INNOVA
ASSET MANAGEMENT

CORONAVIRUS SUMMARY

What has happened and why?

- COVID-19 was an asymptomatic transmitter – meaning it can't be contained like SARS by easily identifying symptoms on a mass scale. It is highly infectious and this has been underestimated by most nations around the world
- Governments were slow to act, and the WHO gave advice that travel was fine – which exacerbated the issue
- It will get exponentially worse in Australia and the US – we were unprepared. However, this may already be priced into markets
- This has led to market panic and subsequent sell off, as the majority of trading today is done by passive investors, many of which are algorithmic
- However, it has been recognised that the virus will slow global GDP, shut down supply lines and make work hard for certain areas. It will hurt productivity, and hence corporate profits. When markets are trading at all-time highs - this causes panic, especially for those fully invested without cash or other liquid securities on the sidelines – so you sell shares

  The media has not helped. Misinformation and lack of education are driving behaviour – which is why people are stockpiling toilet paper instead of cold-and-flu medicine

Innova's Current View

- Asia is starting to be contained, China is the prime example. Healthcare systems in developing Asia are generally much poorer than here, however our hospital system is already at capacity, so having a great healthcare system doesn't help if there is little to no excess capacity. In Asia, Governments are able to be more proactive, as we have seen in their approach to containment and education, which may have been harder to enact in Western Democracies
- Europe seems to be about a month behind Asia, but also seem to be very proactive, however they have to contend with an open border policy. It will spread from Italy to broader Europe
- The US has only tested 500 people in 1 month. Italy tested 10,000 people in 2 weeks. We think the US is going to be hit hard, they just don't know it yet
- Central banks and Governments will step in to offer financial assistance. This could be in the form of bridge financing, tax breaks, retail sale incentives etc. to sectors effected. Unfortunately, this is a health issue, and liquidity injections aren't vaccines

  There could very well be a recession here and globally, so things could get worse before they get better. A viable vaccine and herd immunity will naturally slow the spread, but supply lines and factories need to come back online – this takes time

What are Innova doing in portfolios?

- We positioned for a poorer returning market anyway, however, we were modelling based on financial and economic data. This is a black-swan event that we can't model for. On the plus side, the economic impacts of it are modellable, and we have been modelling them (looking at trade flows, PMI data, retail sales etc.)
- We're reducing areas exposed to retail because we don't see that sector recovering any time soon. Instead we're focussing on global REITs where commercials are obliged to pay rent unless they go out of business, and infrastructure to get access to essential things like energy which are likely to be beneficiaries of this. Even toll roads might benefit as people drive to work to keep themselves isolated from train and air travel. Not everyone is going to get sick

- We're removing instruments with limited upside. They may be able to provide protection, but since we're maintaining equity exposure we need assets that can perform very well if equities fall further from here. Long duration bonds have this potential – so we're allocating more to bonds, but fully expect to have to cut that in the next 6 months
- We're re-jigging alternatives, increasing our gold bullion exposure and where we can we are adding a small allocation to silver bullion. Both have the potential to make substantial gains
- Silver in particular is interesting. If Gold rallies on either virus fears, stimulation fears, Government debt fears or inflationary fears, silver is likely to follow. However, as can be seen from the following chart, the gold to silver ratio is at 100 for only the second time in 45 years – any closing of that gap could result in strong returns (though very volatile – silver is volatile by nature, even more so than Gold):

- Other than these, we're looking at what other opportunities to take advantage of. There may be some great buying opportunities in some areas of the credit spectrum that are being treated as distressed, but aren't. Essentially the credit LIT's that have been launched in the last few years weren't all created equal, but are being treated as such. Some hold good quality assets being priced as if they're subordinated junk bonds. We're also looking at energy as the oil price has tanked – this could present a great entry point in the coming weeks or months. Finally, the Aussie dollar could fall a lot, and when it's below $.59 we'll take a serious look at some hedged global exposure to execute the currency play

Finally, we can't discount the actions of Central Banks in taking a 'doing whatever it takes' position. Every time they've embarked on QE, markets have rallied. It shouldn't be the case this time, since this is a health-related issue, and liquidity doesn't cure viruses, but you can't discount it (which is why we remain invested in equities).