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Coronavirus strikes

COVID-19 (Novel Coronavirus) will have a very significant impact on economies, markets and people's lives. Unfortunately, this is our starting point.

While the virus will have a very significant impact on all parts of society, it's important to remember that it's effectively one-off in nature. What this means is that it should be a 1x price/earnings ratio rather than a 15x price/earnings ratio impact event. This effectively means that the significant earnings hit to companies and markets should not be capitalised into share prices into perpetuity. Similarly, the hit to economic activity should also be seen as a one-off and not factored into economic growth in perpetuity.

In addition to COVID-19, the oil price has also caused a major dislocation in markets. Oil demand has declined, and oil supply has significantly increased. Oil demand is weak in part due to lower economic activity caused by COVID-19, and oil supply has increased due to a dispute between Saudi Arabia and Russia within the OPEC+ alliance. While it's fair to assume that all of these impacts are temporary in nature, it will still take a while to be resolved and could see the oil price continue to move toward the cost of production. Oil companies are likely to delay or postpone new projects in the short term, and these deferments should bring the market back into balance in the medium term. A lower oil price is also stimulatory for economies, but we believe this usual J-curve might be more muted, as lower oil prices will not necessarily get consumers spending more until they get past COVID-19 fears.

We are now in the unusual situation in 2020 of having both monetary and fiscal stimulus operating at the same time. Interest rates are very low and heading toward zero, plus there is further likelihood of unconventional monetary expansion through activities like quantitative easing. In addition to monetary stimulus, we're now seeing aggressive fiscal stimulus being undertaken in a range of countries to try to mitigate the negative economic impact of behaviours around COVID-19. These two strong tailwinds should position us well for the medium term and post-COVID-19.

The most important aspect for markets in this environment is the second derivative change in new cases of COVID-19. The second derivative is effectively the rate of change, or the acceleration and deceleration of new cases. The market generally focuses on the second derivative, as it often highlights the point of maximum pain and destruction. When new cases are peaking is often when fear is at its greatest and governments and institutions are taking their most aggressive action. The interesting point is that China and Korea already have decelerating new cases, with those economies similarly still negative, but improving. Unfortunately, while the early countries are now decelerating, the rest of the world is accelerating.

For markets and the world economy, the focus is on what happens in the USA and, to a lesser extent, Europe. While it is extremely difficult to work out when this second derivative may change (and we see a plateauing of new cases), if the USA follows the path of the early countries, we could see this second derivative change over the next month. This is a big 'if', as countries can follow very different paths based on demographics, geography and policies. It is very important in this instance to try to get ahead of the market, but not too far ahead of the market, as conditions can change rapidly. We are very much in a 'watch, wait and monitor' mode, to see when the second derivative change and plateauing may occur.

Once we're over the worst of COVID-19, I expect to see market leadership coming from sectors like technology, resources and travel. We would also see the strong momentum in sectors like consumer staples, healthcare and real estate continuing post-COVID-19. Resources are likely to have one of the quickest rebounds, post-COVID-19. Resources are currently the cheapest sector – balance sheets are strong, cash flows are still reasonable, and the sector has been significantly negatively impacted leading into COVID-19. Once we see a plateauing in new cases, I think we'll see money re-enter the sector very quickly, given its value, and especially if we see China undertake fiscal stimulus.

Technology, which has also performed poorly over the last month, could lead the market post-COVID-19, given the sector now has much better valuations, long-term fundamentals and structural growth. While travel should improve post COVID-19, it's likely to remain more volatile for longer, as recovery will be more prolonged. While these three sectors should see a strong rebound given their poor performance, it's also important to highlight that sectors like consumer staples, healthcare and real estate will likely continue their strong momentum post-COVID-19. Consumer staples (in particular, supermarkets), currently have strong fundamentals and, given Kaufland's decision not to enter the Australian market and food inflation potentially entering the system, we believe these strong fundamentals will likely continue, even post-COVID-19. Similarly, healthcare is very well positioned for the long term, as is real estate, given the likely continuation of very low interest and capitalisation rates.

These sorts of crisis periods can present excellent opportunities to upgrade portfolios. Typically, at the start of a crisis, the markets sell off indiscriminately – shooting first and asking questions later, so to speak. So if there is a company you've always wanted to own, but it has always looked too expensive, this could be your opportunity to buy a high-quality company with strong long-term fundamentals at much more attractive valuation levels.

This is my ninth investment crisis (Asian Crisis, Russian Bond Default, LTCM, September 11, Tech Bust, GFC, Sovereign Debt Crisis, SARS and now COVID-19) over my 23 years with Fidelity. And although it's fair to say that this crisis is different from each of the previous ones, there are definitely lessons to be learnt from all of them. Mark Twain famously stated that 'History does not repeat, but it does rhyme.'

As it stands today, I'm very comfortable with the Fidelity Australian Equities portfolio. I have a portfolio of predominantly high-quality, blue-chip, large, liquid stocks, including a strong cash position. As events unfold over the next few months, we are ready to deploy the cash, upgrade the portfolio and invest in great companies at attractive valuations for the long term. Fidelity has a team of hundreds of equity and fixed income analysts on the ground, around the world, who will help me find the best investments for the Fund. I'm extremely proud that we performed so strongly through the global financial crisis, and similarly believe that the Fund is well positioned for long-term investment opportunities that will arise from the COVID-19 crisis.

Stay safe and invest well.