

THEMATIC



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*To be fully
comprehensive,
Central Banks reviews
need to reassess their
independence*

As part of Global Research, the main mission of the newly established Global Views team is to strengthen Amundi's thought on key cross-cutting thematic

Should Central Banks save us from ourselves?

From unemployment and inflation to climate change and social inequality, central banks (CB) are on the frontlines. In the context of the ECB's and the Federal Reserve's strategic reviews there are now open debates about their new tools, targets and mandates. But a more profound change in central banks' behaviour should also be discussed, regarding recession aversion, fiscal dependence and markets interaction.

Central banks have become recession-adverse

Over the past decades, CBs have mainly been re-active to external shocks and significant accelerations or slowdowns affecting the economy. They have carefully dealt with the normal phasing of the economic cycle as a natural adjustment, in a sort of cyclical neutrality. Hence, the common view that central banks are "behind the curve" i.e. financial markets are adjusting faster than monetary policy.

But 2018-19 shows a different picture. Major central banks have pro-actively changed their policies without hard evidence of an economic slowdown, as if they were trying to erase the risk before the fact. This recession aversion is different from the implicit "Fed put" often discussed by market participants and researchers as an ultimate safety net for investors in phases of significant turmoil. Both Fed and ECB policies intended to prevent a negative phase of the economic cycle. This behaviour has surprised investors, hence the stellar performances across asset classes in the second half of last year.

Why is it so important to avoid a recession?

The first explanation is that the global economy is still fragile, and a traditional cyclical slowdown could cause significant damage. Many countries that did not improve their economic resilience through structural reforms and public debt reductions might struggle in a recession if the bond market questioned their debt sustainability. In a context of rising populism, a wait-and-see attitude can therefore be dangerous. Secondly, central banks might simply be short of ammunitions to deal with a recession, and therefore need to stop the disease as soon as the early symptoms appear. These good reasons emphasize CBs' cyclical dependency.

Fiscalisation of monetary policy

Another important change is the link between fiscal and monetary policy. According to textbooks, monetary policy is a short-term fix in reaction to an economic shock (such as Covid-19) or to a pronounced slowdown of the economy, before fiscal policy kicks in to restore the growth path. Monetary policy can be implemented in a timely and technocratic manner while fiscal policy requires political

support. The independent central bank pursues inflation targeting and carefully avoids long-term imbalances. We know that, in reality, things are more complex. But still, this has been the intellectual framework among advanced economies. Now Christine Lagarde is calling for more support from euro-area countries with budget surpluses. Although a closer coordination of fiscal and monetary policy looks reasonable, the new mantra is *fiscalisation of monetary policy*. There is a difference between coordination and condition, just as there is a difference between correlation and causality. Though coordination is needed, if monetary policy becomes a condition of fiscal policy then it undermines CBs' independence. Moreover, in an economy where debt to GDP is close to 100%, interest rates are below 1%, taxes account for 40% of GDP, and the central bank is buying 60% of net government debt issuance, the difference between *fiscalisation of monetary policy* and *monetization of fiscal policy* is only semantic. The risk is therefore a loss of credibility in an attempt to support economic growth.

Market and CB reflexivity

Like never before, investors' behaviour and asset classes' movements have become a direct function of central bank decisions, as well as a measure of success of their policies. QE and negative interest rates have significant implications for financial markets, as they erase the need for, and therefore the value of, hedging strategies, while lowering risk premia and artificially increasing diversification. Yet, central banks' influence on wide range of financial instruments leads to a form of Hegelian master-slave dialectic at the expense of their independence. As they try to protect investors and states, CBs become market-dependent.

To be fully comprehensive, the CB strategic reviews need to take these developments into account. While central banks are trying to save us from ourselves, they undermine their own credibility in a form of triple dependence on the economic cycle, fiscal policy and financial markets.

Finalised on 26/02/2020

Central banks reviews

| | |
|-----------------------|---------|
| European Central Bank | 4Q 2020 |
| Federal Reserve | 2Q 2020 |

THEMATIC



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We evaluate two direct channels of domestic stress, consumer and production

Coronavirus and Italy's vulnerability

A deep dive: from local impact to national implications

We leverage data from the Italian statistics office (ISTAT) at a regional and provincial level to put the possible impact of the virus outbreak on economic growth into perspective. With considerable uncertainty about how long the crisis will last, as of now, a zero-growth scenario this year already seems on the cards.

Over the past week, several cases of coronavirus have been confirmed in key production and tourism districts of northern Italy, quickly raising concerns of a recession risk. **Time is a key factor: broad implications will depend on the duration of emergency measures and on the most acute phase of the crisis. A quick return to business as usual may limit the impact to Q1 and facilitate a quick rebound in Q2, limiting the impact on the Italian economy.** Also, any better-than-expected developments on the external front might temper the negative impact on domestic demand. Yet, risks remain skewed to the downside.

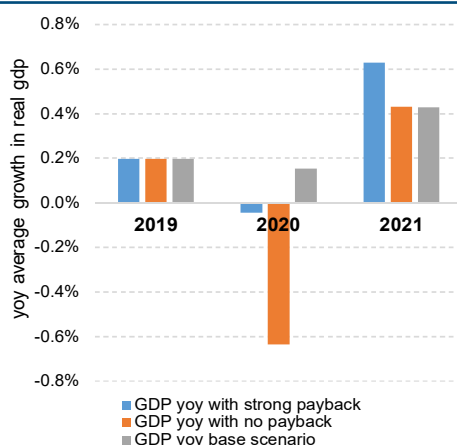
In a recent interview, the **Bank of Italy Governor said that 0.2% of GDP is at stake.** Assuming this as a fair estimate of the shock and that it is concentrated in Q1, **the stress would likely imply a significant contraction in Q1 (-0.6% QoQ), hence a technical recession (after -0.3% QoQ in Q4 2019), and would bring growth to zero in 2020 (if we assumed a significant rebound in Q2 and an average growth rate of 0.2% QoQ for H2 2020). In the absence of V-shaped rebound, growth could well move to -0.6%YoY in 2020.**

Far from any attempt at being exhaustive, we put in perspective the extent of damage, while focusing on two direct channels of domestic stress (loss in consumption and production), trying to find possible "benchmark" scenarios in line with the level of stress described above.

Impact via stress on consumer behaviour: Assuming considerable stress, i.e. that for

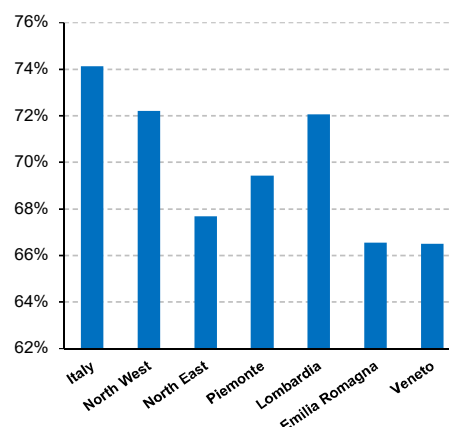
four weeks three categories in particular of consumption (transport, clothing and footwear, hotels and restaurants, which we assume to have a weight on regional consumption equal to the national one) halve in those regions (Lombardy, Veneto, and Emilia Romagna, which account for 37% of final consumption expenditure of resident and non-resident families and up to 32.2% of the total Italian population, i.e. more than 19.4 million people) the impact is approximately between €4.2 billion and €4.5 billion. It is clearly a significantly stressed combination of factors, in terms of breadth (regional level and not the town/area level), duration (four weeks) and impact (halving consumption in selected categories with no offsetting factors). By attributing this impact totally to the first quarter (but allowing payback in Q2), 2020 GDP projections move to below -0.1% YoY. By relaxing the assumptions either on the duration of the stress (two weeks) or geographical extent (only selected provinces), the effects are clearly reduced so that growth projections come back in line with a 0% GDP growth in 2020 if the Q2 payback effect is allowed. Indeed, on the one hand, several factors could mitigate the estimated impact, considering that other spending may partly offset the decrease in the selected categories (e.g. for disinfectants, personal care, online sales vs retail sales); on the other hand, some consumption can be assumed to be gone forever (restaurants, travels etc) with little payback effect to be considered. At the same time, while areas affected are limited in extent, irrational behaviour could

1/ Italy real GDP projections for 2020-2021 under three assumptions



Source: Amundi Research, Datastream, ISTAT, as of 25/02/2020

2/ Services weight as % of reference area value added



Source: Amundi Research, Datastream, ISTAT, as of 25/02/2020

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Little visibility, yet stagnating growth (at best) very likely

heighten risk perception and severely impact consumer confidence not only in the regions affected but also at the national level, amplifying the effects.

Impact via the production channel: Lombardy, Emilia Romagna and Veneto account for around 40% of Italian GDP. At this stage, the implied regional impact is enormous. Assuming that services and manufacturing work at 70% for two weeks, the impact would be around negative €7 billion. GDP growth would decline to -0.3% YoY in 2020, (allowing for payback in Q2). Assuming only a few provinces are affected (Milan, Cremona, Lodi, Padua, Piacenza, for instance) at 50% capacity, then the impact would move GDP growth to 0% YoY in 2020, allowing for payback in Q2. Reports from those areas and companies do not point to a shutdown of activities of this sort. Yet, looking at energy consumption, at a national level energy consumption on Monday, 24 February was 6.6% below the weekly average, and on Tuesday the 25th 2% lower, which could point to a normalisation impact on the production front already taking place.

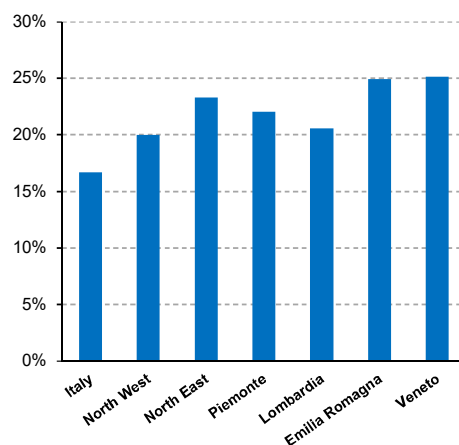
Data are available at regional or province levels. On that basis, **we simulate scenarios where the areas involved are much broader**

than the actual areas shut down or where significant limitations are in place.

Although not necessarily realistic, this exercise may be helpful for putting the numbers and the risks in context. We already expected the Italian economy to grow by a meagre 0.2% YoY this year, supported by weak but positive growth in domestic demand and international trade, with high vulnerability to external and internal shocks. **Recent developments put this projection at high risk,** with the downside scenario projection of GDP growth down to -0.5% YoY (or less) becoming not unlikely, should an extension of the domestic stress limit the extension of payback effects in Q2, or external demand deteriorates further (or a combination of both). Indeed, the stress will work through interacting factors that are difficult to estimate in advance and perhaps focused on selected sectors. For instance, the impact on tourism is estimated to be significant for H1 at least, but may also significantly affect the summer period. According to Bank of Italy, in 2017, activities directly attributable to tourism account for more than 5% of GDP and 6% of employment.

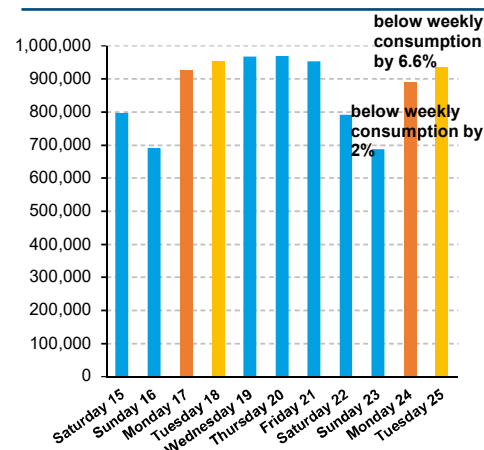
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3/ Manufacturing weight as % of reference area value added



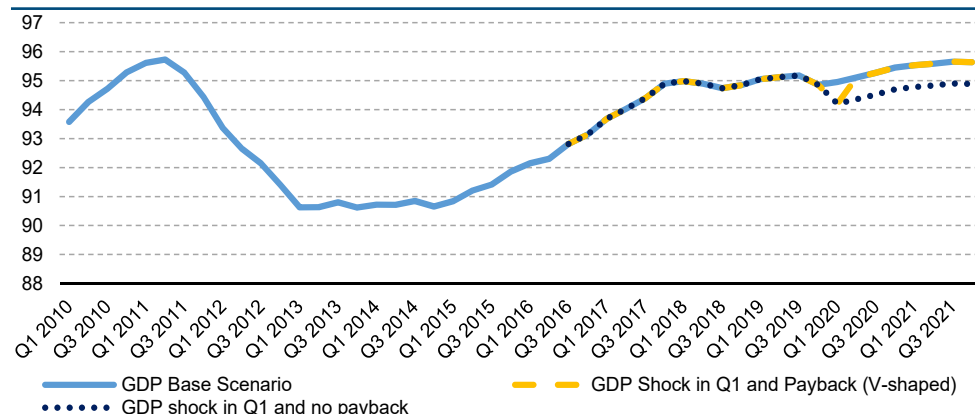
Source: Amundi Research, Datastream, ISTAT, as of 25/02/2020

4/ Italy energy consumption, February (daily megawatt)



Source: Amundi Research, Terna, as of 27/02/2020

5/ Italy GDP projections under 3 scenarios, Q1 2008=100



Source: Amundi Research, Datastream, ISTAT, as of 25/02/2020

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*The credit market
has become
addicted to liquidity*

The repricing of credit risk

Markets are now questioning the assumption of world growth stabilization. Before the sell-off, corporate debt market was driven by liquidity/search for yields without worrying about fundamentals: huge inflows, very active primary market, and tight valuation. This risk-off market moves could penalize global growth, especially given how late we are in the cycle.

In 2019, we switched from low interest rates to ultra-low interest rates for longer with central bank liquidity injections

The global economy entered a synchronized slowdown. Global growth was downgraded to 3%, its lowest rate since 2008. The weakness in growth was driven by a sharp deterioration in global manufacturing activity to levels not seen since the financial crisis, on the back of rising trade and geopolitical tensions, the slowdown of the Chinese economy, and a slump in the auto industry. Domestic demand in developed economies remained solid, supported by strong employment gains and the expansion of the service sector.

The world's major central banks returned to an easing stance, due to weak global growth and muted inflation. In particular:

- The Federal Reserve made a sharp U-turn in the path of its monetary policy in January of last year, ultimately cutting its key rate three times in 2019, compared with its previous own forecast of three hikes. FOMC members consider these cuts as "insurance cuts", as the US economy is driven by solid consumer spending but threatened by global weakness, the US-China tariff war and Brexit uncertainties.
- The European Central Bank delivered a full package, cut its deposit rate by 10bp to minus 0.5% and restarted its asset

purchase program in November. The size is modest (€20bn per month) but the program is open-ended and would last "as long as necessary".

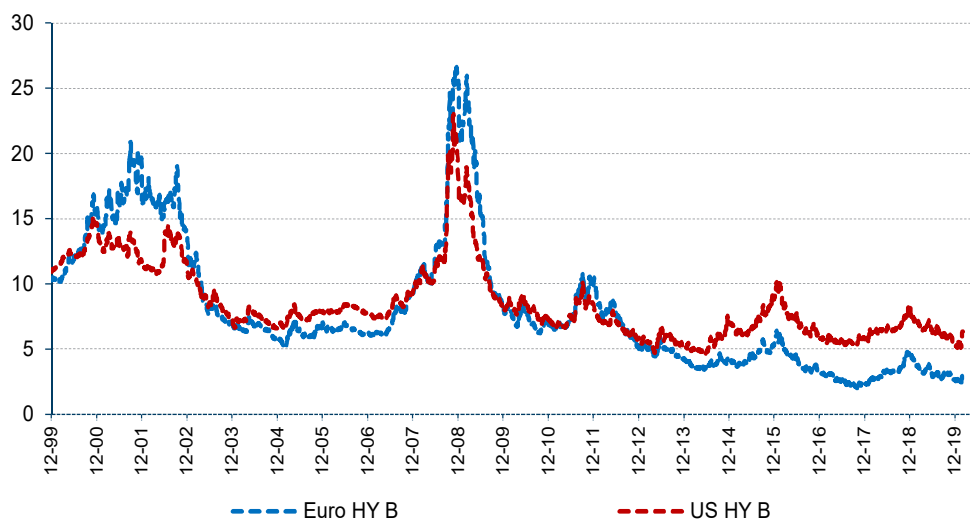
All in all, negative yields have become the new norm after central bank policy and weak growth prospects led to a huge bond rally. The global pool of negative-yielding bonds has jumped to more than \$15 trillion. The vast majority of bonds in Europe and Japan carry negative yields to maturity. In the euro fixed-income space, debt in negative yield rose back to 55% by the end of January, after falling to 45% by end December 2019. Italy, BBB corporates and HY account for almost all available yields above 1%.

The credit market has become addicted to liquidity

Before coronavirus concerns hit the markets, fixed-income investors were looking for a strategy to generate income in a world of low or negative interest rates. The result was:

- **Huge inflows into the corporate bond market.** The growth and persistence of negative yielding debt has pushed investors into taking more risks.
- **Intense activity on the corporate debt primary markets.** Strong demand easily absorbed this new supply and the order books were often spectacular. On Euro IG market, 2019 volumes reached decade-high levels with huge activity in

1/ Yield: Sovereign and Corporate debt (in %)



Source: Bloomberg, Amundi Research - Data as of 28/02/2020

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Ultra-accommodative monetary policy stretched the credit cycle, but it has not disappeared

BBB-rated issuers, long maturities and US-domiciled issuers.

- **Tightening in IG and strong compression in HY.** Investors' demand for spread products pushed spreads and volatility lower and flattened spread curves. In particular, the yields offered by US B-rated issuers reached an all-time low of 4.9% in early February.

Because of this environment, corporate default rates were below long-term average despite heavy leverage of some issuers and weak earnings growth. As long as a company can refinance its debt at advantageous rates, it does not default. In other words, default rates projections are lagging behind current market conditions!

The assumption of global growth stabilisation is now challenged by the coronavirus crisis

Before the coronavirus, the scenario for 2020 priced in by the markets was a stabilisation in global growth as trade tensions and monetary policy eased. In light of the very low/negative returns on offer on sovereign core bond markets, this backdrop would have been favorable for risky assets despite tight valuations.

The assumption of a stabilisation of world growth is questioned today by the markets. The health crisis has the potential to shock the economy via direct impacts (lower tourism, lower goods exports and global supply chain disruption) and indirect impacts (tightening in financing conditions).

Going forward, we have no doubts on central bank willingness to keep a dovish bias. This unprecedented landscape of "negative yields combined with central bank purchases" is unlikely to change substantially soon. Nevertheless, investors could pay more attention to fundamentals and it is difficult at this stage to assess the magnitude of the damage the virus will do to the economy.

The risk is a jump in corporate default rate and wave of BBB downgrade

Corporate fundamentals are at the center of the game. The coronavirus could have a significant impact on companies via:

- **A tightening in financing conditions.** In recent days, growing fears about global growth have caused market volatility and risk premiums on bonds to rise. The coronavirus stopped the euphoria of the primary corporate bond market. The risk is that the market will close for an extended period.
- **Earnings pressure.** If the coronavirus is not contained quickly, it will affect earnings significantly. It is worth noting that earnings growth was already weak even before the coronavirus. The energy,

automotive and tourism sectors will be particularly affected by this health crisis.

This could lead to an increase in:

- **Downgrades.** The riskier environment could encourage rating agencies to downgrade high-leverage US BBB issuers (50% of US IG).
- **Defaults.** Increase in risk aversion and sluggish earning growth is a big threat to low-rated HY companies. Indeed, interest coverage is more closely related to earnings than to interest expense, as interest coverage could be quickly eroded by a hit to earnings.

The shock could possibly prove stronger in the short term, but we are sticking with the view that the situation will stabilize at some point in the coming months, leading to a catch-up thereafter. Additional support from central banks and governments to fight any further deterioration in the economic outlook is a key assumption regarding this view. Nevertheless, we have to remain vigilant, accommodative monetary policies are stretching the credit cycle but it has not disappeared. Sustained risk-off market or a significant risk premium adjustment by the markets could seriously penalize global growth, especially given how late we are in the cycle.

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THIS MONTH'S TOPIC



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*2019 results marked
by a mediocre
global context and
the fading impacts
of the US tax reform*

US and European corporate earnings: after four quarters of stagnation, what is the outlook for 2020?

Fourth quarter 2019 earnings season confirmed the flat trend of the past 12 months. Hardly had 2019 ended than all eyes turned to 2020. For several months now, the earnings growth consensus for 2020 looked too optimistic. The spreading of coronavirus has only made us more cautious. The epidemic will certainly have a big impact on the first quarter of 2020 but some catching-up can be expected in the following quarters. In the short term the market should remain nervous. In the longer term a cautious optimism should eventually prevail.

Flat earnings for the fourth consecutive quarter...

Q4 2019 earnings season is gradually coming to its end. The time is ripe for an assessment and to adjust our forecasts for 2020 while factoring in the coronavirus impact.

Earnings were flat for the fourth consecutive quarter in Q4 2019 on both sides of the Atlantic, at +3.1% for S&P 500 companies and -0.2% in Europe (see charts 1 & 2). They continued to be driven by the sharp slowdown in global growth since its 2017-2018 peak, and, in the case of the US, the fading of the impact of the 2017 tax reform.

Nonetheless, downward momentum in earnings forecasts has been less pronounced in the US than in Europe. Q4 2019 blended earnings of S&P 500 companies were ultimately a little better than expected, (+3.1% as of 18 February vs. -0.3% on 1 January) while it was the contrary for the Stoxx 600 in Europe, (-0.2% vs. +3.7%). We mustn't read too much into this slight uptick in US Q4 forecasts as it has not spilled over into the following quarters; just the contrary.

...wide sector disparities

However, the stagnation Q4 2019 of earnings conceals wide sector disparities in both the US and Europe.

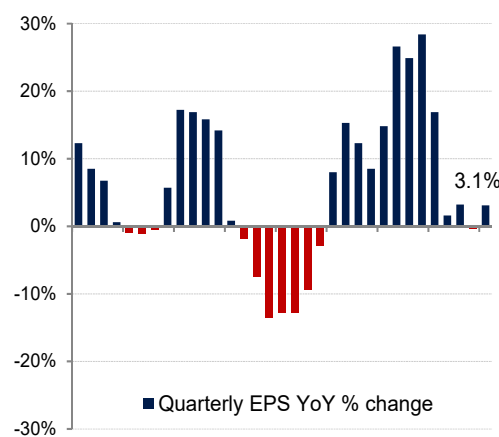
Energy and commodities stocks have dragged down overall earnings growth on both sides of the Atlantic. They alone have subtracted three to four points of EPS growth from the S&P 500 and the Stoxx 600 (see charts). These two sectors have declined over the past few quarters mainly because of slowing growth worldwide, particularly in China. Many commodity prices fell in Q4 2019, including an average year-on-year decline of 9% by both Brent and the CRB index of industrial commodities. Meanwhile, oil sector earnings fell far more in the US than in Europe, as US groups are more integrated upstream and, hence, more exposed to shifts in crude oil prices.

On the other hand, financial companies' earnings fared well, in both the US (+12%) and Europe (+4%), albeit more so in the US, given the economy's stronger growth, a more favourable yield curve, and the leading role played by their investment banks.

Across the other sectors, in the US, manufacturing (-10%) and consumer discretionary (0%) took a hit, due, respectively, to troubles at Boeing, Ford and GM.

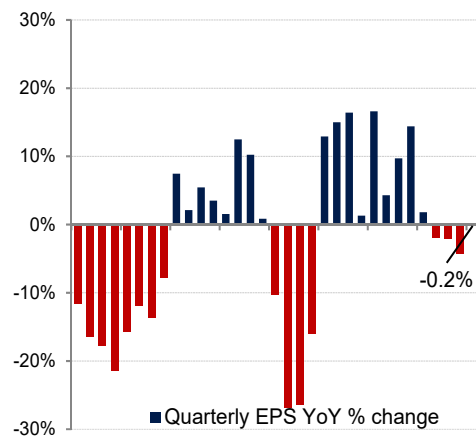
However, technology – a sector that is crucial to Wall Street, accounting for almost 25% of total capitalisation – recovered

1/ S&P 500 Quarterly results



Source: IBES, Amundi Research

2/ Stoxx 600 Quarterly results



Source: IBES, Amundi Research

THIS MONTH'S TOPIC

For months, the 2020 consensus seemed far too optimistic...

... The Coronavirus has reinforced these doubts!

The size of the Chinese economy has quadrupled since the time of SARS in 2003...

(+9%) after declining for three consecutive quarters.

In Europe, autos (-27%) were squeezed by lower volumes and the costs of future development (CO², autonomous cars, etc.) while luxury goods (+14%) continued to gain despite the Hong Kong demonstrations. Earnings improved as well in consumer staples (+7%), healthcare (+4%) and in industry (+5%); the latter being driven by the momentum of Airbus and the electrical equipment

After four flat quarters, what is the earnings outlook for 2020?¹

To date (February 24), the IBES consensus continues to forecast 2020 EPS growth of about +9% for the MSCI ACWI, including +8% in the US, +7% in Europe and as high as +15% in emerging markets.

For many months we had felt that these forecasts were unrealistic and were rather considering a 5% EPS growth, both the US and Europe, given top-line pressures and poor pricing power of corporates, late-cycle wage rises spillover from higher customs duties and less share buybacks in the US,

A new factor has now emerged – the coronavirus epidemic, with all its resulting uncertainties on global growth and business operations.

The coronavirus epidemic has thrown a wrench into forecasts

While the epidemic is developing and many restrictions remain in place, it would be guesswork to quantify the coronavirus's global impact. Still, it does appear greater than the SARS epidemic of 2003 which hit Chinese GDP hard in the 2nd quarter of that year. However, as usual in this type of crisis, the initial shock is likely to be mostly absorbed in the following months, due to firebreaks being set up (with a more favourable policy mix, etc.), automatic stabilisers (falling bond yields, etc.) and deferred consumption of some durable goods. For example, Chinese growth was hit by SARS for just three months before beginning to rebound sharply in the third quarter of 2003.

But this time, the initial shock should be greater, due to unprecedented quarantine measures taken in Wuhan and its Hubei region and nationwide travel restrictions. A lack of workers, of masks in sufficient numbers and of spare parts is nipping in the bud any attempt at relaunching work on a large scale. For example, according to the US Chamber of Commerce in Shanghai, which is 700 km from the epicentre of the epidemic, two thirds of US companies in the

Shanghai region have resumed production since 10 February, but 78% of them don't have enough workers to operate at a normal pace. Meanwhile, Volkswagen, to take one example, had planned to reopen its Shanghai plant on 10 February, but has already pushed back this date twice, to 17 and then 24 February.

Beyond China, the global fallout of the coronavirus epidemic will be of another magnitude compared to SARS, as China's share of the global economy has quadrupled since SARS.

...especially as China is now at the heart of many value chains

China, the "world's workshop", is now at the heart of many value chains. As a result, the repercussions of the coronavirus-related standstill will be felt not just in China but well beyond.

Wuhan, for one, is a major auto production centre. That's where Dong Feng, China's second-largest automaker, is headquartered, along with many foreign automakers and equipment makers, such as GM, Nissan, PSA, Renault, Honda, Valeo or Faurecia. With supplies of electronic cables from Hubei cut off, Kia, Hyundai and Renault Samsung Motor plants 1500 km away, in Korea, have been forced to lay off 25,000 workers temporarily.

China is also a key player in electronics and many foreign manufacturers rely on its subcontractors. According to the *Nikkei Asian Review*, as of March 2019, 41 of Apple's 200 main suppliers were Chinese, i.e. three times greater than in 2012 and more than its US suppliers (37). On top of that, many foreign suppliers do some of their manufacturing in mainland China, such as Taiwan's Foxconn, which, early February, lowered its 2020 Sales guidance, as its workers were quarantined when they returned from vacation leave.

Something that is less widely known: China is also closely intertwined into pharmaceutical value chains. 80% of active principles used in Europe are from Asia, China in particular. This could lead to empty stocks or even supplies being cut off entirely.

Lastly, despite the support measures announced, the post-epidemic rebound should be less stark than in 2003, as the Chinese economy's structure has changed profoundly since then. In 2003, China was far more focused on manufacturing; nowadays, services are playing a much greater role. One way to think of it is this: in 2003, additional workers were all that was needed to ramp up the pace of production line and make up ground lost to SARS; this time, it will be harder to make up the lack of services.

¹ See our longer version in a thematic paper soon available: *US and European corporate earnings: overshadowed by Covid-19*

THIS MONTH'S TOPIC

...and the exposure to China of the Stoxx 600 companies increased eightfold over the same period!

Earnings cut are inevitable...

... the capacity of the market to look beyond the valley will depend of the length of the epidemic

In recent days, the epidemic seems to be slowing down in China but has started to spread beyond, especially in South Korea, Iran and Italy.

Within China, the preventive measures taken one month ago, just before the Chinese New Year (24-30 January) remain nonetheless very strict which is casting doubt on the announcements of business returning to normal. If these restrictions were to last a few more weeks, many companies would face liquidity squeezes. No doubt they would receive public assistance but, as usual, smaller private-sector companies would be much more vulnerable.

Earnings will be under particular pressure at one fourth of listed companies

Given the Chinese economy's increased weight and involvement in value chains, the global repercussions should be greater this time, and will spill over clearly into companies' financial results.

For example, Stoxx 600 companies' direct exposure² to China averages almost 8%, up from less than 1% in 2003. Meanwhile, of the 24 sectors of the GICS nomenclature, six are more than 10% exposed. These six sectors – autos, energy, luxury goods, semi-conductors, tech hardware and basic materials – together account for 23% of the market capitalisation of the Stoxx 600, but, more importantly, 37% of the rebound in earnings forecast for 2020.

In the US, S&P 500 companies' 5% exposure to China is slightly lower than Europe, but exposure is 10% or higher in six sectors as well, out of which five are in common with Europe (autos, energy, luxury goods, semi-conductors and tech hardware), along with a sixth, consumer services, which includes hotel and restaurant chains, cruise ships and casinos. These six sectors that are most heavily exposed to Chinese demand together account for 18% of the market capitalisation of the S&P 500 and 26% of the rebound in earnings forecast for 2020.

In light of the above, 2020 earnings forecasts will depend closely on how fast business returns to normal in China. This is particularly the case in Europe, which is more heavily exposed to China and where domestic margins are generally lower than those achieved in emerging markets. Sales warning and Profit warning should therefore burgeon in Q1 2020.

If the epidemic wears off a bottoming out should take suit from April. However, the extent of this will vary from sector to sector. To take one example, only a very few restaurant meals, hotel stays, and cancelled travel plans will be made up. In contrast, a significant portion of lost sales

in the first quarter in luxury goods, will be made up later.

All in all, assuming a peak in April, instead of the 7 to 8% 2020 EPS growth thus far forecast by the IBES consensus (for the United States and Europe), we feel it is more reasonable to adjust our post-coronavirus forecasts from +5% to +2% in the US and from +5% to 0% in Europe, as Europe is more heavily exposed.

It's still worth being cautiously optimistic

After showing very little reaction at the start of the epidemic, the equity markets finally buckled on 24 February, one month to the day after the start of quarantine measures in Wuhan. From peak to trough (from 19 to 25 February), the Stoxx 600 and S&P 500 lost 7%-8%, but given their previous rally, they were only down 3% since the start of the year, following increases of 23% and 29% last year.

In the past, sharp equity sell-offs have always been followed by a rebound in subsequent months. The same could happen this time, but the timing and extent of any rebound are uncertain.

In particular, the timeframe will depend on how the epidemic progresses. With SARS, the market bounced back after the epidemic hits its peak. This time, investors will also be looking at when businesses and supply chains return to normal, which could delay the rebound by a few more weeks.

As for the extent of the upturn, while valuations may still have some upside potential due to particularly low interest rates, it is also important to take into account forthcoming cuts to earnings forecasts.

Between the string of poor economic indicators, profit warnings and defaults to follow, a possible rebound of the epidemic and the unpredictability of the Democratic primary in the United States, the market could remain volatile for some weeks. That's why hedging strategies are crucial.

That being said, between the authorities' determination to provide support, the watchful eyes of the central banks and the lack of alternatives to equities in an environment of extremely low interest rates, cautious optimism is still the proper stance.

(Finalised on February 25, 2020)

² Regarding luxury goods, a distinction must be made between direct exposure (purchases by Chinese persons in China) and indirect exposure (purchases by Chinese tourists outside China); indirect exposure is typically twice as high as direct exposure.

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