The journey

momentum
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COVID-19 AND YOUR INVESTMENTS

Introduction

Global financial markets have been volatile over the past year, with the uncertainty of 2019 primarily being due to the escalating US-China trade war.

Adding to this, in December 2019, the first case of COVID-19 was diagnosed! The SARS-CoV-2 coronavirus epidemic that began in China's Hubei province continues to spread and has led to significant infections in South Korea, Italy, Iran and the United Kingdom. Cases are being reported elsewhere daily, with South Africa now no longer being the exception as our infection count also increases daily.

Impact of COVID-19 on markets

The economic cost associated with a severe epidemic is estimated to be approximately $2.7 trillion in lost output. The Organisation for Economic Co-operation and Development (OECD) cautioned that the pace of global growth could halve if the spread of the coronavirus is not contained. The OECD has cut its expectation for global growth to 2.4% from 2.9% and warned that it could fall as low as 1.5%.

Should the outbreak peak in the first half of 2020, a recession in major economies may be short-lived and a recovery could follow in the second half of the year. Having said that, declining corporate profitability and deteriorating financial conditions may limit the extent of a subsequent recovery.

The reaction of global equity markets has been severe with the US equity markets falling 26% year-to-date. Locally, the South African stock (All Share Index, or "ALSI") market has fallen 22%. Domestic and major international equity markets continued to sell off in the first half of March 2020. The performance of portfolios with relatively high allocations to equities and other growth assets such as listed property has consequently been disappointing.

The alternative

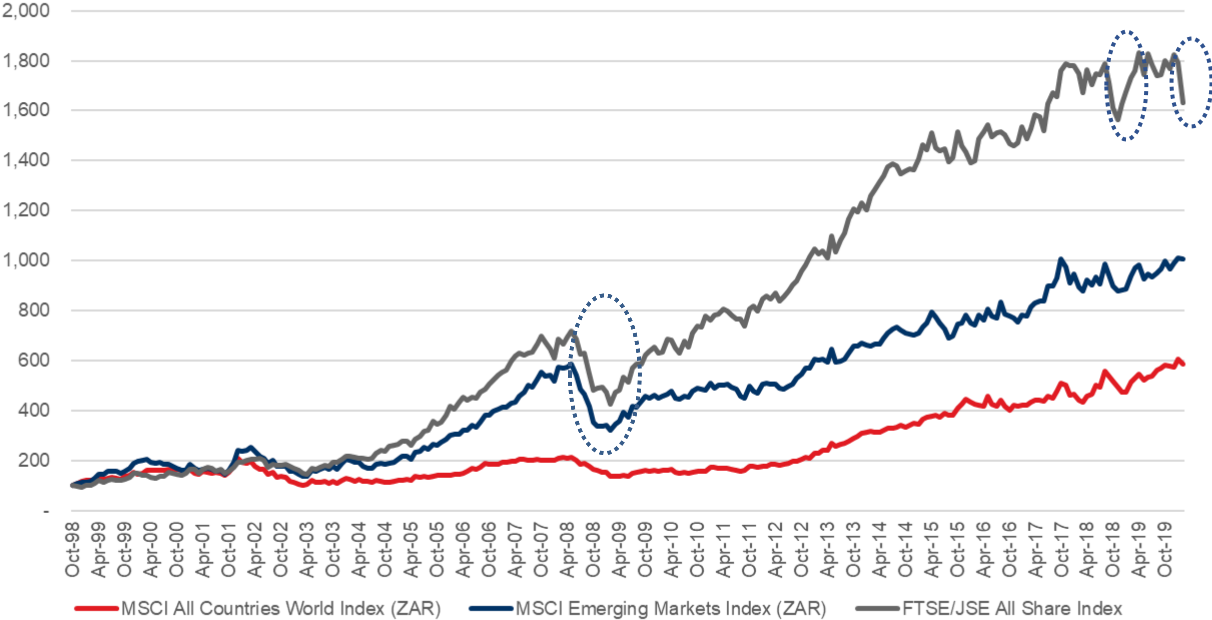
Although cash and bonds are not as severely impacted by the outbreak, they are unlikely to return more than inflation + 2% per annum over the long-term. Defined contribution funds generally target investment returns in the region of inflation +5% to ensure that their members achieve a reasonable retirement outcome. To achieve a long-term real return of 5% or more it is necessary for funds to invest in equities and other growth assets rather than an overweight allocation to cash and bonds.

A material allocation to growth assets exposes the investor to greater short-term volatility. Higher volatility is managed through efficient portfolio construction and diversification across shares, asset classes, asset strategies and geographies. More conservative strategies have higher allocations to defensive asset classes and returns are consequently less volatile but are on average lower in the long term than portfolios targeting a higher long-term return.

It is critical that investors understand the investment outcome they are aiming for as well as the risk profile of their investment strategy. This knowledge will guide them to stay the course in volatile market conditions rather than to flee to less volatile but possibly inappropriate asset classes.

The history

It is important to remember that we have experienced volatile markets like this before, on more than one occasion. The graph below shows the cumulative performance of the FTSE / JSE All Share Index (ALSI), the MSCI Emerging market and the MSCI All Countries World indices since 1998.



What the graph shows is the major market declines through time. As an example, over the three months to November 2018, the South African equity market posted losses of 14.5%, a retraction of similar magnitude to what we have just experienced. The ALSI subsequently quickly recovered.

Going back further, consider the recovery of the ALSI after the market crash of 2008. Note how strongly the market has performed on a cumulative basis since then. Also consider the likely returns investors would have experienced had they taken their money out of the market and missed the runs post these market shocks.

The sharp recovery of 2008/09 may not be repeated in the current market environment as it may take time for trade volumes to revert to historical levels, but we ultimately expect reversion over the medium term.

What should investors do?

When investment markets are volatile, it's tempting to make emotive decisions based on the positive or negative information we see in the media. Momentum Consultants and Actuaries recommends that funds stay invested and stick to your long-term investment strategy except if the circumstances of their members change which will warrant a full review of the investment philosophy.

It is easy to get caught up in the negative sentiment that often drives markets, rather than focusing on the fact that these markets comprise assets such as underlying companies, that continue to generate earnings even in challenging market conditions. Global research over many years shows that investors who stick to a carefully constructed long-term investment strategy outperform investors who make many changes based on short-term market volatility. We encourage you to consult with a suitably qualified consultant before making any changes to your fund's investment strategy.

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for Momentum Consultants & Actuaries
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