16 March 2020

Strategy update

Lockdown in global economy calls for a more cautious investment strategy(*)

Summary

- Corona is a global problem.
- China proves that forceful action can bring the virus under control.
- Drastic measures are leading to a global economic recession from the 2nd quarter.
- Governments are taking the right measures also from an economic point of view, which mitigates the consequences and stimulates the recovery afterwards.
- Opportunities arise in equity markets, but the short-term news flow remains too negative to take action now.
- Equity positions have fallen back to the norm as a result of market movements. We'll keep it that way.

Corona (Covid-9) is a global problem

- Drastic measures are being taken to contain the virus in Europe, and the US seems to be following suit.
- In China and Korea, such a drastic approach is bearing fruit as the number of new infections is falling sharply. Meanwhile, quarantine measures there are being reduced and economic life is resuming.
- But recently published Chinese economic indicators indicate that the economic damage in the lockdown period was much greater than initially estimated.
- On top of this, Saudi Arabia started a price war with the other oil producers, causing a fall in oil prices. This is good for consumers in the long run, but now poses a risk to the financial stability of a number of (American) oil companies and also depresses investments in the sector.
- Our economists are translating all this into new economic forecasts:
  - The major economic regions of China, Europe and the US are going through difficult economic times.
  - Two consecutive quarters of shrinking economic activity are expected for Europe and the US. The biggest damage is concentrated in the 2nd quarter.
  - The reduction of quarantine measures, fiscal and monetary support and a return of confidence ensure a recovery in the second half of the year.
  - On average, however, in 2020 the Eurozone will clock up a negative growth rate and for the US growth remains well below trend.

Unseen crisis, unseen measures

- Governments are taking unprecedented measures not only in the health field, but also in the monetary and economic spheres:
  - The US central bank (Fed) reduced its policy interest rate by 1.5% in two steps to just above 0%.
  - Monetary injections and more flexible regulation keep the financial system going. Because base rates were already so low (read negative), the European Central Bank (ECB) mainly

- appealed to this type of measures. Initially, this provoked some criticism, but in essence it is a good package of measures.
- Companies are supported by budgetary measures. For the time being, there is little coordination, but almost everywhere tax and other charges are postponed and guarantee funds are set up. The German government, for example, is providing almost EUR 500 billion for credit guarantees and has indicated that it will go much further if necessary.

Uncertainty kills the bull

- Although the Chinese (and Korean) scenario provides some guidance, too little is known about the virus itself to predict its development in the coming months.
- Nor can the impact on the economy be correctly estimated. Especially the length of the lockdown is a crucial factor here.
- That stock markets do not like such scenarios has already been proven several times. In recent weeks we have seen a classical flight to safety:
  - With price declines since the stock market peak (19 February) of more than 30% in Europe and the US, the markets have long since settled for a short production drop. A severe recession is now in the prices.
  - Secure government bonds are very much in demand, causing returns on this paper, including in the US, to fall to unprecedented depths.

We wait and see

- Assuming that this crisis is temporary, the share price movements of recent weeks have undoubtedly created opportunities.
- However, this does not mean that the markets will seize these opportunities immediately.
  - We have already seen that the security of government bonds is being sought, even at interest rates that in no way compensate for inflation,
  - and that shares were shunned even when unrealisticly negative scenarios were factored in.
- The news flow for the coming months will almost certainly remain negative:
  - Economic indicators will deteriorate dramatically;
  - Profits of listed companies will take a hefty dent.
- The fall in prices over the past few weeks has drastically changed the positioning of our portfolios. The equity weight is now close to the norm and we are going to keep it that way in the short term.
- Within the equity portfolio, we have a slightly more defensive sector positioning and within the regions, we opt mainly for emerging markets and are more cautious for Europe.

Edited to 16 March 2020 (6.00 p.m.)

(*) The investment strategy described in this document relates to all investment funds (undertakings for collective investment) managed by KBC Asset Management NV, which make explicit reference in their investment policy, as laid out in the prospectus, to KBC Asset Management's investment strategy. The stated strategy is not, therefore, altered in the case of other investment funds, the investment policy of which does not refer directly to KBC Asset Management's investment strategy. It is possible that these investment funds are managed in a way that differs from the investment strategy. You should always read the prospectus and the Key Investor Information Document for the relevant investment fund.