

Update from the Global CIO

The thought of an invisible enemy that spreads easily and carries a non-trivial mortality rate brings shivers down most people's spine. COVID-19 has been such an enemy and is slowing down the global economy with people moving into hiding. We have not witnessed a global health emergency of this magnitude since the Spanish Flu pandemic in 1918.

The financial predicament we are dealing with has elements similar to the 1987 crash, the 1998 economic fallout stemming from the failure of Long Term Capital Management (LTCM), the terrorist attacks of 9/11 in 2001 and the Global Financial Crisis of 2008. Like the 1987 crash, stock markets are falling at a breathtaking pace. In 1987, portfolio insurance schemes adding fuel to the fire on the downside and today, constant volatility and risk parity approaches act in a similar fashion by shedding positions as volatility increases. Like the 1998 LTCM fallout, highly levered funds are forced to sell into an illiquid market. Like 9/11, the enemy is unknown and breeds fear and uncertainty with people scared to travel. Like 2008, markets are frozen and liquidity is very limited because good collateral is lacking in an environment of fear, uncertainty and solvency threats.

We can be optimistic that the effects of the virus will pass and life will go back to normal at some point. The key question is when. Chinese society seems to be on a path to normality after a complete economic halt for 6 weeks. Odds are it will be longer for the rest of the world, though maybe not significantly longer.

We can also be optimistic that the authorities have learned how to reduce the pain of crises like 1987, 1998, 2001 and 2008 with central banks that act fast and provide liquidity.

The solvency aspect, similar to 2008 is what keeps credit markets frozen. We are seeing the initial signs of fiscal plans to temporarily plug the cash flow hole from inactivity in the economy to reduce solvency risks. This can only be temporary and has limits. The key question that remains is how long inactivity will be required to stop the propagation or when will we find an adequate remedy for people to be confident enough to go back to work and for society to return to normal.

Markets currently appear to be pricing a slowdown in the economy. The medium-term repercussions are difficult to ascertain but we should remain confident that the economic machine may be down but not out.

For now, we are not making changes to our tactical asset allocation position because uncertainty prevails and the cost of trading is excessive but we will be looking to adapt to the environment as events occur.

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