FIXED INCOME

Monitoring China's Outbreak, and Other Potential Market Shocks

January 25, 2020


Michael Hasenstab, Ph.D.
Chief Investment Officer,
Templeton Global Macro


Calvin Ho, Ph.D.
Senior Vice President,
Portfolio Manager,
Director of Research,
Templeton Global Macro


Attila Korpos, Ph.D.
Senior Global Macro & Research Analyst,
Templeton Global Macro


Diego Valderrama, Ph.D.
Vice President, Senior Global Macro & Research Analyst,
Templeton Global Macro


Hyung C. Shin, Ph.D.
Vice President,
Senior Global Macro & Research Analyst,
Templeton Global Macro

The Templeton Global Macro team takes a look at the implications of the coronavirus in China, and positioning for potential market shocks.

We are closely monitoring the impacts to global financial markets from the outbreak of a new strain of the coronavirus in China, and other parts of the world. Already, we've seen significant impacts on various risks assets. This is a stark reminder that an unexpected event can occur at any time, and that portfolio diversification is critical when markets are priced for perfection.

What we know so far is that the coronavirus appears to be less fatal (4% mortality according to World Health Organization [WHO]) than SARS (severe acute respiratory syndrome) was in 2003 (11%), but reporting is still in the early stages and the peak in severity remains unknown. The WHO does not view the outbreak as a public emergency of international concern at this stage, but continues to monitor. At this point, the virus appears less likely to become a global pandemic as SARS was in 2003.

To counter the rising number of cases, China has shut down travel in Wuhan, a city of 11 million people where the outbreak originated. Similar measures have been implemented in other cities. Many public events have been cancelled. However, the coronavirus outbreak is occurring during the Lunar New Year, a time of peak travel and public gathering, as well as a high point in economic activity for the year. Both the human impact and economic disruption are amplified by the timing, similar to the SARS outbreak which also peaked during the Lunar New Year in 2003.

From a macro standpoint, consumption and travel sectors in China are likely to be hit most acutely by a virus outbreak, with the potential for spillover effects to the global economy through trade and supply chain disruption. We have experienced and monitored these types of events in the past, such as with SARS in 2003 and Swine Flu in 2009. The real danger is if a virus has high transmission and high fatality rates, which the current coronavirus has not reached at this point, according to the WHO.

Nonetheless, the current situation remains fluid and has the potential to worsen in the near-term. While the human and economic impacts from a virus outbreak can be severe in the short-term, the effects tend to be relatively short-lived. However, the trigger effects on various overvalued asset classes can be significant.

Overall, we continue to see elevated global risks—we have been positioning our strategies to be uncorrelated to overvalued asset classes that appear vulnerable to elevated tail risks. Events in early 2020 have already shown the potential flashpoints around the world, including escalating tensions in Iran and the Middle East. We believe investors need to focus on building portfolios that can be uncorrelated to broad market risks.

Important Legal Information

This material reflects the analysis and opinions of the authors as of January 24, 2020, and may differ from the opinions of other portfolio managers, investment teams or platforms at Franklin Templeton. It is intended to be of general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice.

The views expressed and the comments, opinions and analyses are rendered as at the publication date and may change without notice. The information provided in this material is not intended as a complete analysis of every material fact regarding any country, region or market, industry or strategy. The views expressed are those of the investment manager and the comments, opinions and analyses are rendered as of the publication date and may change without notice. The information provided in this material is not intended as a complete analysis of every material fact regarding any country, region or market.

Data from third party sources may have been used in the preparation of this material and Franklin Templeton Investments ("FTI") has not independently verified, validated or audited such data. FTI accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments opinions and analyses in the material is at the sole discretion of the user.

What Are the Risks?

All investments involve risks, including possible loss of principal. Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments. Investments in emerging markets, of which frontier markets are a subset, involve heightened risks related to the same factors, in addition to those associated with these markets' smaller size, lesser liquidity and lack of established legal, political, business and social frameworks to support securities markets. Because these frameworks are typically even less developed in frontier markets, as well as various factors including the increased potential for extreme price volatility, illiquidity, trade barriers and exchange controls, the risks associated with emerging markets are magnified in frontier markets. Bond prices generally move in the opposite direction of interest rates. Thus, as prices of bonds in an investment portfolio adjust to a rise in interest rates, the value of the portfolio may decline.

Diversification does not guarantee profit nor protect against risk of loss.