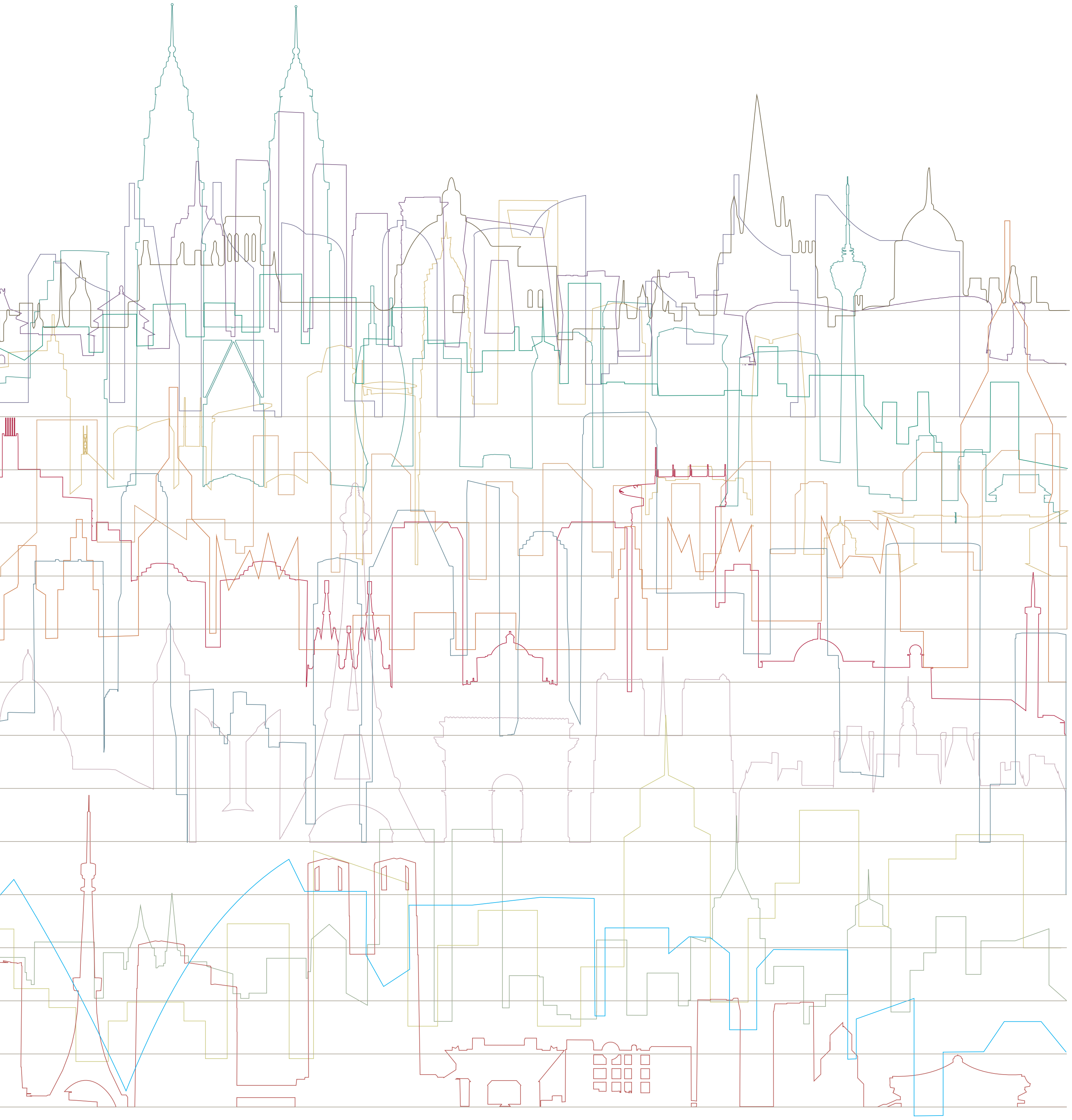
COVID-19 DISRUPTS WORLD EQUITY MARKETS



Our first *International Equity Review* of the new decade, published in January, reviewed the 2019 performance of the international equity markets noting that 2019 was the best year of the decade. It reported the performance of fifty major world equity markets in 2019, set in the context of performance during the past decade. Although we raised the spectre of the potential impact of COVID-19, we did not foresee the extent of the damage. We usually report on much longer periods, however the scale of the crisis warrants a timely update so we present our second *International Equity Review* of the year. The first quarter of 2020 has reversed most of the 2019 gains for most markets. We present here an update of the recent performance in the international equity markets analysing the extent to which the COVID-19 event has been absorbed. The impact has been massive with some markets losing up to 50% of their value, however although the response has been uniform in direction it has varied across markets in both magnitude and rate of recovery. There are positive signs that key markets are beginning to recover. Emerging markets appear to be suffering most.

Key observations:

1. Equity markets overall as represented by the *MSCI All Country World Index (MSCI ACWI)* in US dollar terms gained 24% during 2019, the best annual performance of the decade – these gains have all been lost in the first quarter of the new decade. The index is 2.4% down on 1 January 2019, having lost 21.7% in QI, 2019 shedding all the gains of 2019 and an additional 2.4% to boot.

2. March was the most volatile month and caused the most damage to returns, although there was a slight recovery in the second half.

3. Half the markets experienced a loss of greater than 30%, only seven lost less than 20% and all markets suffered a negative return in the first quarter.

4. Only five of the top fifty markets remain above the levels they enjoyed at 1 January 2019; Denmark (12.5%), Switzerland (9.8%), China (7.1%), US (2.4%) & Taiwan (0.6%).

5. The UK market has fared particularly badly with a maximum loss in the quarter close to 50% with a slight recovery to a net loss of 35.5% by the end of the quarter. This earned the UK rank 38. Sterling declined by 6.5% to the dollar which contributed to the poor performance.

6. China has shown resilience with a maximum draw down of 20% in the quarter recovering to a net loss of 10% by the end of March. The US trails with a maximum draw down of 30% and a loss for the quarter of 20%.

7. The loss of 23.9% suffered by the *MSCI EM* index although equal to the *MSCI Ex US*, the former has been buoyed by the above average performers of China, Taiwan and Korea which combined account for 57% of the index. Almost all emerging markets were down more than 30%.

8. The *MSCI BRICS* index with a loss of 21.1% for the quarter is bolstered by a 70% weighting in China which masks the significant sell off in the other four BRICS' markets. All four are in the bottom half with Brazil ranking 50th having lost 51.2% of its value.

9. Gold provided a useful hedge with a return of 3.9%.

10. Most currencies suffered against the dollar, particularly in the emerging markets where the currency depreciation contributed considerably to the losses.

The global picture

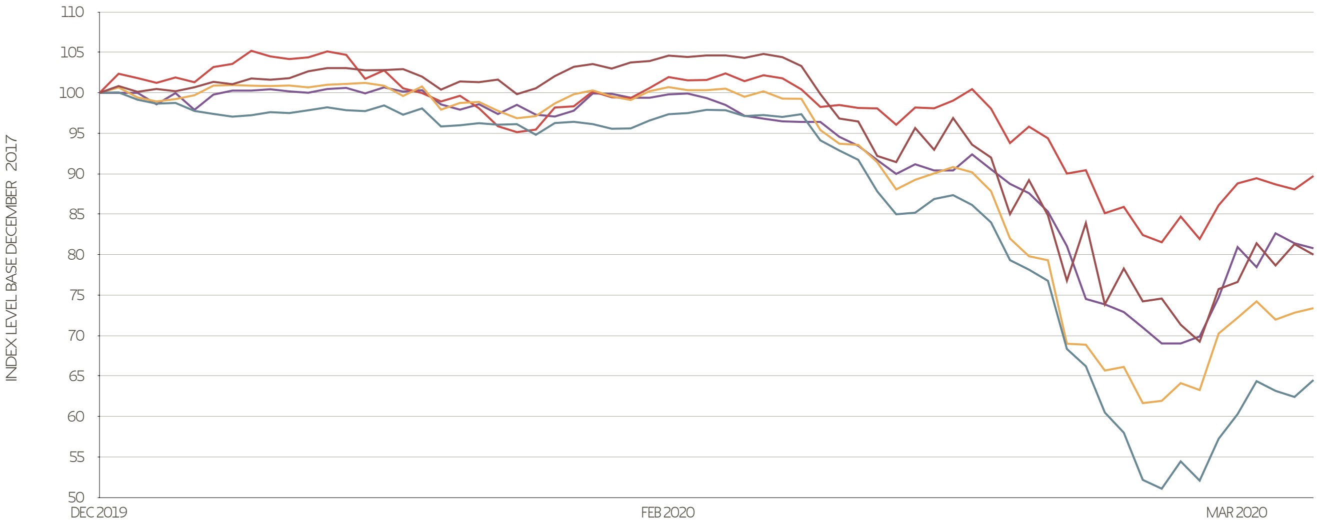
Figure 3 reports the performance in US dollar terms for the largest fifty equity markets in rank order for the first quarter of the new decade, the damage across markets has been significant and chiefly incurred in March (Table 1). However, Figure 1 shows that there was a slight recovery in the second half of March – whether green shoots or a 'dead cat bounce' remains to be seen. Nevertheless, the markets seem to be responding less to the evolution of COVID-19 virus itself and rather more to the economic impact of lockdown by region. A major concern is that markets may not yet be reflecting the full impact of the global economic fall-out from the pandemic. Given the range of forecasts from quick bounce back to deep recession, the markets may be too sanguine in the face of such Knightian uncertainty which is not amenable to probability assessment.[1] The damage inflicted by the global lockdown and the attendant interventions of governments (fiscal) and central banks (monetary) may have long-term effects and severe economic consequences, the assessment of which remain intractable problems. Table I reports the rankings by quarter one performance for the top fifty world equity markets and the returns for each month. Figure 3 also reports the performance of several key regional indices and Gold. Gold outperformed all markets with a return of 3.9%, Denmark showed the lowest loss for the quarter at -7.4%.

UK fragility

The UK equity market, despite having turned in an excellent performance in 2019, ranking 4th for the year and 8th for the decade, has been the hardest hit of the major markets and seriously lags the European Union (EU) markets. The 35.5% loss sustained for the quarter was further partially attributable to the 6.5% depreciation of sterling against the dollar. The Euro on the other hand depreciated by only 2.1% for the same period. At its lowest point in March the UK equity market was down 50% quarter to date. Clearly, COVID-19 amplifies the Brexit uncertainty. Furthermore, the major UK oil companies which constitute a significant weight in the UK equity index have lost much value. It seems that markets are weighting in reports of the potential high direct effects of the pandemic and the deleterious effects the increased government debt burden will have on a country currently seeking a new uncertain role in the world.

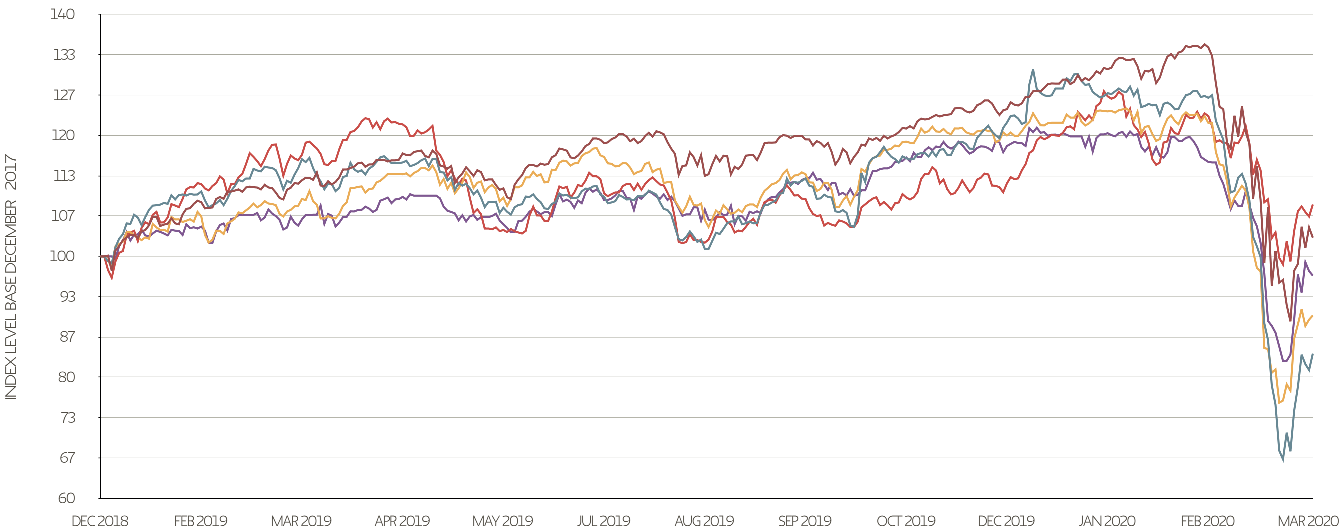
[1] *Frank Knight, Risk, Uncertainty and Profit (1921).*

FIGURE 1. Major equity markets performance 1st quarter 2020 ($ returns) SOURCE: Oxford Metrica



EQUITY MARKET PERFORMANCE FOR THE QUARTER ENDING 31 MARCH 2020 — USA — GERMANY — JAPAN — CHINA — UK

FIGURE 2. Major equity markets performance ($ returns) SOURCE: Oxford Metrica



EQUITY MARKET PERFORMANCE FOR 15 MONTHS ENDING 31 MARCH 2020 — USA — GERMANY — JAPAN — CHINA — UK

FIGURE 3. Major equity markets performance 1st quarter 2020 ($ returns)

SOURCE: Oxford Metrica

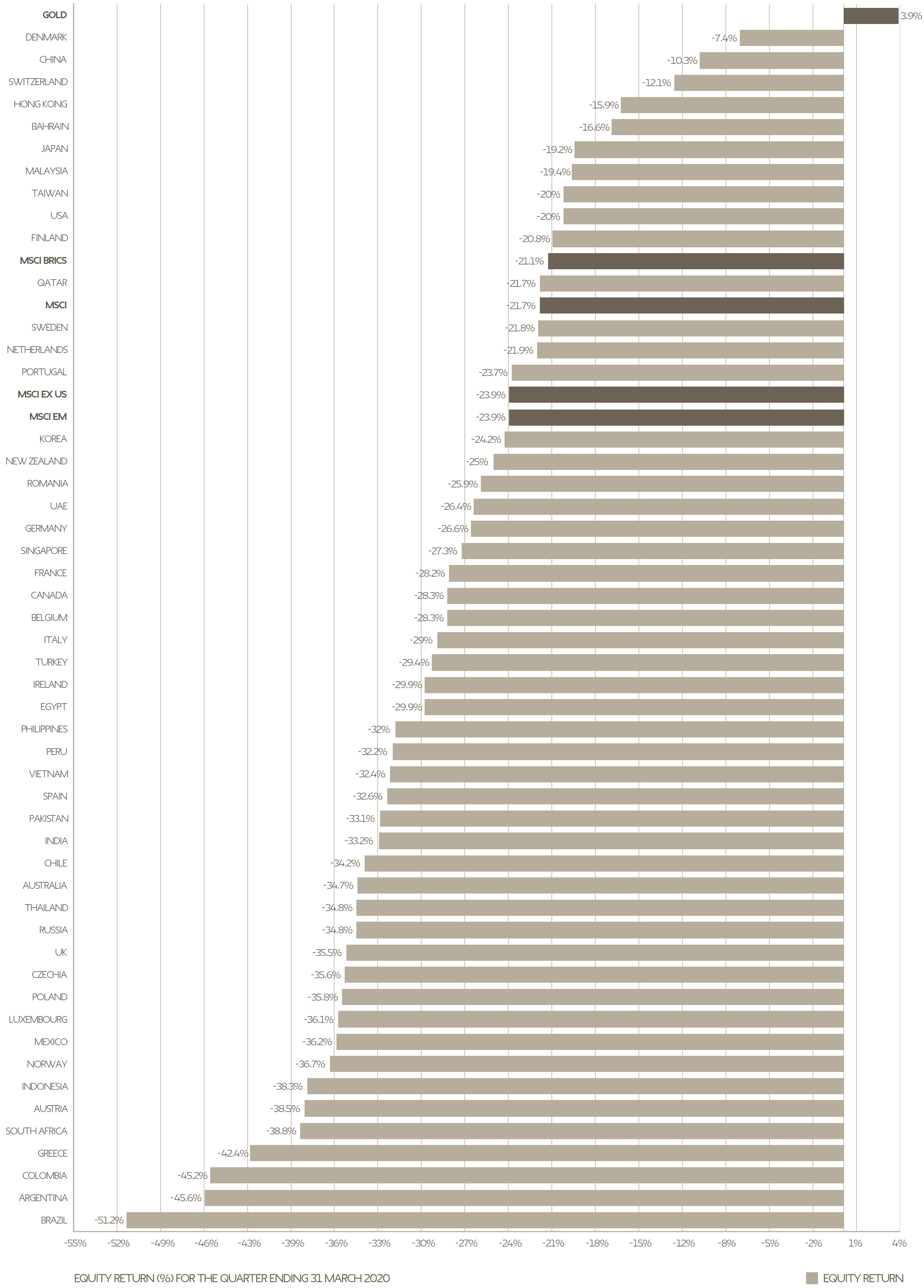


TABLE 1. International equity markets performance ranking ($ returns) SOURCE: Oxford Metrica

Rank	Country	Return Q1 2020	Return January	Return February	Return March	Currency Q1 2020
1	Denmark	-7.41%	2.21%	-5.02%	-4.62%	-2.06%
2	China	-10.28%	-4.86%	0.96%	-6.59%	0.49%
3	Switzerland	-12.09%	0.54%	-7.93%	-5.04%	0.23%
4	Hong Kong	-15.86%	-6.37%	-1.06%	-9.17%	0.49%
5	Bahrain	-16.61%	2.95%	0.16%	-19.13%	-0.59%
6	Japan	-19.21%	-1.48%	-8.67%	-10.21%	1.03%
7	Malaysia	-19.41%	-3.76%	-5.91%	-11.00%	-5.21%
8	Taiwan	-20.00%	-5.23%	-1.91%	-13.94%	-1.14%
9	USA	-20.00%	-0.16%	-8.41%	-12.51%	0.00%
10	Finland	-20.83%	1.11%	-6.89%	-15.91%	-2.14%
11	Qatar	-21.73%	-0.03%	-9.08%	-13.89%	-0.58%
12	Sweden	-21.77%	-2.59%	-6.89%	-13.75%	-6.49%
13	Netherlands	-21.87%	-3.76%	-9.18%	-10.62%	-2.30%
14	Portugal	-23.74%	-0.58%	-9.93%	-14.84%	-2.30%
15	Korea	-24.17%	-6.82%	-6.87%	-12.62%	-5.02%
16	New Zealand	-25.03%	-2.21%	-7.42%	-17.19%	-12.06%
17	Romania	-25.95%	-0.53%	-10.33%	-16.98%	-3.11%
18	UAE	-26.42%	1.58%	-4.94%	-23.80%	0.00%
19	Germany	-26.61%	-3.13%	-9.09%	-16.67%	-2.14%
20	Singapore	-27.30%	-3.59%	-6.55%	-19.31%	-5.58%
21	France	-28.15%	-4.14%	-9.23%	-17.43%	-2.30%
22	Canada	-28.27%	-0.47%	-7.48%	-22.11%	-8.52%
23	Belgium	-28.34%	-2.50%	-11.38%	-17.05%	-2.30%
24	Italy	-29.02%	-2.27%	-6.09%	-22.65%	-2.14%
25	Turkey	-29.40%	3.60%	-14.71%	-20.09%	-9.88%
26	Ireland	-29.90%	-3.84%	-9.26%	-19.66%	-2.30%
27	Egypt	-29.93%	1.28%	-5.55%	-26.75%	1.97%
28	Philippines	-31.97%	-8.22%	-5.90%	-21.23%	-0.08%
29	Peru	-32.16%	-5.30%	-9.72%	-20.66%	-3.73%
30	Vietnam	-32.36%	-2.72%	-5.90%	-26.11%	-1.89%
31	Spain	-32.58%	-5.34%	-6.61%	-23.74%	-2.30%
32	Pakistan	-33.14%	2.36%	-8.61%	-28.52%	-6.82%
33	India	-33.23%	-2.16%	-7.52%	-26.21%	-5.50%
34	Chile	-34.21%	-7.69%	-11.63%	-19.36%	-11.99%
35	Australia	-34.73%	-0.19%	-11.39%	-26.21%	-13.13%
36	Thailand	-34.78%	-8.01%	-12.32%	-19.14%	-8.49%
37	Russia	-34.79%	-3.04%	-14.39%	-21.45%	-20.63%
38	UK	-35.49%	-3.87%	-11.59%	-24.10%	-6.52%
39	Czechia	-35.60%	-4.26%	-10.44%	-24.90%	-9.05%
40	Poland	-35.76%	-5.95%	-15.75%	-18.93%	-8.70%
41	Luxembourg	-36.06%	-7.60%	-4.54%	-27.51%	-2.30%
42	Mexico	-36.21%	1.34%	-10.48%	-29.68%	-19.62%
43	Norway	-36.72%	-6.33%	-12.11%	-23.13%	-16.07%
44	Indonesia	-38.27%	-4.82%	-11.91%	-26.38%	-14.33%
45	Austria	-38.54%	-4.64%	-10.00%	-28.39%	-2.14%
46	South Africa	-38.80%	-8.34%	-13.39%	-22.91%	-21.48%
47	Greece	-42.35%	-1.85%	-20.81%	-25.84%	-2.30%
48	Colombia	-45.22%	-6.17%	-7.36%	-36.98%	-18.97%
49	Argentina	-45.64%	-4.49%	-15.40%	-32.72%	-7.10%
50	Brazil	-51.24%	-7.71%	-12.63%	-39.53%	-22.77%

China shows its mettle

Figure 1 illustrates the resilience of the Chinese equity markets to these shocks compared with other markets. Chinese stock prices were down 10% for the quarter ended 31 March, in comparison to the 20% lost in the US markets. The Chinese markets suffered less, with a maximum draw-down of 20% against 30% for the US, and its recovery has been faster. Figure 2 tracks the performance for the 5 major markets from January 2019 to the end of Q1, 2020. The US markets suffered a loss close to the whole of 2019 gains whereas the Chinese markets lost little over two-months' worth of their 2019 gains. This resilience is even more impressive when one considers that the returns quoted are in dollars and that currency movements damaged the Chinese returns slightly. The world average returns as represented by the *MSCI ACWI* were only slightly behind the US. Markets are relatively sanguine about China's recovery, and current prices will surely be seen by many as a buying opportunity as China leads the world out of the slowdown.

Emerging markets hardest hit… greatest opportunity?

Emerging markets ended the last decade on a promising improvement in 2019, this has been brutally reversed in the first quarter of 2020. Firstly, consider the performance of the BRICS, aside from China the others have been significantly pared back by losing more than 30%; India (-33.2%), Russia (-34.8%), South Africa (-38.8%) and Brazil (-51.2%) have been among the worst casualties. This may augur poorly if these economies full into recession, although there may be many individual buying opportunities for the astute investor.

The outlook

All of the potential risks we identified in January remain and are amplified by the COVID-19 pandemic. *"Looking ahead, equity markets will continue to press into uncharted waters with respect to geo-political factors, and the effects could result in a major repricing in 2020. Three major risks in particular could severely disrupt equity markets in 2020. The first is the outcome of the US election. If President Trump fails to be re-elected, interest rates and taxes are likely to increase and cause US growth to slow down. In such circumstances equity markets everywhere are likely to be adversely affected. Secondly, a break-down in the trade discussions between the US and China could also disrupt markets. Finally, the play-out of Brexit is likely to sharpen focus on existing internal issues within the European Union. Without further full financial integration the Euro is likely to continue to depreciate." International Equity Review N.1 2020.*

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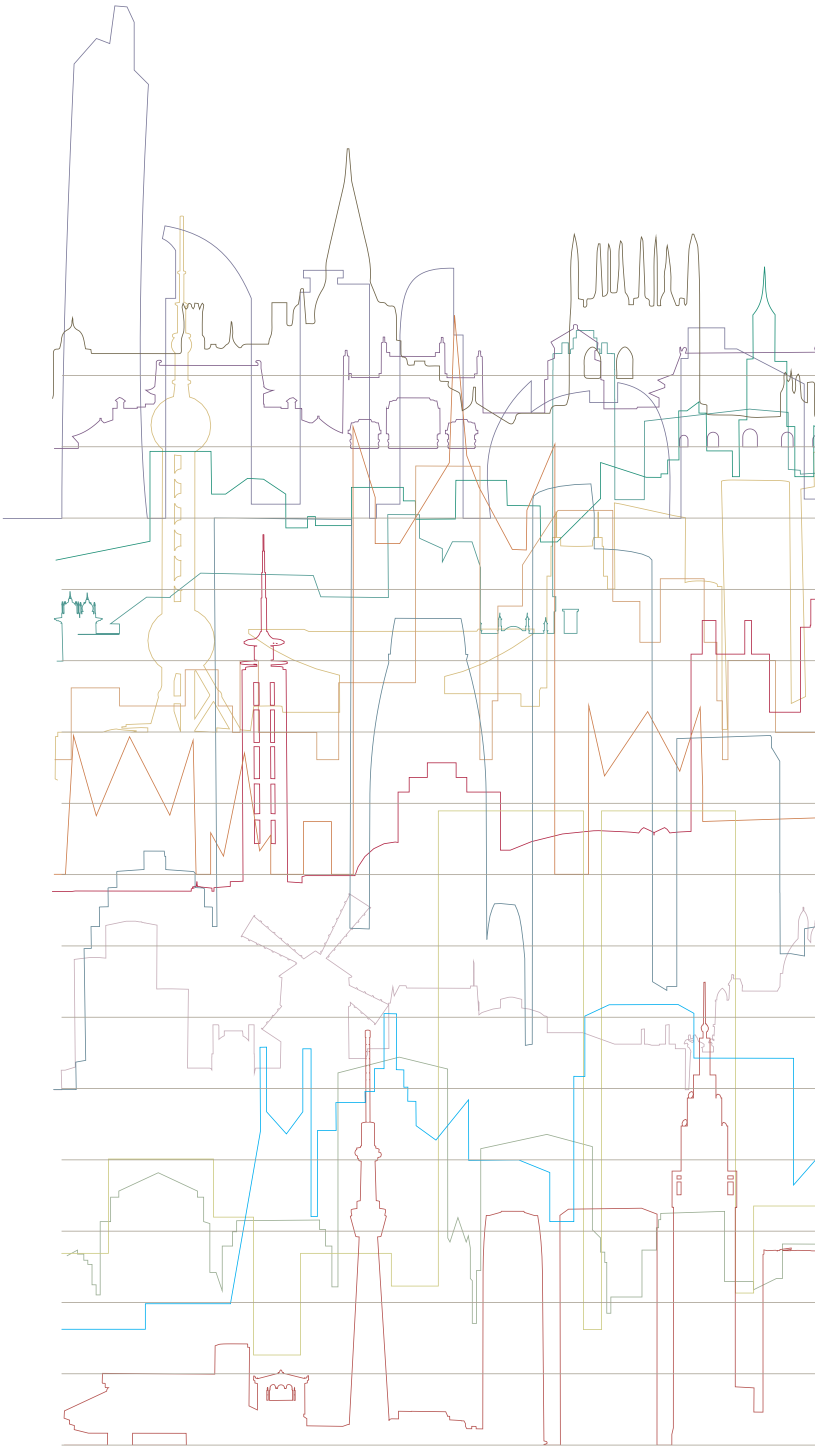

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Dr Rory Knight, is Chairman of Oxford Metrica and a member of the Board of the Templeton Foundations. He was formerly Dean of Templeton, Oxford University's business college. Prior to that Dr Knight was the vize-direktor at the Schweizerische Nationalbank (SNB) the Swiss central bank.

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