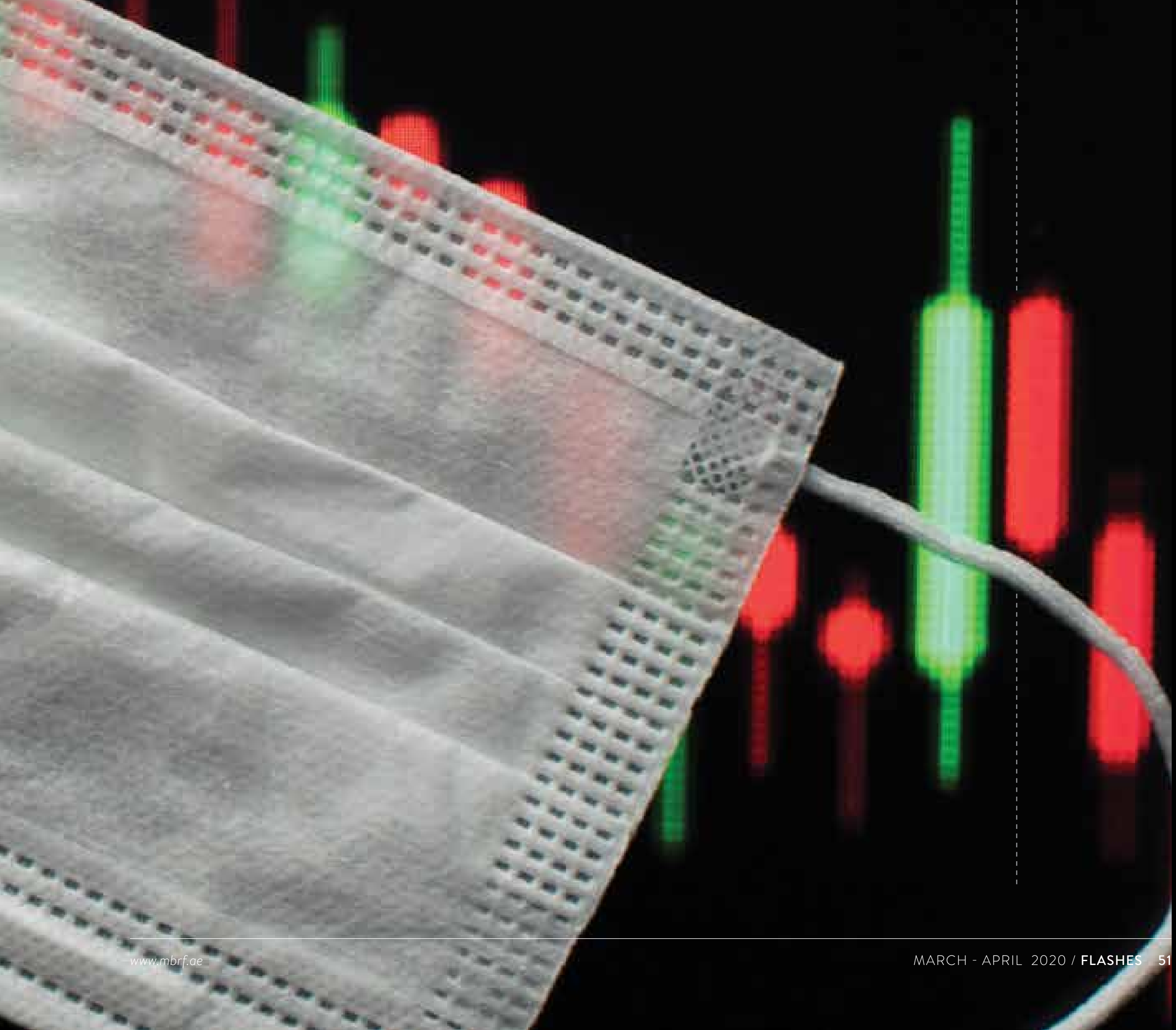
Investing in the Time of Coronavirus

*By Maurice Gravier**

What a difference a month makes. Just four weeks ago, our monthly column was about taking profits on equities. As we write today, there is no profits to take anymore, anywhere. "Markets take the stairs up and the elevator down": they tumbled in the meantime. Equities are now down -30% for the year, High Yield -20%, and even Government Bonds and Gold are lower, hit by the rush to preserve capital. The Coronavirus crash of 2020 will certainly be remembered in history as were 1929, 1987 and 2008, but the key difference is obviously that we are still in the middle of it. Today, we will share our analysis of the current situation, before formulating recommendations of what to do, and maybe more importantly what to avoid doing, in such an extraordinary context.



Let's start with the same methodology that led us to sell stocks one month ago, i.e assessing risks and rewards through the analysis of three key market drivers: the backdrop, the valuations, and behavioral factors.

The backdrop is rather bleak. Let's face it, the COVID-19 is pushing the world into a global recession, putting an end to the longest expansion in history. China leads the way with a double-digit drop in activity in Q1, and the West follows, with hundreds of millions of people under "social distancing" measures. Our in-house scenario is now for flat to negative growth in developed economies in 2020, but uncertainty prevails, as we simply don't know when the pandemics will end. Policymakers have to win a battle on three fronts: fighting the virus itself, but also providing enough liquidity to prevent a financial crisis, and finally limiting the economic damage to preserve the ability to rebound. The responses are not shy. There have been 42 rate cuts since the beginning of February which is more than in the 2 months which followed Lehman's bankruptcy. Public aid, from fiscal stimulus to various commitments, cumulates more than $3tn globally, an unprecedented level. Finally, we shouldn't forget that there is light at the end of the tunnel: the most vigorous healthcare measures in Asia are bearing fruits, with China, Singapore and South Korea seeing a clear inflection in the number of cases. Assuming that the pandemics will be contained, the key question is whether the economic damage will be transitory, or sustainable.

The second driver is valuations, i.e. what is currently being priced-in by markets. This is of course highly dependent on the actual economic trajectory, but stock markets are priced for a severe -20% drop in earnings, and most of markets discount more than a temporary economic impact.

Bleow:
Maurice Gravier

It's difficult to talk about stocks being a "bargain" given the level of uncertainty, but without a doubt, current valuations support much better long-term returns than a month ago.

Finally, behavioral factors have probably never been as important. Volatility is in uncharted territory, should it be implied by derivatives, or realized, day after day. These extreme fluctuations happen at a critical time for the market structure: excessive leverage, "gamma negative" structured products, quantitative strategies, among others, generate forced, price-insensitive liquidations, at a time when banks have considerably reduced their ability to be an intermediate and take positions. Illiquidity amplifies the fluctuations, which triggers more forced selling, in a vicious circle. Yes, extreme negative sentiment is a positive, but the short-term remains quite dangerous.

This analysis also provides some key pointers to navigate the current extraordinary environment. Let's start with what should be avoided.

DON'T panic. As long as your investment horizon is long enough, your portfolio should be fine. Historically, the frequency of positive returns on a 5 years period is more than 86% for equities, and close to 100% when the valuation at the starting point is low.

DON'T take short-term bets. The difference between speculation and investment is basically diversification and rationality. There is no way to predict the short-term, especially on a single asset.

DON'T leverage in unreasonable proportions, or with a mismatch in duration, because it could make you a forced seller at the worst time.

Now, on the positive side, crashes have always been times of opportunity for the long-term fundamental investors, as long as simple rules are followed.

SET your time horizon taking into account your financial goals with a margin of safety, should any unexpected event happen. There is a relevant asset allocation for 3, 5, 7 years or more, with attractive expected returns generated by the current turmoil. On shorter horizon, align the duration and the risk level to focus on safety rather than returns.

Be DIVERSIFIED: this is a golden rule, across asset classes and regions. It is also about making sure that your investment portfolio is driven by different factors than the rest of your wealth – should it be oil, or tourism for example.

Invest PROGRESSIVELY: the oldest systematic investment process is probably one of the wisest. Investing a fixed amount every month in a diversified portfolio averages purchasing prices and smooths returns.

ADAPT to a bear market playbook. The previous decade was about leverage, momentum and passive investment, the current one should reward being flexible, contrarian, and selective.

We live in extraordinarily difficult times. Your health is obviously the most important asset of all, and we encourage you to take all precautions to safeguard it. With regards to wealth, which is about the future, the current situation might just prove to be an opportunity. Stay safe, keep calm, and invest wisely for the long-term.

---

*Maurice Gravier is Chief Investment Officer, Wealth Management at Emirates NBD, responsible for providing Emirates NBD's private banking and retail clientele with comprehensive financial advisory and valuable guidance on investment strategies. Gravier has over 20 years of investment experience, running large pools of assets for sophisticated international investors, across asset and wealth management. He held senior positions in Natixis Asset Management in France, Lombard Odier in Switzerland, Majid al Futtaim Trust in Dubai, before joining Emirates NBD in 2018. Gravier is a French national with a Masters in Management from ESCP Europe in Paris. Website: https://www.emiratesnbd.com/en/