INVESTMENT UPDATE

Financial Framework
wealth and estate planning

Coronavirus Update

11th March 2020

As humans, we tend to panic about uncertainty while it's happening to us and as we react to the media and the news in general real or 'fake'. We tend to think this will last for longer and be more destructive than is usually the case. It's a behavioural error we all make. Later on, we regain perspective and realise it wasn't so bad after all.

There is no doubt that the Coronavirus is bad and the lack of response from the US to control the virus alongside a badly timed price war in the oil market has led to financial markets reacting violently, leaving global equities dropping and government bond yields falling to unprecedented levels.

But what does this actually mean to you? It's at this time where it is important to keep perspective. Events such as the October 1987 stock market crash, the Asian financial crisis and the tragic events of September 2001 are all examples of moments in time that seemed catastrophic for markets, but the world recovered afterwards.

By holding well diversified, globally spread, multi-asset portfolios, the risk of a single event causing a large drop in your portfolio can be managed. Financial planners know this, which is why you trust them to build your financial plan in the first place. They build you a long-term plan and work with investment houses that can provide these types of investments and match them to your risk profile.

This is all well and good in theory but what has actually happened in practice...

Take a cautious investor in a well-diversified strategy designed to provide capital protection whilst aiming to achieve a return over inflation in the long term. Whilst the FTSE 100 may have dropped 13.4% Year to Date as at Friday 6th March, an investor invested in this type Fund would be up 0.46% (6th March 2020). The portfolio is doing everything it is designed to do for the type of investor that is suited to it.

On the flip side, an Adventurous investor in a typical Multi-Manager Adventurous Fund is down 6.82% on the year, which is still only around half of the FTSE, showing that even those investors who don't lose sleep at night are still getting protection from well diversified multi-asset portfolios. The type of protection that trackers and individual stocks just cannot.

Well diversified, multi-asset strategies based on strong Strategic Asset Allocations are designed to weather these storms and protect your money by spreading it across the globe and across asset classes so that if one thing falls, such as the FTSE, it is offset by other assets, such as US Government Bonds. This is your long-term anchor, allowing you to invest, safe in the knowledge that your portfolio will, over a reasonable time period, reflect the characteristics and investment goals that you signed up for.

Let's not forget, China and South Korea responded quickly and drastically to the virus – and have seen new infections falling, suggesting a path forward for the rest of the world. If the infection rate can be brought under control, and stimulus measures used to support the economy, things may not be as dark as they seem.

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How should we respond? Behavioural Finance and the markets
Behavioural finance is defined as: "The study of the influence of psychology on the behaviours of investors or financial analysts. It also includes the subsequent effects on markets. It focuses on the fact that investors are not always rational, have limits to self-control, and are influenced by their own biases."

According to Carl Richards in his book The Behaviour Gap: Simple Ways to Stop Doing Dumb Things with Money':

"It's not that we're dumb. We're wired to avoid pain and pursue pleasure and security. It feels right to sell when everyone around us is scared and buy when everyone feels great. It may feel right, but it's not rational."

The outcome of analysis shows that investors tend to react negatively and want to sell their investment assets when prices have already fallen, meaning they sell at the bottom and miss out on any subsequent recovery. They feel it is 'safe' to invest again once the 'panic' is over and 'things have settled down'. By this time, they have often missed most or all of the upside. Investors behaviour is driven by emotion and, although understandable, it goes against the most fundamental principal of investing which is to 'buy low and sell high'. The emotional response is often the inverse of what we should be doing, as demonstrated by the below diagram illustrating investor behaviour at different points of a market cycle:

It is important to try and focus on the fundamentals of the markets and remember that strategies are implemented for the long term. Although events like those we have experienced in the last few days inevitably concerns clients, for the shrewd investor who can see through the noise and focus on the longer term, it also creates buying opportunities.

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In summary
The market is clearly responding to new information as it becomes known, but the market is pricing in unknowns, too. As risk increases during a time of heightened uncertainty, so do the returns investors demand for bearing that risk, which pushes prices lower. Investment approach is based on the principle that prices are set to deliver positive future expected returns for holding risky assets.

The important role financial professionals play in helping investors develop a long-term plan they can stick with in a variety of conditions. Financial professionals are trained to consider a wide range of possible outcomes, both good and bad, when helping an investor establish an asset allocation and plan. Those preparations include the possibility, even the inevitability, of a downturn. Amid the anxiety that accompanies developments surrounding the coronavirus, decades of financial science and long-term investing principles remain a strong guide.

10th March: 'The day after'....
The FTSE 100 has recovered some ground from yesterday's 'Black Monday' sell-off, regaining its footing above the 6,000 mark as investors eyed the launch of fresh stimulus to fight the economic impact of the global coronavirus outbreak.

The UK blue-chip index rose 152 points, or 2.6%, to 6,117, clawing back some of the losses from yesterday's 497-point, 7.7% plunge.

The oil price rose, with the price of a barrel of Brent crude climbing 5.1% to $36.12 a barrel, after losing a quarter of its value yesterday in its biggest one-day fall since the 1991 Gulf war.

On the FTSE 100, Shell (RDSb) and BP (BP) were among the biggest risers, after the oil majors were hit hard in yesterday's sell-off. Their shares climbed 4.3% to £13.61 and 3.3% to 328.6p respectively.

'Mid-cap' stocks on the FTSE 250 climbed 2.3% and other European markets also lifted at the open, with the German DAX 30 up 1.5% and France's CAC 40 adding 1.8%. Italy's FTSE MIB was up 2.4%, despite the country's government yesterday extending emergency measures to fight the spread of the coronavirus nationwide. These include travel restrictions and a ban on public gatherings.

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