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INVESTMENT MANAGEMENT



## 3 February 2020 – Market Update: Coronavirus: Seeking to protect GBaR portfolios from a new risk event

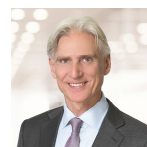
SOLUTIONS & MULTI-ASSET | GLOBAL BALANCED RISK CONTROL TEAM | MARKET PULSE | 3 February 2020

As expressed in our 2020 outlook “Not the Usual Suspects”, the GBaR team began the year with positive expectations of the global macro environment and reduced concerns over global trade tensions. Stable if slow growth in the key economies of the US and China, combined with fiscal stimulus-driven support from the likes of Japan and the UK, should support risk assets in general, although it is important to differentiate between attractively priced and overpriced markets. Hence we entered 2020 with a recently-increased exposure to risk assets. However, as ever we remained alert to new or unexpected risk events. One such event presented in mid-January, shocking global markets: 2019 Novel Coronavirus (2019-nCoV)<sup>1</sup>.

This coronavirus was first reported on 31 December 2019, in the city of Wuhan, capital of China’s Hubei province, but really caught investors’ attention in the latter part of January, as its spread accelerated rapidly, causing fears that it could become a pandemic. This led to heightened market volatility, with the VIX moving from a level of 12.98 on Friday 23 January to 18.23 on Monday 27 January<sup>2</sup>. Equities and risk assets such as oil fell sharply.

The spread of the virus has been exacerbated by its emergence coinciding with China’s lunar year holiday, a period when hundreds of millions of people traditionally travel to celebrate with family and friends. International travel has helped spread the virus outside China, with cases reported in the likes of the US, France, Australia, Japan and a number of Asian countries.

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<sup>1</sup> World Health Organization (WHO), [www.who.int/emergencies/diseases/novel-coronavirus-2019](http://www.who.int/emergencies/diseases/novel-coronavirus-2019)

<sup>2</sup> Source: CBOE. [www.cboe.com/vix/?gclid=EAIaIQobChMIq6KimKS45wIVg7HtCh2UQAMKEAAYASAAEgKF3PD\\_BwE](http://www.cboe.com/vix/?gclid=EAIaIQobChMIq6KimKS45wIVg7HtCh2UQAMKEAAYASAAEgKF3PD_BwE)

In order to understand likely future developments, much analysis compares the current situation with SARS, which emerged in 2003. Initial analysis suggests that the 2020 coronavirus is more infectious than SARS, but potentially less virulent. Unlike SARS, this virus is infectious during its incubation period, which lasts up to 14 days.

The following table shows a comparison of the current coronavirus, not only to SARS, but also to other epidemics in the intervening period.

#### Exhibit 1: Comparing past epidemics with 2019-nCoV Coronavirus

		SARS	Human Swine Influenza (H1N1)	Middle East Respiratory Syndrome (MERS)	Avian Influenza (H7N9)	2019-nCoV Coronavirus
	Acute periods	Late-2002 to mid-2003	May 2009- August 2010	2013 – 2015 (ongoing)	Winter & spring of 2014, 2015 and 2017	From Dec-2019 onwards
Mainland China	Confirmed Cases	5,327	128,033	1 (traveller)	1,537	569
	Fatalities	349	805	-	619	17
	Mortality Rate	6.6%	0.6%	-	40.3%	3.0%
	Geographic Spread	75% of confirmed cases took place in Beijing and Guangdong, which combined accounted for 15% of national GDP	Widespread across the country	-	80% of confirmed cases took place in Zhejiang, Guangdong, Jiangsu, and Shanghai, which combined accounted for 30% of national GDP	78% of confirmed cases took place in Hubei, which takes up 4% of national GDP
Global	Confirmed Cases	8,098	11-21% global	2,494	1,568	578
	Fatalities	774	>18,449	858	615	-
	Mortality Rate	9.6%	0.001-0.007%	34.4%	39.2%	-

Source: WHO, National Health Commission, Center for Infectious Disease Research & Policy, Morgan Stanley Research. Data of 23 January 2020.

In our opinion, a key difference between 2003 and 2020 is the relative speed with which Chinese authorities have acted, for example unprecedented moves to restrict movement in cities at the epicentre of the virus. Furthermore, there has been a higher degree of transparency from China's policymakers, which as the situation evolves may ultimately prove reassuring to a broad cross-section of observers, including investors. However, in the near term markets as a whole, and industries such as travel, retail and entertainment in particular, are likely to remain vulnerable to greater downside volatility.

#### What actions have we taken in Global Balanced Risk Control (GBaR) portfolios?

As we have seen the coronavirus outbreak develop, we have moved to reduce exposure to risk assets such as equities, with the aim of protecting our portfolios, as potential panic selling intensifies. Given the virus's 14-day incubation period, it may take more time before we are able to gain a fuller understanding of its likely longevity and consequences. In the meantime – and whilst we anticipate a heightened risk of downside volatility related to this risk event – it is prudent for us to remain relatively conservatively positioned. By monitoring the situation closely, we aim to identify the appropriate point at which to move back into risk assets.

We have provided the target asset allocations of each of our five Luxembourg SICAV funds in the following table, as of 3 February 2020.

	VOLATILITY P.A. <sup>1</sup>	EQUITY %	FIXED INCOME %	COMMODITIES %	CASH %
MS INV Global Balanced Risk Control Fund (EUR)	4% – 10%	26.8	53.1	4.3	15.7
MS INV Global Balanced Income Fund (EUR)	4% – 10%	32.2	46.0	4.6	17.2
MS INV Global Balanced Fund (EUR)	4% – 10%	28.9	43.8	4.4	22.9
MS INV Global Balanced Defensive Fund (EUR)	2% – 6%	11.0	67.2	3.4	18.4
MS INV Multi-Asset Risk Control Fund (USD)	4% - 10%	23.4	53.6	4.5	18.5

Source: Global Balanced Risk Control team, Morgan Stanley Investment Management.

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<sup>1</sup>: Volatility targets are indicative ranges. There is no assurance that these targets will be attained.

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