LGT Vestra Snapshot - East versus West: the impact of coronavirus – 08.04.2020

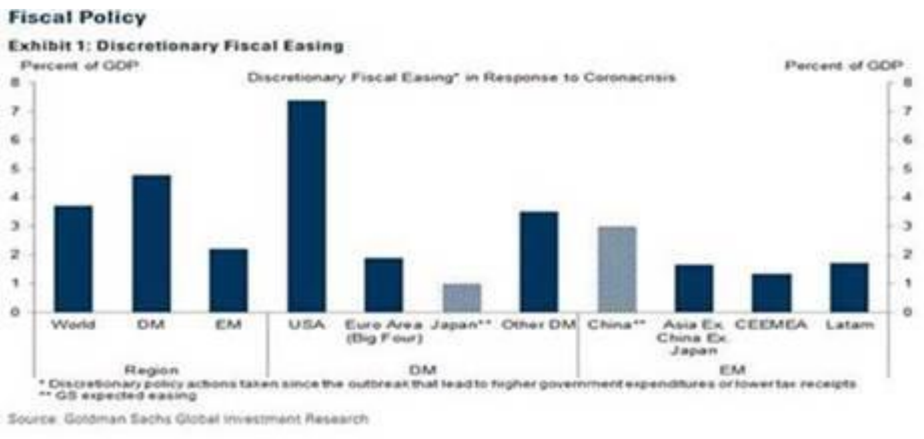
East versus West: the impact of coronavirus

8th April 2020

The old adage used to say that when the US sneezed the rest of the world caught a cold, however for the last few years there has been increasing evidence that there is a decoupling underway between the East and the West. The evidence of this decoupling is particularly clear when assessing how both parts of the world have dealt with the Coronavirus and how this has impacted the stock market performance of these respective regions. Thus far, from a stock market perspective, Asia has been successful in decoupling itself from the West as Asian assets are outperforming western assets, and with a lower volatility. Since the start of this year, the IA Asia Pacific ex Japan Index is down -15.56%, China's Shanghai stock market down just -11.57%, whereas the FTSE 100 is down 25.26%, MSCI World down -18.53% and the S&P down -17.24% (source for all five, FE Analytics 07.04.2020). If this difference in performance continues, then investors will take note.

Broadly speaking, while Asia* went into lockdown much quicker and implemented this lockdown in a more comprehensive manner via testing, contact tracing, obligatory mobile phone applications, mass temperature screening and severe punishments for flouting the rules - their fiscal response has been more measured and reserved than the West. On the other side of the world, the UK and the US were slow to put in place lockdown measures - and even when they did, it felt alarmingly impotent as people continued to party with impunity. Meanwhile, the US and UK have responded to the economic lockdown with huge and unprecedented fiscal measures, aimed at maintaining household incomes and stave off a wave of mass bankruptcies. It appears that Asia's forthrightness early on in the crisis, has allowed them to emerge from the lockdown quicker, and with the requirement for fewer fiscal measures. The table below from Goldman Sachs clearly demonstrates this imbalance between Western and Emerging Market (EM) fiscal easing.

Discretionary fiscal easing



Source: Goldman Sachs Global Investment Research

Aside from the well versed benefits that emerging economies have over the West, such as better demographics and having greater growth potential, we believe that Asia has two other noteworthy advantages that could allow them to emerge from this slowdown in a strong positon.

Firstly, from a monetary policy (interest rate) perspective, Asia are a few years behind the West. Interest rates in the western world are already at all-time lows. This means that the impact of any further rate cuts to consumers and businesses in the Developed World is minimal (ie consumers get very little benefit if rates go from 0.25% to 0%, as mortgage rates cannot go lower). Meanwhile, Asia's starting point for interest rates was much higher coming into this downturn therefore, has considerably more monetary ammunition to stimulate the economy as the impact of these cuts are more powerful on the end consumers and businesses.

Secondly, the dramatic fall in the price of oil will be beneficial to Asia and in particular, China and India. Both these economies are large net importers of oil. In fact, when you look at the impact that it could have on stimulating the economy it is quite staggering. For India, it could amount to a figure close to 2% of their GDP. For China, one of the world's largest importers of oil, it will also act as a powerful stimulant to growth. When combined with other local fiscal and monetary action, we believe that the mix for economic recovery is potent. A final point to be made here is that we have seen Asian (and EM) currencies sell off sharply versus the Dollar during this crisis, further making the case for some Asian currency exposure very compelling.

While we believe there are still extremely compelling investment opportunities in Western economies, it is no secret that the very long term prospects for Western economies were already dwindling as a consequence of higher debt, aging populations and lower growth. The early indications of the impact of the Coronavirus are that it will saddle Western governments and companies with yet more debt to service. On the flip side, Asia, free from the weight of the excessive debt burden hanging from their neck, looks set to emerge from this crisis in better order, with its youthful population and companies trading at attractive valuations. Many of our investments, even our UK funds, will be beneficiaries of this growing middle class in Asia. For example, our largest holding in the Balanced model portfolio on a look through basis, Unilever, achieves 59% of revenues from emerging markets despite being listed on the London Stock Exchange (source: Unilever Q4 results).

Following the changes that we made to the LGT Vestra Model Portfolios (MPS) at the end of March, our Investment Committee continues to meet on a regular basis as we continue to evaluate the situation both close to home but also further afar. When the opportunity arises we may look to change our equity allocation to Asia and China.

*Japan has been excluded from the references to Asia.

Quarterly commentary and dial-in

The standard MPS commentary for the quarter-end will be available this afternoon. Tomorrow we are hosting scheduled dial-ins with members of the MPS team to give further insight into our market views, performance attribution, portfolio positioning and what we think may lie ahead. If you do not usually receive our quarterly commentary and would like to or would like the details of the dial-in, please reply to this email.

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