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BREAKING NEWS
25 February 2020

Coronavirus: economic, market and portfolio implications

The spread of the coronavirus carries risks to the global economy beyond the obvious human toll. We cannot yet fully evaluate the scope and severity of the risks, and comparisons to previous pandemics are of little use given the dramatic increase in the size and importance of China's economy. The bottom line: While signs point to somewhat better global growth this year, the coronavirus factor further affirms the latest guidance from Nuveen's Global Investment Committee for lower return expectations in 2020.

Commentary from
Nuveen's Global Investment Committee

ECONOMIC INSIGHTS

Because of its genesis in China, the coronavirus is both a demand and a supply shock to the global economy. Outside of China, however, evidence based on February's survey data (U.S. consumer sentiment and the eurozone purchasing managers index) suggests that demand remains solid and supply issues are the key risk.

That said, we believe there will be negative production effects, even in less-affected economies like the U.S. and Europe, because of the disruption to global supply chains running through China as well as Korea and potentially Japan. Initially, the effect may not be strong, as producers who rely on parts from these areas may be able to wind down existing inventory. But if the Asian production stoppages worsen or last well into the second quarter, a global supply crunch will likely affect the already-weak manufacturing sector.

That would mean an impact on jobs and the wider global economy. Should the virus be contained in the near future, however, much of the lost growth from the first half of the year could be made up in the second half as inventories rebuild and Chinese consumers make up for lost spending.

But the damage done to global factory output may already have put us on a path to lower global GDP growth than we were expecting heading into 2020. Most of that dent comes from slower expected growth in China (even with a "bounce" in the second half) but any expectations for a resurgence in U.S. private investment or overall eurozone growth, for example, need to be pushed back as well.

MARKET IMPLICATIONS

Over the past month, a pattern of market response to perceived and actual threats from the coronavirus has emerged: High-quality bonds, gold and safe-haven currencies like the U.S. dollar have rallied while more production-intensive commodities like oil have suffered, as have the stocks of companies domiciled in or exposed to the affected areas. U.S. stocks had not reacted much until Monday, 24 February, when the market swooned at the open of trading.

The chief risk to markets from here remains high valuations in the U.S. equity and credit markets. U.S. risk assets were "priced to perfection" or something close to it following the three Federal Reserve (Fed) rate cuts last year and the resolution of various trade deals. Even after Monday's drop, U.S. equity markets still reflect a very positive outlook for earnings growth and the U.S. economy, along with, potentially, a market-friendly status quo result in the November election. All of that can be thrown into doubt should the global impact of the virus continue to spread.

In the near term, look for stocks and other risk assets to respond negatively to signs of deterioration in economic data.

OUR OUTLOOK

In Nuveen's Global Investment Committee 2020 Outlook, we called for "a clearer path for growth," but the obstacles that have been cleared (trade and Brexit) now have a new hurdle to take their place.

Still, there's not much, at a high level, that we would change to our outlook if given the opportunity. While the virus remains a major downside risk, most actual economic data have surprised on the upside so far in 2020, so the news has been far from unanimously bad.

For investors worried about the implications of the coronavirus on portfolios, following are thoughts on defensive positioning from Nuveen's asset class leaders and Solutions portfolio construction experts. And for all investors, Nuveen continues to advocate that taking a long-term view, diversifying portfolios and deploying active management are methods to address both the risks and the opportunities of major market disruptions.

Equities

- We prefer defensive, yield-seeking stocks to ride out times of market turmoil.
- On the other side of market dislocation, affordably priced cyclical stocks could snap back once the underlying health of the economy resumes.
- Longer term, we prefer quality growth stocks, favoring a sector that tends to do best amid modest economic expansion.
- Global investors may look for value in countries that are not yet exposed to the virus and have strong fundamental reform stories underway, such as India and Brazil.

Fixed income

- The move in fixed income markets year-to-date has come primarily from the drop in interest rates more than an acute widening of credit spreads on investor de-risking.
- The latest bond market move is being dominated by considerations of the coronavirus' impact and the likelihood that rates will need to go lower sometime soon with more than two Fed cuts priced in by year end.
- U.S. corporate credit spreads came into this period at close to all-time tight levels, which reflected too much complacency about the virus' impact in addition to moderating signals around global growth.
- Given the still-supportive fundamentals and technicals for fixed income assets, we are looking to exploit recent volatility to selectively add risk in portfolios.

Real estate

- Our base case is that the coronavirus will have its greatest effect on economies and real estate in Asia Pacific in the first quarter, before growth rebounds in subsequent quarters.

- Should the virus continue to spread into the second quarter, further disruption in global supply chains, production and business profitability would take a larger toll.
- We anticipate more policy support to mitigate near-term risks to economic growth.
- Tactically, we expect more downside pressure on retail rents. Except for China and Hong Kong, where fundamentals were already weak, office rents should hold up better unless we see a true pandemic crisis.
- Logistics remain a favored investment, as do student housing in Australia and multifamily properties in Tokyo.
- Overall, commercial real estate remains an appealing risk mitigator for many investors.

For more information, please visit us at nuveen.com.

Endnotes

Sources

Bloomberg.

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A word on risk

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GCM-1099578PR-Y0220P