"Disease desperate grown, by desperate appliances are relieved, or not at all"
Hamlet act iv scene 3

COV-19 has gone global despite the largest ever 'cordon sanitaire', restricting the movement of more than 50m Chinese people. As the international response clicks into gear, it seems the virus will continue to spread until the cleansing heat of summer arrives and/or a vaccine is discovered.

Beyond the sad loss of life, the economic cost to China has been huge. The February purchasing managers indices (PMI) show a slump in manufacturing (35.7) and services (29.6) activity. Both readings are lower than the financial crisis and, at less than 50, indicate rapid economic contraction. Encouragingly, there are signs that the infection rate in China has peaked and citizens are slowly returning to work. This has prompted talk of a rapid 'V' shaped recovery, an optimistic notion that we struggle to share.

Firstly, to avoid a renewed outbreak as workers return to their crowded, 'virus-friendly' factories, elements of the disruptive restrictions will remain in place, with communities being quarantined if infection rates spike. Even if the majority return to productive employment by the end of March, China's recovery will be hamstrung by the global spread of the disease. Virus-hit South Korea and Japan are integral parts of the Chinese supply chain and the demand for Chinese exports will soften as the rest of the world enters a period of rolling economic and social dislocation.

The unfolding epidemic outside China will remain a significant drag on growth as we head into the summer. Despite superior healthcare, it could prove harder to control the virus in western democracies; unlike Chinese citizens, westerners are less prone to obeying the diktats of their politicians, making quarantines hard to enforce. Furthermore, we are only in the early stages of a 'social winter' as people panic and authorities take increasingly draconian steps to contain the virus: many Italian Serie A matches were played behind closed doors last weekend; Japan has shuttered all schools until the end of April; Saudi has restricted travel to Mecca and Medina; the US and Korea have postponed joint military operations and numerous companies have cancelled seminars and conferences. In the meantime, travel bans are becoming commonplace as facemasks and hand gel sell out across Europe (despite their limited worth).

If this narrative were unfolding early or mid-way through a business cycle, it would be much easier to forecast a rapid recovery. However, to quote John Gent, one of our Investment Committee, "this crisis is impacting supply chains and final demand at a time when (a) the global economy was already sluggish after the hit of tariff increases and Brexit (b) monetary policy's impact on fixed investment has been weakening for many years (c) the pervasive use of the private equity business model has created a much larger segment of over-indebted corporates and (d) we have more instruments like ETFs that amplify vicious cycles set off by market declines."

To highlight just one element, poor quality borrowers are already challenged. Low quality energy companies must now pay 10% more than a US treasury when issuing high yield debt; in late 2018 the spread was less than 4%. Unicredit, a tier 1 Italian bank, issued a 7-year bond on February 12th. Priced at 100, the bond now trades at 89; a loss of 11% or three times the bonds coupon. Finally, venture capital/private equity backed companies that rely on an unquestioning flow of cheap investment to sustain their unprofitable business models will surely struggle as revenues falter; caveat WeWork.

Put simply, there are plenty of fragilities born of an over-extended business cycle and (QE fueled) poor capital allocation that will be tested by this economic pothole. A corona grenade has been lobbed into the economic pond; we wait to see what fish (whales?) surface.

Turning to markets, after being initially dismissive, the accelerating global infection rate has finally triggered a reaction. Safe haven assets have been heavily bid, with the yield on the 10-year US treasury falling to 1%, a record low. In Europe, the yield on the 30-year German bund turned negative. Conversely, equities saw pervasive weakness with the S&P500 having its worst week since the financial crisis, losing 10% in record time.

Looking forward, news flow will continue to deteriorate as, apart from the recent Chinese PMI, economic data has yet to turn. Similarly, corporate guidance has only just started to sour, with worse expected as we head towards the (end March) first quarter earnings season. It is hard to see sentiment improving in the near term. Similarly, politics could prove a wildcard as disruption and hardship lead citizens to question the competence of the incumbents.

Whilst the long run impact of corona mismanagement on President Xi's and Ayatollah Khamenei's authority bears future analysis, the most immediate political questions hang over the November US Presidential election.

As the virus builds in the US, Trump needs to deliver a coordinated, competent response. This will be more difficult after he fired both his homeland security pandemic co-ordinator and his Director of global health security and biodefense in 2019. As other countries have already proven, managing the fallout from this infection is a messy, chaotic business. In many ways, fear of the virus is more damaging than the disease itself. As it spreads across the US, will Trump be blamed by the electorate if the response is found lacking? As importantly, if the stock market remains under pressure and the economy flirts with recession, the electorate will become restless. As Clinton famously noted, the key variable for getting re-elected is "the economy, stupid".

All of which sharpens our focus on the ballots to select the Democratic Presidential nominee. On March 3rd we have the "Super Tuesday" primaries that account for 34% of the pledged delegates. With left-wing Bernie Sanders and the centrist Joe Biden competing to be the lead contender, a decent showing from either candidate will firmly establish them as Trump's likely opponent. At this time, the bookies see Trump beating both contenders. Whilst that remains the most likely outcome, if Trump's (in)competency is exposed by a corona epidemic and the late-arrival of Mike Bloomberg splits the center-ground vote, this could open a path to the White House for Sanders. In normal times we would argue that the US is not ready to elect a socialist; but these are unusual times. Equity markets would take a dim view if Bernie builds momentum.

All of this has naturally led to questions of whether to "buy the dip". For the past decade, it has been profitable to add to equity risk, particularly in the US, on any 10%+ pullback. Whilst the pace and violence of the sell off has been unsettling, we note that the scale is relatively modest. By the end of February, the MSCI World equity index had lost 12%; uncomfortable but much less than the sell offs in 2011 (-23%), 2015 (-18%) and 2018 (-20%). After a decent run-up in 2019, the index has only retraced the last 4 months.

In the near term, equities could indeed bounce after such a sharp fall. This recovery could be amplified by monetary and fiscal stimulus, as the major central banks and governments act to stave off a precipitous slowdown. Futures markets are already pricing in three US rate cuts this year and the HK government has just given every permanent resident HK$10,000; others will follow suit. The question thereafter is whether this response will bear fruit. Will lower rates, more QE funds, tax cuts and handouts stimulate corporate activity and aggregate demand, thereby prolonging this aging cycle beyond a corona soft patch? Or are we at the end of the cycle, where stimulus loses its efficacy and the COV-19 slowdown finally calls time on the accumulated excesses of the last decade. The next month or so will be telling.

The UK — Deficit & Surplus Regions

As Prime Minster Johnson looks set to tear up the government's fiscal rules to boost spending in the North of England, it is interesting to look at the existing regional disparity. Below are figures showing the revenue (tax) and expenditure per head in different parts of the UK; the net fiscal surplus or deficit is shown in the right hand column. The figures are from the Office for National Statistics.

UK Public Sector					
Revenues and Expenditure	**Revenue**		**Expenditure**		**net fiscal balanced**
2018-19	**per head £**		**per head £**		**per head £**
UK	12,213	-	12,835	-	**622**
England	12,470	-	12,559	-	**89**
Wales	9,391	-	13,698	-	**4,307**
Scotland	12,015	-	14,497	-	**2,482**
Northern Ireland	9,825	-	14,821	-	**4,996**
North East	9,495	-	13,560	-	**4,065**
North West	10,159	-	12,939	-	**2,780**
Yorkshire & the Humber	10,188	-	12,278	-	**2,090**
East Midlands	10,461	-	11,784	-	**1,323**
West Midlands	9,959	-	12,503	-	**2,544**
East of England	12,433	-	11,772		**661**
London	18,177	-	13,826		**4,351**
South East	14,341	-	11,967		**2,374**
South West	11,406	-	12,405	-	**999**
ONS: Country & regional public sector finances, 2018					

As one would have guessed, whilst England is about break even, Wales, Scotland and Northern Ireland are in significant deficit. Inside England, the east, south east and London funds the rest. Whilst highlighting the glaring disparity and reinforcing the need for a productivity revolution outside London and the south/south east, it also suggests that we can ill-afford to neglect the more prosperous regions as this government seeks to consolidate its new found voters in the northern reaches.

Policy Matrix Summary

The matrix below is a summary of our current outlook for the various equity, bond and commodity markets that we monitor. It shows areas where we are either positive or negative; for all other asset classes, we have a neutral view. It is not intended as anything other than a high level guide on where we stand at this time.

6-12 Month view	Overall	Equities	Bonds	Alternatives
+	Alternatives Cash	Latin America Gold Miners China A Shares UK mid-caps	Inflation Linked Emerging Market	Uncorrelated Strategies Gold
−	Equities Bonds	European US Technology	UK European panese Corporate High Yield	

Market Performance

All performance numbers show % changes except for bond yields which show yield changes.

	29 Feb 20	-1 Mth	-3 Mth	-12 Mth
CURRENCIES (VS USD)				
GBP	1.2823	-2.9%	-0.8%	-3.3%
CHF	1.0359	-0.2%	3.6%	3.4%
AUD	0.6515	-2.6%	-3.7%	-8.2%
JPY	107.8900	-0.4%	-1.5%	-3.1%
EUR	1.1026	-0.6%	0.1%	-3.0%
BOND YIELDS (10 yr)				
UK	0.44	-0.08	-0.26	-0.86
US	1.15	-0.36	-0.63	-1.57
Germany	-0.61	-0.17	-0.25	-0.79
Australia	0.82	-0.13	-0.22	-1.29
Japan	-0.16	-0.09	-0.08	-0.13
EQUITIES				
US. S&P 500 (USD)	2,954.22	-8.4%	-5.9%	6.1%
UK. FTSE 100 (GBP)	6,580.61	-9.7%	-10.4%	-7.0%
FTSE Europe Ex UK (local)	263.57	-7.8%	-7.0%	2.9%
Japan. Topix (JPY)	1,510.87	-10.3%	-11.1%	-6.0%
China. Shanghai Comp (RMB)	2,880.30	-3.2%	0.3%	-2.1%
HK. Hang Seng (HKD)	26,129.93	-0.7%	-0.8%	-8.7%
Australia. All Ords (AUD)	6,511.50	-8.6%	-6.3%	4.1%
FTSE Asia Pac ex Japan	522.29	-4.5%	-3.1%	-2.7%
FTSE World (USD)	601.05	-8.6%	-6.6%	2.1%
FTSE World (GBP)	697.65	-5.7%	-5.4%	6.3%
COMMODITIES				
Oil (WTI)	44.76	-13.4%	-18.2%	-23.6%
Gold	1585.69	-0.2%	8.3%	20.7%

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