Groupe Conseil Wermenlinger
Investment Advisors

Strategic outlook—Special edition

At the time of writing, the coronavirus health crisis, with its dramatic development and fatal consequences, has caught just about everyone's attention, and that is perfectly understandable. Investors are increasingly jittery—which is clearly reflected on stock markets, as is often the case. Over the past few weeks, as you have no doubt noticed, equities have fallen sharply in value. Many investors have become worried, even fearful.

This is not the first time we have experienced this kind of problem. SARS and H1N1 are two examples. More recently, the Ebola virus wreaked havoc in Africa. There are sure to be other viruses that will have all the necessary traits to spread turmoil and bewilderment. How should investors react in such situations?

For a number of years, when I make decisions in a climate of uncertainty and particularly in more volatile settings, I have initially taken a probability-weighted approach. This involves developing a few scenarios and assigning each a probability weighting. It's a very unscientific exercise but one that has the advantage of being based on experience and real-life events. Yet, as we're well aware, no one can predict the future. Once this step is completed, I turn to science, which allows me to objectively analyze my scenarios. Lastly, I share my ideas with my advisors, as well as economists and analysts. So, what about today's situation? As I see it, there are four possible scenarios.

Scenario No. 1 — The World Health Organization (WHO) declares a pandemic. Despite numerous governments' best efforts to contain the crisis and quarantine their populations, nothing seems to stop it. Millions of people are affected, and I dare not even think about casualty figures. A serious global recession follows. Raw material prices fall sharply. For many countries, monetary policy will not be particularly effective, given the very low levels of current key interest rates. Only countries banding together with strong and coordinated fiscal policy with a focus on productivity, plus a good measure of time, can help put economies back on the path to growth. 15% probability.

Scenario No. 2 — The WHO declares a global pandemic that is smaller in scale than expected, owing to quarantine efforts in subsequent weeks. A smaller recession swiftly follows. Government and monetary authorities work together to implement effective financial policy. Markets respond with skepticism, and safe havens like gold, the U.S. dollar, the yen and the Swiss franc increase. A number of central banks announce cuts in key interest rates. 20% probability.

Scenario No. 3—There is no formal announcement of a pandemic in the short term, but the situation remains serious, particularly for the 50 countries most affected today, including China, South Korea, Italy and Iran. A short recession follows. Government authorities and central bank decision-makers decide to take no risks and pursue an easing in monetary policy to keep the cost of credit at current levels. Fiscal policies are quickly implemented to avoid an excessive slowdown. Markets react cautiously, but positively. Consumer confidence is upbeat once again. 45% probability.

Scenario No. 4 — A pandemic is avoided. Certain countries need to maintain their efforts to prevent any further spread. Others adopt stringent measures particularly aimed at travellers crossing their borders. The spread of the virus slowly subsides. Some countries experience a recession, others an economic slowdown. Globally, there is a brief recession followed by a strong recovery as inventories are low. Markets are quick to factor in the recovery, and prices gradually recover. 25% probability.

This exercise is only a first step, as there are bound to be any number of scenarios. However, I am optimistic because the science of finance—through its theories of market efficiency, particularly those advocated by Eugene Fama and Kenneth French—has clearly demonstrated the markets' ability to assess public companies' fundamental long-term value. In the short term, markets are sporadically influenced by emotions, special geopolitical or other circumstances, occasional bubbles and particularly unusual monetary or fiscal policies.

We will know more by the end of March. In the meantime, my recommendation is to avoid acting on impulse. I believe instead you'll be better served by adopting and maintaining a long-term investment vision that reflects your personal goals.

We remain available for any questions you may have and assure you that we're following the development of this health crisis very closely.

Laurent Wermenlinger, F.Pl., FCSI® (Fellow of the Canadian Securities Institute)
Vice-President and Portfolio Manager