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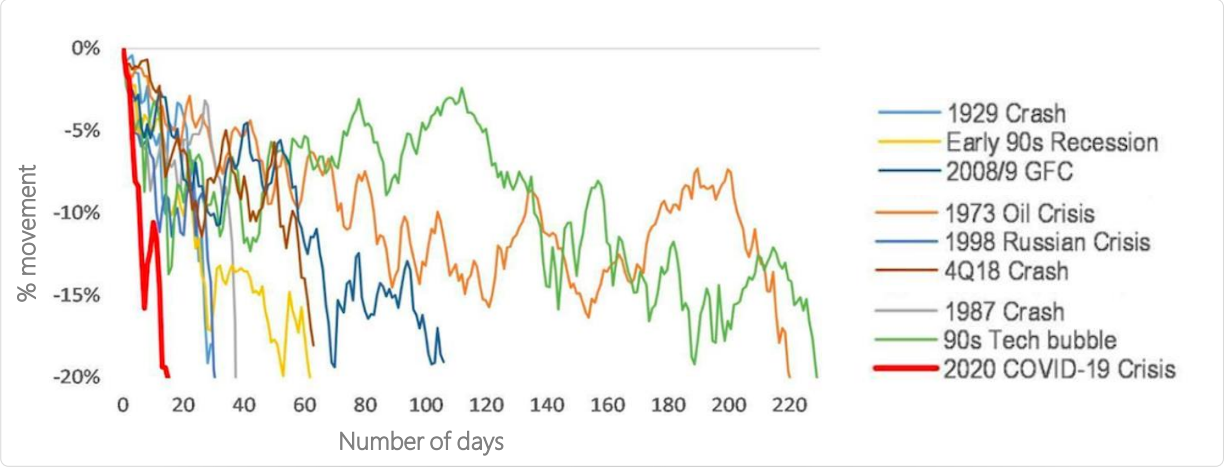
CORONAVIRUS: HOW DOES IT COMPARE TO OTHER CRISES?

As the coronavirus outbreak worsens and investors continue to run for cover, it's an interesting time to take a look at how this sell off compares to other notable historic events over the last century.

The chart below shows the steep gradient and relative speed of the descent of US markets during this year's Covid-19 in comparison to other well-known stock market declines. Most notably, this crisis has caused a bear market, a decline of 20%, in half the time of the Great Depression back in 1929.

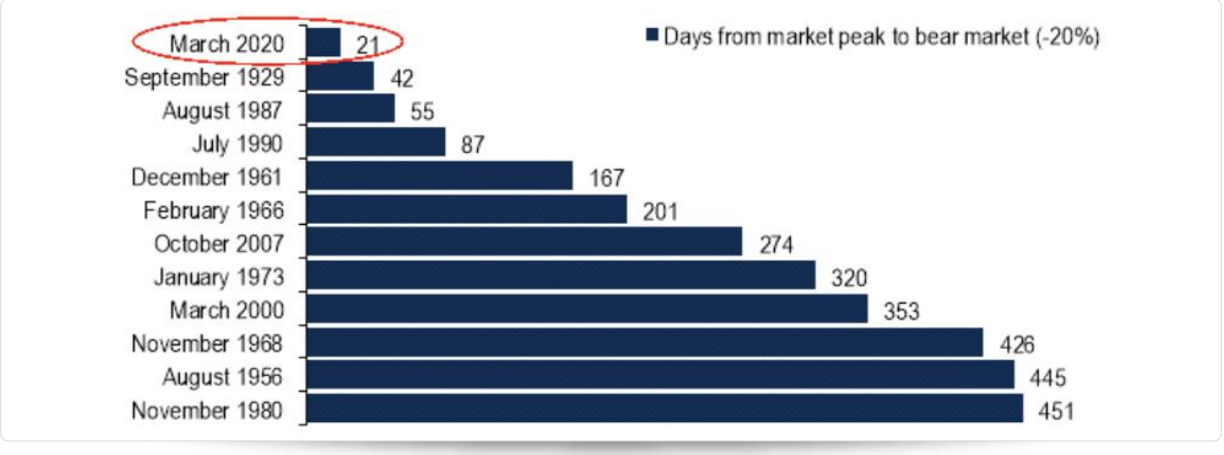
It goes without saying though that each situation is very different in its own right and, as such, the market will naturally behave in different ways. Below you can see, in relative terms, how the S&P 500, FTSE 100 and Gold behaved during other periods of volatility.

US market movement during financial crises



Source: Robin Wiggs, Financial Times

Time taken for US markets to reach bear market territory



Source: Robin Wiggs, Financial Times

S&P 500

The S&P 500 index represents the market capitalisation of 500 US listed companies and is generally accepted as a good barometer of the health of the US economy. When times are good, investors have confidence and the S&P rises. This is reflected in its 10-year average annual return of 7.99%.

The most recent price crash that most people remember was that of 2008-2009. The culmination of years of lax lending practices to those with bad credit and little or no savings, combined with rapidly rising prices, created a housing bubble. If the borrower couldn't pay, the increase in home equity would offset their loss. Once the housing market began to slow down and huge numbers of these subprime mortgage loans defaulted, the bubble burst. Many institutions had huge exposure to these bad loans, including the likes of Lehman Brothers who dissolved as a result. From peak to bottom (October 2007 through to March 2009, a period of 17 months), the S&P fell 56.8%.

But to put this in perspective, we should also look at the flipside. From March 2009 to February 2020 the S&P increased well over 500% in a bull run lasting an unprecedented 11 years. Furthermore, if we look at the chart below, the quickest bear market in history has only seen the S&P marginally break the prevailing trend line from the 2009 low.

Source: Tradingview, S&P 500 weekly timeframe

This year, in 2020, the US economy was thriving. Stock markets were at record highs, unemployment at record lows. Unlike 2008, there was no systemic underlying issue that might cause a crash. The catalyst for the sell off was an external one.

A global pandemic is difficult, if not impossible, to accurately predict and price in. It is first and foremost a public health issue, albeit one with the potential to disrupt the economy. Once it starts to threaten local revenue, this health issue begins to encourage a sell off as those investors, who have held stock for years and enjoyed a significant upside, capitalise on the opportunity to take profit.

But the speed of the sell off over the last few weeks has been unprecedented. This is almost certainly a reflection of the panic and concern surrounding the coronavirus epidemic, aggravated by continued uncertainty over when the situation will likely be resolved.

There is hope in the fact that we have survived and managed to control previous epidemics. Should Covid-19 also be contained, and the economic damage lessened by the stimulus measures already implemented by central banks around the world, including near zero interest rates and trillions of dollars in liquidity, we would likely see the markets bounce back strongly.

If this is the case, the external factor is resolved and the S&P trades at a significant discount compared to earlier this year, there would be nothing stopping investors from coming in and picking up blue chip stocks at bargain prices, just as they did in 2009 and every other crisis before it.

Gold

Gold is widely regarded as the number one safe haven asset. When the stock markets fall and investor sentiment switches to 'risk-off', we tend to see a flock to the precious metal for protection and Gold prices appreciate. The opposite can be said when investor sentiment is 'risk-on'. In this case investors will tend to sell their Gold holding in favour of equities.

However, the relationship isn't always this black and white and there are times where the stock markets and Gold actually correlate. This is what we are seeing now with the Covid-19 global pandemic.

The reason for this? Liquidity. Given the uncertain times (both in public health and the economy), investors are selling assets to release cash. We saw a similar occurrence during the global financial crisis back in 2008-2009 when both the stock market and Gold fell together.

Below is a recent price action chart of Gold (XAUUSD) on a weekly timeframe (where each candle represents one week's worth of price movement).

Source: Tradingview, Gold weekly timeframe

In terms of a potential price where we could see a rebound, from a technical analysis point of view $1350 - $1400 could be an interesting zone to pay attention to. A number of technical indicators are appearing to confluence at these price levels; long term trend line, 200 week Exponential Moving Average, as well as 61.8% Fibonacci retracement of the most recent upward leg.

Fundamentals could also support the technicals in upcoming weeks and months. Central banks around the world are currently pumping additional liquidity into global economies to keep them ticking over. Once the number of new Covid-19 cases starts to decline and we get back to normality, we may well see a run back to assets with sound money principles, such as Gold. Investors who are now holding cash will look to protect themselves against further devalued fiat currencies.

FTSE 100

The FTSE 100 is a share index that represents the largest 100 companies on the London Stock Exchange and is seen as a good indicator of the performance of the largest businesses listed in the UK. At time of writing, the FTSE is trading at 5000 - a level not seen since the 2011 crash. With a decline of 34% since the start of 2020, we're firmly in bear market territory.

The last time that we saw the FTSE sell off to this degree in such a short space of time was June 24th 2016 - the first trading session after the UK public narrowly voted to leave the EU. Although there are many differences between the circumstances then versus now, uncertainty is the key factor both have in common.

After the Brexit vote, $2 trillion of value was wiped from global markets, sterling fell to levels not seen since 1985. Blue chip stocks such as Tesco, Barclays and Barratt Developments suffered double digit share price falls of 18%, 20% & 40% respectively.

However, as seen with the example given on the S&P 500, after the initial sell off, bargain hunters soon returned looking for oversold stocks. By the end of 2016, the value of the FTSE was 26% higher than at Brexit lows. For example stocks like Tesco, Barclays and Barratt Developments, which had all recovered the majority of their losses, if not more, posted 30%, 52% and 26% gains respectively.

Source Trading view, FTSE 100 daily timeframe

Besides the Brexit referendum, it's worth highlighting that we have also come through the dot com bubble, the 2008 financial crash, the 2011 stock market crash and have gone on to reach all time record highs each time. While we are certainly not out of the woods yet and there could be more selling pressure ahead of us, the market is resilient. Often investors that are new to the markets will be discouraged by the sea of red on their screens. However, more experienced investors, those who have lived through previous periods of market volatility, may take advantage of the opportunities this sell off offers. The best prices come at the worst times.

Report accurate as of Friday 20th March 2020.

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