Update on the current correction in equity markets

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We are seeing a major correction occurring in all global equity markets as investors try to assess the impact of the coronavirus on corporate profits. The Dow Jones is now down over 12% from the peak it reached on the 12th February as near panic grips many markets.

The extensive factory closures and travel bans that we are seeing in many parts of the world due to the coronavirus outbreak will no doubt have a real impact on global economic activity and this will in turn impact the profits of many companies.

These types of markets, where uncertainty and fear are leading to many investors selling indiscriminately – while not that frequent – are nothing new. In these types of markets "the good the bad and the ugly" all get sold down heavily as investors reduce their overall exposure to the equity market.

In times like these, there are a few things to bear in mind:

- The correction is happening at a time when many sharemarkets around the world had reached record highs on investor optimism of continued world growth, with many stocks arguably in over-valued territory.
- While the coronavirus is being taken very seriously by government authorities, so far the virus has led to around 3,000 deaths. To keep this in perspective, it is worth noting a 2017 World Health Organisation study attributed between 300,000 and 650,000 deaths per annum from the annual influenza virus.

So how does this impact IML's portfolios and what are we doing about it?

Clearly this will be a negative month for investors with losses recorded in every sector.

IML's portfolios will also be negatively impacted by the current correction as all stocks get sold off heavily:

- Many stocks with unproven business models that have been optimistically valued by speculators for some years now usually perform much worse than companies with established operations. IML's portfolios do not hold any speculative companies.
- In all of our portfolios we hold a good weighting to cash which means we do not have to 'panic sell' and can look to perhaps buy good quality stocks when they get oversold.
- Our portfolios are tilted towards companies which we believe are relatively immune to the consequences of the impact of the virus on economic activity – here we are talking about companies like Telstra, Coles, Ausnet and Sonic. Many of these stocks also offer attractive sustainable dividends.

- While our portfolios own companies like Sky City, Crown Casinos and Events Entertainment which will all be directly impacted by the drop in tourism numbers, all these companies have proven business models and healthy balance sheets to help them ride out the current storm. Many of these companies also hold very valuable property assets.
- The Australian dollar has also fallen heavily – down over 6% since 1 January 2020. This fall in the Australian dollar is a positive for all Australian exporters. It is also a positive for Australian companies that have large operations offshore. Thus companies like Brambles and Amcor, while not necessarily completely immune to a downturn in economic activity, declare their dividends in US dollars and these are then translated at the spot rate when paid to Australian investors.
- It is impossible to say exactly when the current volatility will settle down. However when the sharemarket does recover, good quality companies with real businesses and sustainable earnings and dividends will again be well sought by investors and should recover well.

Conclusion

Clearly this is very painful for all equity investors, many of whom have benefitted from the good gains seen in recent years. We have been through corrections like this before and will remain disciplined in our approach to investing at all times.

We draw investors' attention to Lesson 8 of our recent book, 20 Lessons from 20 years for further detail and thought on this matter. You can find the book at www.iml.com.au/20-lessons

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