7	6.2	-26.1	-3.8	-15.7
Greece	-26.0	-22.1	-4.9	-45.1	12.7	-30.1	-3.0	-36.7
Portugal	-11.0	-6.8	4.7	-13.1	8.7	-1.3	1.8	-10.1
Switzerland	-4.2	-7.9	0.8	-11.1	7.6	4.6	0.3	-8.2

Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 31 March 2020. Data and commentary prepared by Peter Bennett.

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