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CORONAVIRUS: LOOKING TO THE LONG TERM

In assessing the threats posed by the coronavirus outbreak, governments, central banks, companies and investors must consider scenarios that range from short-lived disruption to a persistent threat with profound implications. All that's certain is that the coronavirus is having a significant impact on the global economy and financial markets – in the short term at least.

But what about the long term? Last Monday equity markets suffered their steepest falls since 2008 – prompting comparisons with the global financial crisis: the event that has defined the past 12 years.

The similarities should not be overstated though. The 2008 crisis was intrinsic to the financial system itself, not a response to an external threat. For all its potential impact, the coronavirus outbreak is a much more conventional crisis. Thus far, the moves have been large but orderly; there seems to be very limited risk of systemic failure in part because banks and the financial sector in general is in much better shape than it was in 2008.

There are differences, too, in the way that the authorities are reacting. In 2008, the response was largely channelled into extraordinary monetary easing. With coronavirus, however, governments are turning to fiscal policy to offset the economic impact of the virus. We have already seen significant fiscal stimulus in the UK, Hong Kong and Singapore, and large-scale spending looks likely elsewhere.

There is, though, one crucial point of comparison with 2008. If we look back not only to the 2008 crisis but to previous market crashes – from the oil crisis of 1973 to the bursting of the dotcom bubble of 2000 – we can see a persistent pattern. Bear markets tend to be relatively short-lived and give way to much longer-lasting bull markets.

Given this historical precedent, investors should be looking to ensure that their money is in companies well-placed to come through a downturn in good shape – however long that downturn lasts.

That puts a premium on quality. As the established economic certainties shift, highly leveraged companies look increasingly exposed. The quantitative easing that followed the financial crisis led to massive issuance of corporate debt. This allowed firms to fuel the bull market through share buybacks. Those companies that have gorged on debt now look distinctly vulnerable. So investors should focus only on those with strongest balance sheets.

There are other factors to consider too. The sharp fall in the oil price is compounding the woes of highly indebted energy firms. Meanwhile, the virus's impact on tourism and travel-related companies is substantial. Already, there have been bankruptcies in the travel and energy sectors**.** And many other companies face severe challenges from the disruption of supply chains.

Not all companies are exposed to those factors, of course. And that's why the coronavirus should prompt a resurgence in active investment. To concentrate on companies with robust balance sheets and low exposure to damage wreaked by the virus, investors need to be selective in their stock-picking.

After the last crisis, passive approaches provided an easy means harnessing a debt-driven bull market. But today, passive strategies leave investors fully exposed to the teeth of the bear.

Martin Gilbert, Chairman, Aberdeen Standard Investments

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