# FACETOLOGY

**10th March 2020**

## Stocking up

There were echoes of October 1987 in the small hours of Monday morning. Markets were crashing (on a Monday) but the reason for it could've been one thing or another, or a combination of both. But clearly it was going to be more than what they call an "event day" – meaning a drop of 2% or more.

At FACET we were also conscious that some of the big City banks had chosen Monday as the day to relocate and separate various teams of staff to different offices to prevent all-out contagion of Covid-19 across their vast dealing floors. Even before the market opened we heard some stories of staff turning up at the wrong place and computers stubbornly refusing to work. This was eerily familiar to the crash of 1987 when power cuts caused by the hurricane compounded the problem of coping with the crash itself.

But yesterday, seeing the price of crude down over 30%, one's first thoughts might have been that this was related to the dramatic pick up in the spread of Covid-19 and the economic impact of the Italian government shuttering Lombardy.

This would make sense to some extent. Energy consumption in China has fallen as factories shut and economic activity is falling across the developed world both in manufacturing and the service economy.

But in fact, the collapse of the oil price is almost entirely due to a price war which has broken out between OPEC and Russia. Since 2016, OPEC and others have cooperated to restrain oil production in order to support the price of oil in the wake of falling global demand. Indeed, a recent report from the IHT Markit Crude Oil Market Service predicts that Q1 2020 global oil demand will be the largest quarterly drop ever. The spread of Covid-19 is clearly a factor but there are other long-term factors at play.

However, it appears that Russia believes that stable prices above $50 only serve to keep the ever-expanding US shale oil industry in business. US shale producers, it must be remembered, need a far higher oil price to remain profitable.

It looks like we could be in for a repeat of 2014 when OPEC and others orchestrated a strategy to push oil prices down to under $30 per barrel – a point that put quite a few US shale oil producers out of business. But overall, the US producers proved to me far more resilient than previously suspected and the OPEC strategy ultimately failed.

That whole saga could repeat but, for now, the markets have marked Brent oil down to $33 per barrel which, of course, is bad news for the oil majors such as BP and Exxon et al. It is, on the other hand, pretty good news for the consumer and will also keep a lid on inflation.

At any other time, this would be the headline story were it not with the 24-hour obsession with Covid-19. The situation materially worsened over the weekend with the news that the Italian government had placed total restrictions of movement outside Lombardy plus a few other regions. As of today, there are 9,172 Covid-19 cases in Italy and the number is rising at an accelerating rate. The charts do look rather ominous.

Meanwhile, the news is full of understandable concern about who is coming into our airports and what effect it will have on our lives should the UK lose control of our own so far limited outbreak.

Our job here at FACET, however, is to try and look through what is going on right now conscious that the stock market is supposed to be a forward-looking vehicle that correlates to what we think the world will look like nine months or so from now. A look at the Chinese Covid-19 gives some reasons to be optimistic.

Over the last 48 hours, the number of new cases has dropped from a peak 3,000 a day back in February to just 46 on Sunday and only 17 yesterday.  Very few seem to be talking about this – particularly in the markets.

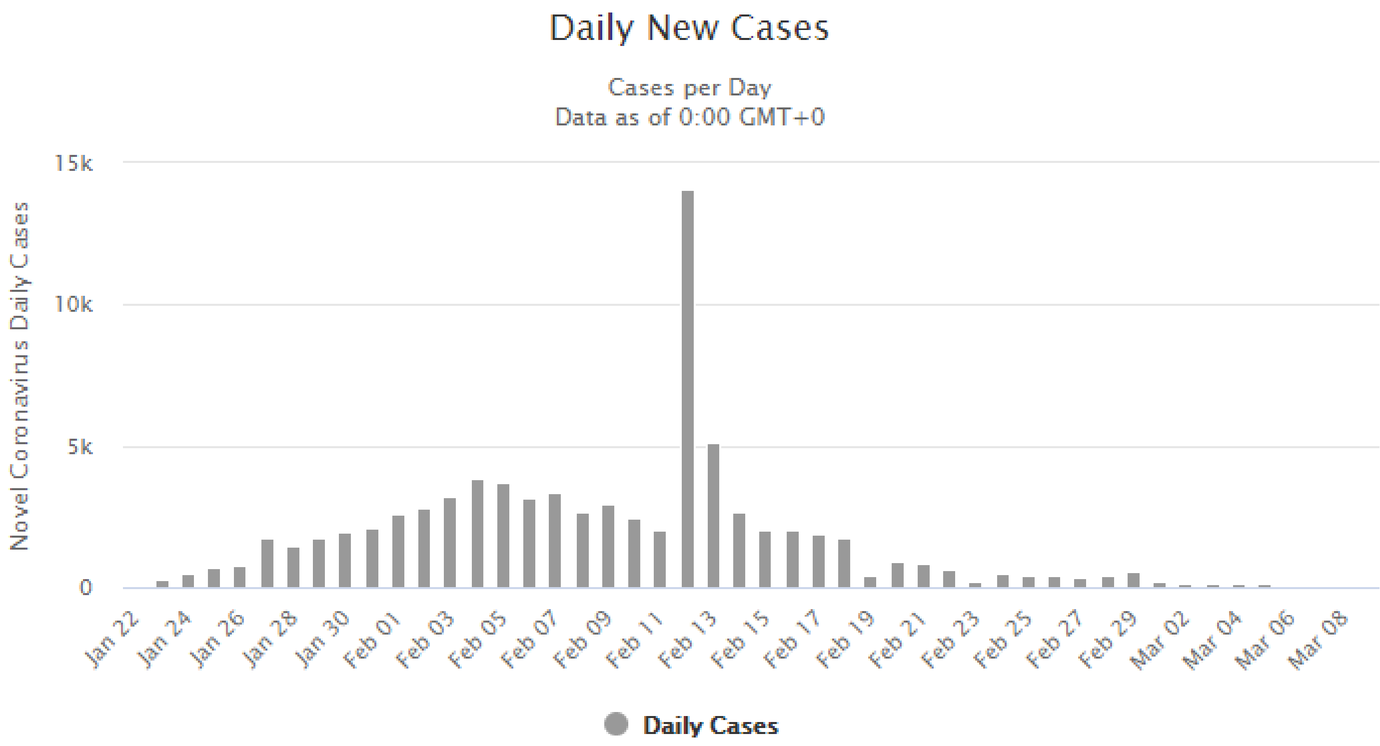


Chart courtesy of Worldometer

Whereas in Italy, it is only just getting going at an accelerating rate:

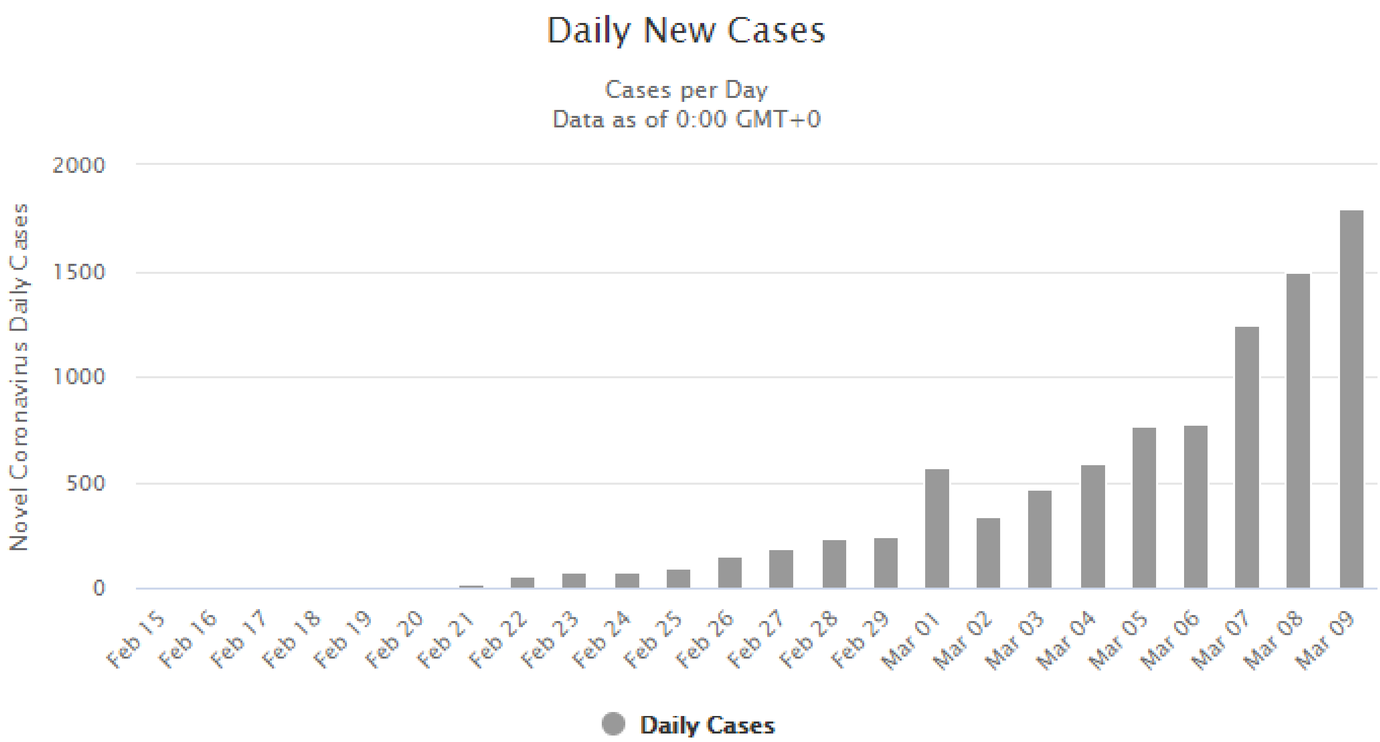


Chart courtesy of Worldometer

Now some may claim that China is not being entirely truthful with the numbers. But if they were being truthful about the almost exponential increase in their reporting to the World Health Organisation earlier in the year, it wouldn't make sense to change their reporting methods now.

It is more likely, in our view that the efforts to contain the spread through quarantine are actually working in that the virus is running out of people to infect within the confines of those areas. There is also mounting evidence that warmer weather helps to hinder Covid-19 and that the start of Spring in central China – where temperatures are now several degrees higher than in Italy – may be contributing to a turn in the statistics.

If this is broadly true, then stock markets will find a floor sooner rather than later. It has been a brutal sell-off but it does bring with it opportunities. The FACET client portfolios were defensively positioned going into this and we are watching markets closely with a view to investing cash into solid good-quality stocks at valuations not seen for years. Initially, we will look again at the USA where the economy is still in good shape and where, it must be remembered, this crash came from an all-time high and are really only back where they were in August 2019.

We will, of course, keep you posted and will be happy to answer any questions you may have.