Market update 24 March 2020

What happened last week and what to expect this week?

Coronavirus/COVID-19

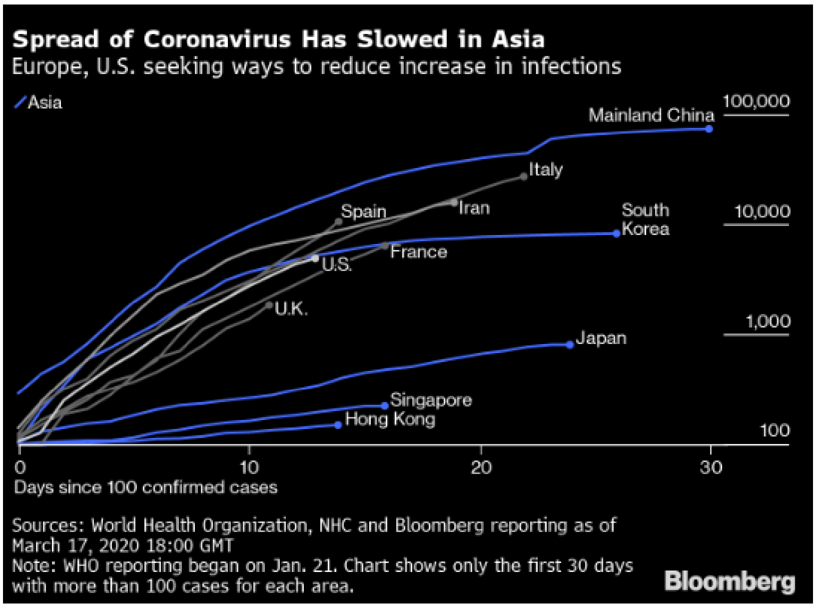
It might be the first time that every country in the world has a common goal; to win the battle against Covid-19. The last time we faced pandemic at this massive scale was a decade ago during the Swine Flu (H1N1) but the mortality rate of H1N1 was close to 0%. If we trace back further to a century ago, in 1918, there was a more severe pandemic namely the Spanish Flu. It infected 500 million people, about a quarter of world population that time, and wiped out the global population of 50 million people giving mortality rate of around 10%.

	Covid-19	Ebola	Swine Flu (H1N1)	SARS	Spanish Flu
Period	2019 - Now	2014-2016	2009-2010	2002-2003	1918-1919
Number of cases	276,000	28,000	700 million - 1.4 billion	9,000	500,000,000
Death toll	11,500	11,300	150,000 - 575,000	700	50,000,000
Mortality rate	4.2%	40.4%	Close to 0%	7.8%	10.0%
Infected case % of world population	Close to 0%	Close to 0%	11-21%	Close to 0%	25%

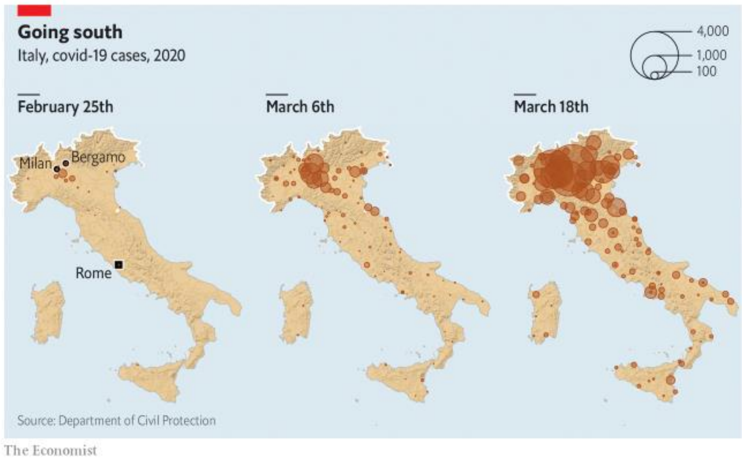
Source: WHO

Now the world is in the midst another pandemic called Covid-19. Currently, Covid-19 mortality rate is at 4.2%, much higher than H1N1 but the number of cases is much lower. Ebola and SARS have a high mortality rate but it did not have the global impact since the number of infected people is close to 0% of the population.

Our opinion, is the number of infected cases will grow exponentially in the near future since Covid-19 just started to spread out in high population country such as USA, Europe, Indonesia and India even though we will see a low number of new cases from China. The negative side is it will rise the number of cases stimulating fear on the world which eventually will lead to global economic recession and on the bright side we will see a lower mortality rate.



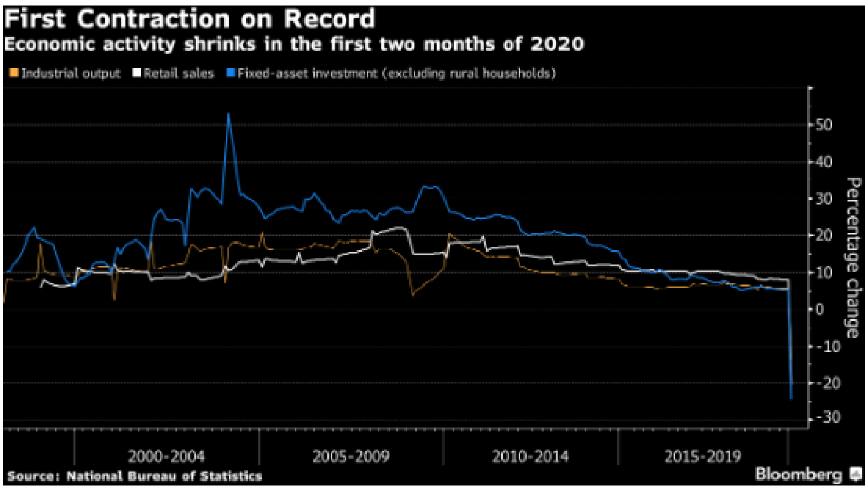
Currently Italy is overtaking China as the country worst-hit by covid-19 with reported case of close to 60 thousand and death toll of more than 5 thousand and mortality rate of more than 9%. The southern part of Italy is less hit by the outbreak bu the worry is people has fled from the north and might spreading the virus in the southern part as well.



- Recession is almost inevitable

After 10 years of global economic expansion, we are most likely to head in to the recession at the end of fourth quarter of 2020. The general definition of recession is a fall in GDP in two consecutive quarters. The market cap of global equity markets has plunged by over $30 trillion in just the last month. Nearly every major equity market is down between 30% and 40% year to date, and some prices are plunging and surging at double-digit daily rates.

Early readings on the extent of damage the Covid-19 outbreak poses to the economy aren't encouraging. China, which is about a month or so ahead of the U.S. in combating the disease, just reported a 13.5% drop in industrial production during the first two months of 2020, while its retail sales fell 20.5%. And this from a country whose data tend to play down problems. The Covid-19 is starting to show up in U.S. economic figures for the first time, initial claims for unemployment benefits surged 33% in the latest week, up 70,000, to 281,000 one of the biggest one-week jumps on record.



What the economy needs right now is the right response from the official. We think that fiscal policy will have much greater impact compare to the monetary policy since monetary policy will only provide liquidity, impact lag and there is a limit of how much the central banks could cut their interest rate. As we can see, the Fed has reached their limit this week since the current Fed fund rate is 0%.

On the other hand, the impact of fiscal policy can be directly be perceived by the society. First, direct money transfer and medical assistance could provide buffer for the household to maintain their purchasing power. However, for emerging countries, there is extra risk since running a huge budget deficit will trigger currency depreciation which lead to flight of capital. Second, the government need to take an extra care for the companies that could bring the whole financial system to a meltdown. Lack of economic activity could rise the number of debtors who are not able to repay their debt then threatening the liquidity of banks. Once Banks run, it will become a self-fulfilling prophecy of economic recession.

- Shape of recession, V or U or L?

Many people stocked on supplies in recent weeks which initially pulled forward the demand for the following months into today. This means the actual start of the recession could be delayed for the future periods because we will see a spike on economic activity today. To make the economic impact worse, quarantine rules that governments impose will also hurt the services sector even further.

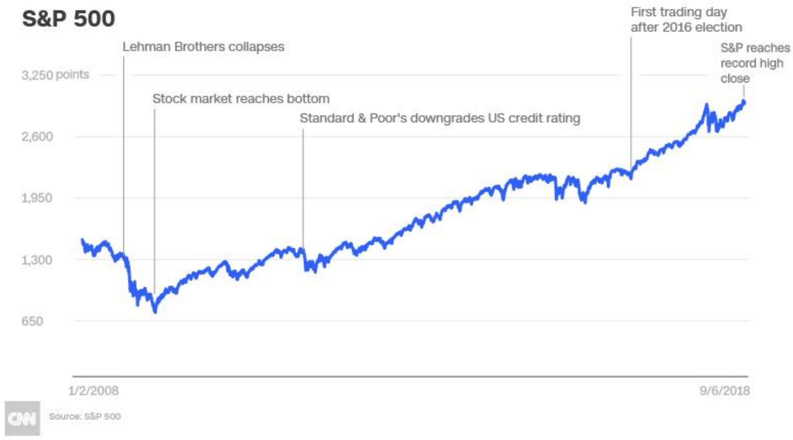
The duration of quarantine could be a big determinant as to whether it is a V or U or L with longer duration pointing toward the latter. We think there are three factors can start to kick in.

1. Domino effect
Airlines, hotels and any other recreational services industry have felt the impacts with workers being laid off and it will create a chain reaction to other industries as the displaced workers will tighten their spending and eventually hurting the economic as a whole.

2. Permanent behavioral/ operating changes
As more companies try to apply 'Work from home' scheme, some may realize that they can fully function remotely and this could lead offices being shutdown permanently. In addition, people could become accustomed to this situation as they might prefer to have do leisure activities at home (such as watching Netflix) and such it could reduce future socially based economic activities.

3. Wealth effect
It is obvious that people are more likely to spend more money when they fell the economy is in a good shape. Given that the market will likely to crash, people will rush to cash out their assets even though they will take substantial losses. But in the market, for every seller there is a buyer. So, who's buying? Those with rational mind and excessively amount of cash will take these assets. Thus, we will see a greater social diversity in the future.

How do countries recover before? At the end of the world wars, the Italian economy grew by about 35% in 1946. By 1949 it had already recovered all the ground it lost during the war and then some. The German economy shrank by a staggering 66% from 1944 to 1946, then grew at an annual average rate of 12% over the subsequent decade. In 1999, real GDP in South Korea had already risen well above the peak reached in early 1997, before the Asian financial crisis struck. After 2008, the US enter the second longest economic expansion in US history as we can see from the long expansion of its stock market.

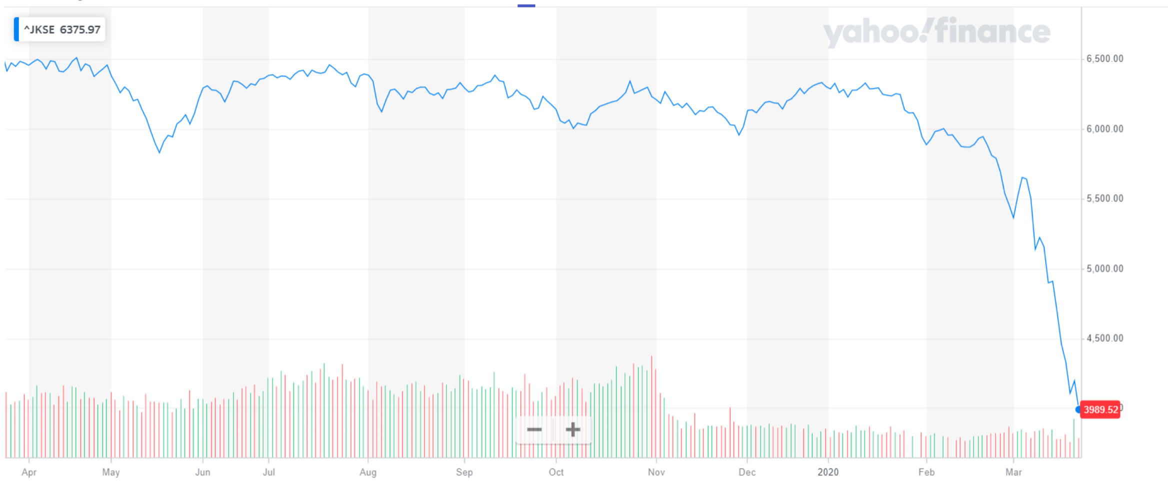


However, history does not always repeat itself, a dangerous pandemic working its way across a highly integrated global economy is an unprecedented event. The global financial crisis did not kill millions while dangerous pandemic could take years before the economy resume to their full capacity.

By looking at the mortality rate, we think the current pandemic will not make a L recession curve and more toe U curve since the number of reported cases at the moment is understated. It is undoubtedly will have greater economic impact compare to the H1N1 since the global economy at the moment is much more integrated compared to a decade ago and China, the central of the outbreak, represent 15% of global GDP.

Market Indexes (16 March 2020 - 23 March 2020)

- During the period, JCI depreciated by 20% from 4,907 to 3,989 and in YTD basis JCI had depreciated by.36%. JCI is not immune from the sell off on risky assets as investors are looking for safer alternative at this moment. We might still seeing more downward pressure since investors are still digesting the effect of Covid-19 on the economy.
- However, we look at this opportunity to accumulate stocks since many stocks are trade below their historical mean. We prefer the market leader of each industry and have low level of leverage.



JCI last 1 yea as of 24 March 2020 (Source: Yahoo Finance)

- IDR also took a beating after as it depreciated by 9.26% in only a week to 16,575/USD, the lowest level since June 1998. In YTD basis, rupiah had depreciated by 19.39%.

Coronavirus progression as well as worries on the recession issues surrounding the global economies and due to the outbreaks as well as central banks' responses to it are still stood as some of the main catalysts to watch out for which may move our index and currencies. From internally perspective, we are keeping our focus on Rupiah, Indonesia CAD and trade balance which all in all is a crucial factor in our investment strategy.

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