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Update on current market developments

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The 2008 global financial crisis was caused by the banking system experiencing a funding crisis, which then negatively impacted its solvency position as banks were forced to sell assets at distressed levels in order to raise cash to meet the claims of depositors. The current financial crisis is unique and has been caused by an unexpected and abrupt halt to the free movement of people in a number of Western countries in order to contain the spread of the Coronavirus.

The immediate consequence of this has been a significant reduction in consumers' discretionary spending. Sectors which are particularly hard hit are airlines, restaurant chains and the leisure industry in general. The hit to consumer spending will be exacerbated by a sharp reduction in labour incomes in those sectors as many staff will inevitably be laid off. In this environment it is reasonable to expect a significant deceleration in global economic activity and a marked decline in corporate earnings, reflecting weaker revenues and reduced pricing power. The significant decline in equity valuations in recent weeks reflects much of this outlook.

In recent days we have seen further bold action from the world's key central banks. Rates have been cut dramatically by the Fed and brought down by the Bank of England. The Fed, Bank of Japan and the European Central Bank have announced more quantitative easing and it is quite likely that the Bank of England will follow suit.

Elsewhere, most countries have put in place programmes to try to ensure adequate credit lines for business to borrow against a temporary downturn. Considerable liquidity has been released into markets to ensure that funding stress is kept to a minimum and to ensure that financial markets continue to function. Building upon central bank action, governments are providing fiscal stimulus to support those companies and individuals most affected by what will be a sharp reduction in economic activity. In this context the French President has said companies in France will not be allowed to go bust, which he hopes to achieve through tax breaks and credit lines.

Despite central bank and government support it is likely that market participants will want to see considerably more guidance from the corporate sector regarding the likely hit to revenues and profits from the Corona Virus outbreak before we will see a meaningful improvement in sentiment. However, in the current uncertain and fast-moving environment most companies are, quite understandably, reluctant to commit to giving much in the way of guidance to investors. Elsewhere, economic data releases are only now beginning to reflect the impact on global economic activity. In the short term, and reflecting what is still an information vacuum, we are likely to see ongoing volatility in financial markets, notwithstanding the much cheaper equity market valuations available relative to the start of the year.

Inevitably equity markets will find an appropriate clearing level which will then form a platform for a meaningful improvement in sentiment. The catalyst for this is likely to be a combination of further aggressive official policy support, improving visibility on the outlook for revenues and profits and the pathway to a more normal economic environment becoming clearer.

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