SPECIAL EDITION

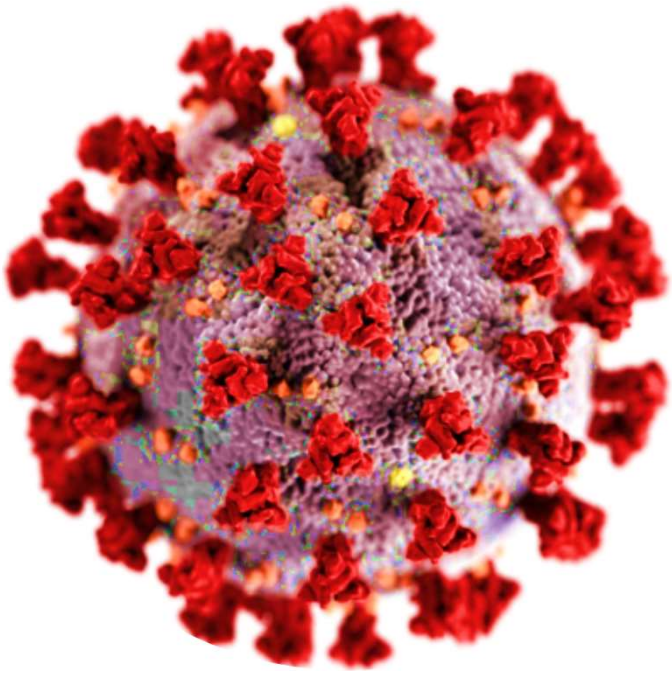
19 March 2020

SMART INVESTOR

BROUGHT TO YOU BY NMG BENEFITS

The impact of the

Coronavirus on global markets



The coronavirus scare has the world "on the edge of its seat", impacting everything from business activity to travel. The virus' impact on the global economy is noticeable, yet the full scale of its effects remains to be seen…

Reports of the rampant number of infections outside China have significantly impacted markets around the world. One prime example of the virus' impact is the recent cancellation of the Mobile World Congress (MWC) in Barcelona. The MWC is considered the most important mobile technology event in the world and its cancellation will, no doubt, impact mobile technology companies planning announcements and unveilings at the conference.

So far, the World Health Organisation has confirmed that as at 18 March 2020, 204,043 people around the world have been infected. Of the people infected, 8,231 have died – but over 80,000 have recovered at the time of writing. But what is next? And how will the virus impact the global economy?

The news has overshadowed positive economic data. US jobs report smashed expectations recently, with the US economy delivering 273,000 new jobs in February versus an anticipated 175,000. This pushed the unemployment rate down to 3.5%, in line with a 50-year low, although the results need to be taken with a hefty dose of salt as the data was gathered before the coronavirus spread increased substantially.

SMART INVESTOR
BROUGHT TO YOU BY NMG BENEFITS

The importance of China

China is both the world's second largest economy by GDP and the backbone of global manufacturing. In fact, it is the fastest country ever to reach second place, with the US holding a commanding lead.

There are numerous companies, across multiple industries around the world, which are dependent on Chinese manufacturing to stay in business. Therefore, it is no wonder the virus is having such a deep impact on the global economy.

Naturally, this means that the impact of the virus on production in China spreads far beyond the country's borders. Numerous international corporations have production facilities in China, including fashion brands such as GAP and Abercrombie & Fitch, telecommunications giants such as AT&T, tech companies such as Apple and many others. Many of these brands, such as sporting goods manufacturers Nike and Adidas, also rely heavily on income from retail in China. Nike, for example, produces 20% of its products in China and 17% of its revenue comes from sales in the country.

Moreover, the epidemic has impacted travel to and from China, as many airlines have cancelled flights to China across the board. In fact, passenger numbers have dropped by 55% as compared to last year. This does not only damage the travel industry in the form of flights and hotel reservation cancellations, but also significantly reduces tourist spending in the country. This can be summed up by China's Purchasing Managers Index (PMI) hitting 35.7, its lowest point since its inception in 2005.

THE INITIAL SCARE

When reports of a new, deadly virus surfaced in late January, the market initially panicked. Markets in China, which were just returning from the Lunar New Year holiday vacation, tumbled 10%, as many indices and ETFs showed dramatic declines. Moreover, a general shutdown of factory activity was put into effect across the country. To keep the market balanced, Beijing injected $174 billion into the market.

The impact was not limited to Asian markets, as many US-based companies are dependent on Chinese factories to manufacture their products. This was seen especially in the technology sector, which is why many tech companies were also on the decline in early February, dragging main Wall Street indices down with them. In addition, as China is the world's largest oil importer, the black gold also suffered a significant blow, dropping around 16%.

How will the virus affect Q1 profits?

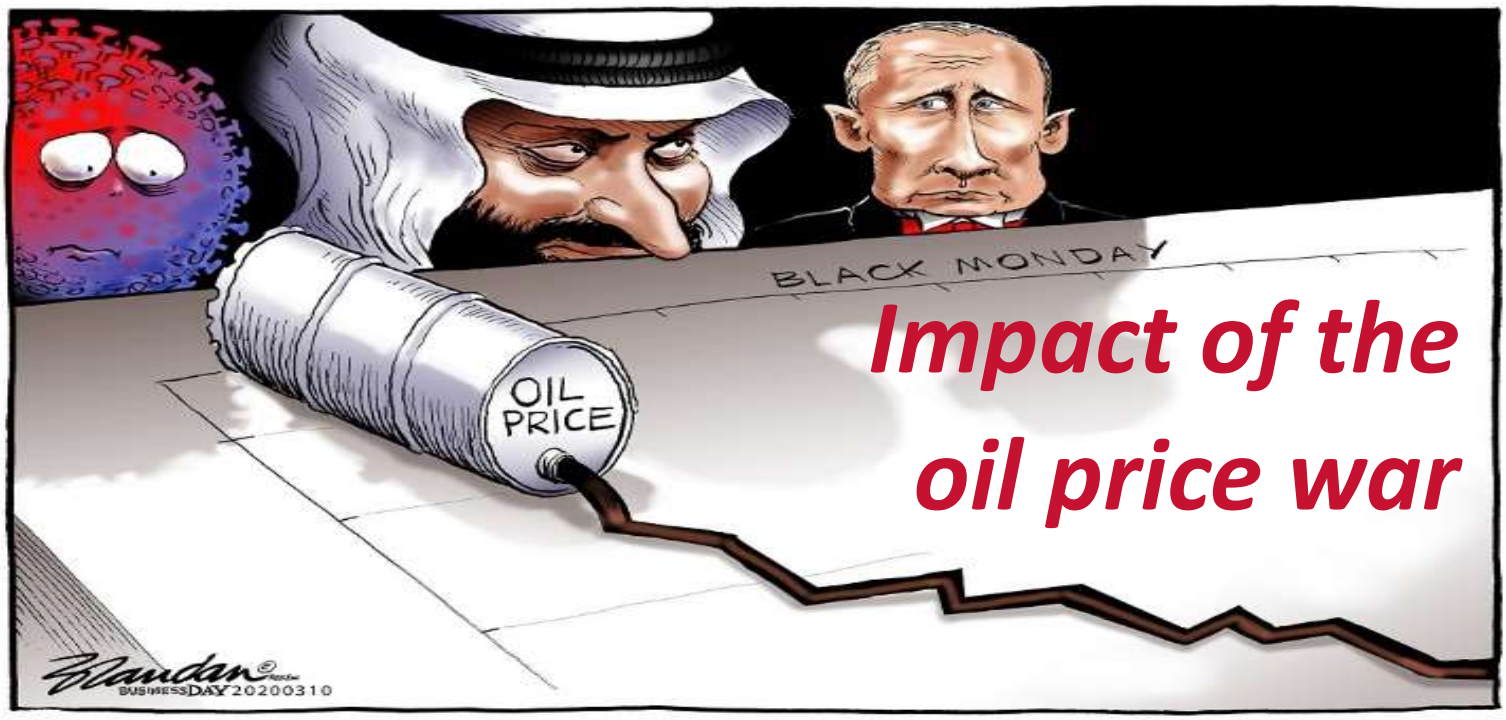
In mid-February, Apple, one of the world's largest companies, which relies heavily on Chinese production, issued a revenue warning. According to the company, the factory shutdown in China has damaged its production to such an effect that it will not be able to reach its iPhone manufacturing targets in Q1, 2020.

Apple is just one of many companies that have such a reliance on Chinese manufacturing, and it is very possible that other technology companies may also make such announcements. Several other high-profile companies issued similar warnings, including MasterCard, Coca-Cola and Procter & Gamble.

Gold on the rise

Traditionally, when global markets are down, safe-haven assets show gains. This time around, it is evident that investors are flocking to gold to hedge their investments, as the precious metal has risen in price tremendously, reaching levels not seen in eight years.

In mid-February, gold hit the psychologically important $1,600 mark and has continued to climb since. Some analysts believe that as long as the coronavirus continues to impact markets, gold prices could rise as high as their all-time high of nearly $1,800, set in 2011.



Impact of the oil price war

Oil prices plunged as much as 33% to $27.34 on Monday 9 March 2020, the lowest since 2016, after which it recovered slightly to just over $34 dollars per barrel. This marked the biggest one day fall since 1991. This came after last week's announcement that the OPEC allies, led by Russia, failed to agree to participate in OPEC's oil production cuts. This led to a retaliation from the world largest oil producer, Saudi Arabia, who slashed oil prices as it embarks on a pricing war.

The impact of the price war has put the rest of the world's oil producers under massive pressure, along with the banks most exposed to them, as the two sectors were hit hardest during Monday's market sell off. Among the casualties was South African energy producer, Sasol, whose share price fell by as much as 40% on the day, only to be followed by another massive drop on 12 March 2020 as the share price briefly dipped below the R29 level.

The Share price has now lost almost 95% of its value since April last year. With the potential of more oil production cuts on the cards, as Saudi Arabia escalates the price war and US shale produces come off line, there could potentially be more volatility to come.

But with every cloud comes a silver lining. South Africa is one of the world's most reliant countries on oil imports, with data indicating that net oil imports as a % of GDP amounts to over 3%. The sharp decline in oil prices will thus provide much needed relief to local cash strapped consumer, as well as energy producer Eskom, who has been relying heavily on its open-cycle gas turbines to meet electricity demand. Eskom has spent approximately R50bn on diesel since 2009, and as much as R6.5bn in its 2019 financial year.

Whether or not this will be a significant enough boost to avoid a ratings downgrade seems unlikely, however every cent saved improves the countries fiscal outlook.

Looking into the future

It is not possible to fully predict how the virus will impact markets. Currently, markets are declining around the world, as more and more cases of the virus are being reported outside of China, including several deaths reported in Italy. Wall Street is going through dramatic dips, such as the $1.77 trillion which was erased from the SPX500 in just two days. The impact is not limited to the US and Asia – the UK100 index, GER30 and FRA40 have also suffered significant blows. Whether or not the bearish trend will continue, remains to be seen.

What next for investors?

As equity markets have been sent into a tailspin and macroeconomic forecasting into overdrive by coronavirus. The economic growth prospects and risks are interconnected. In addition, fundamental factors that work in financial markets such as consumer spending are connected to supply chains in which China is often a common denominator. We view supply chains in electronics, electrical equipment and textiles stand to be hit the hardest, because of the Chinese share of output in those sectors. It is important for investors to consider risks such as contagion impact, its effects and crisis management preparation when making investments into the businesses. Liquidity, balance sheet strength, exposure to the yen, dollar, Swiss franc and gold are some of the themes NMG is assessing for its clients.

We cannot underestimate the negative impact that the Coronavirus will have on short term earnings of many companies as they incur losses. For some businesses, the impact could be more devastating than others. Airlines, hotels and cruise ships are expected to bear the biggest brunt.

It is however important to remember that Macro events, even ones as severe and scary as COVID-19, don't usually have material long-term impact on the true value of high quality companies with good balance sheets. If the intrinsic value of a businesses does not change, we can expect the business to recover in good time as the world normalizes.

DON'T PANIC!

As long term investors in equity markets, we always need to be prepared for economic downturns.

This is especially true for investors who are saving towards long term financial goals such as retirement fund savings. It is imperative that we do not lose sight of this long-term financial strategy when faced with economic, political and stock market crises.

Market upswings make investing in share markets attractive, but market downturns are the opportunity cost of achieving bigger returns over time. History has proven to us time and time again that drastic market declines are always followed by an exponential recovery, thus rewarding patient investors.

As a long term investor in growth assets, we should be happy to ride out the market cycles. The best form of protection against large swings is a well-diversified portfolio!

Finding a better way