InPrivate

Bank of Ireland

At Bank of Ireland Private we have a long history of ensuring we keep you up to date during periods of uncertainty and change. Unfortunately, today is one such period in our history. Over the past number of weeks Covid-19 has become a worldwide pandemic that we must all take action against. Given the nature of the current situation, I hope you, your family and local community are coping and managing to navigate through this difficult time, as best you can.

Aside from the very human challenges we will all face as a community, there is also the impact for you as investors and clearly there are a great many unknowns at this point in time.

Before addressing this I want to update you on how our services have adapted over the last days and weeks, to better serve you:

- As always, your Private Client Manager is available to host a meeting with you, either by phone or via your preferred technology.
- We have been conducting regular due diligence testing with our outsourced essential service providers with extra focus in recent weeks and we are confident in their ability to provide the services we require to run our business and protect clients' interests without disruption.
- Our investment teams and all of our investment managers are monitoring changes in markets constantly and have been taking steps to mitigate the impact of market volatility on your behalf.

As you will no doubt be aware the Covid-19 outbreak and its secondary effects have resulted in a heightened level of volatility in markets. These are challenging times for investors but as in previous periods of uncertainty, our advice in general is to stay focussed on the long term and take time to seek advice on the impact of short term market events.

In the enclosed analysis from our investment team, there are a number of key points to bear in mind:

- While there has been a significant event in markets we are seeing significant actions being taken by Central Banks and governments which will provide support to alleviate the crisis.
- There are already some encouraging signs of recovery in China which help to put a semblance of timeframe around the market volatility.

Finally, I want to assure you that all of the team here in Bank of Ireland are working to do all they can on your behalf to mitigate the impact of the current situation on your portfolio.

Please contact your Private Client Manager if you need any further information.

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Covid-19

Its impact & what investors need to consider

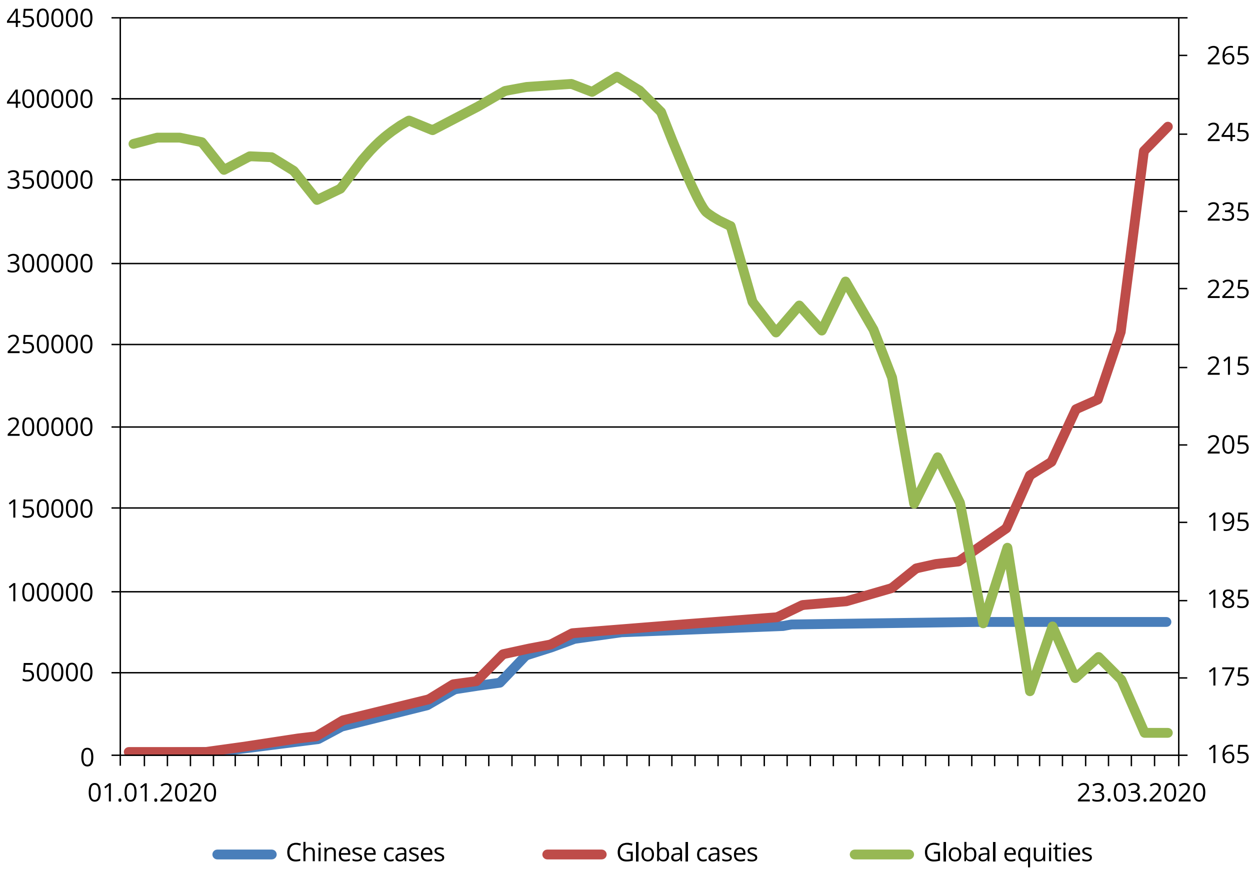
Bank of Ireland

Kevin Quinn, Investment director

From the outbreak of Coronavirus in China, markets had initially responded in quite a muted fashion. There was a belief that this was mostly a Chinese or at worst an Asian problem, that would impact on global supply lines. Secondly, investors mistakenly compared the impact of the virus to the likes of SARS, MERS and Ebola. And thirdly there was a general view that economies were strengthening as trade tensions eased.

That narrative was discarded once it spread into Europe and other developed democracies. With worsening data about the speed and fatality levels in developed economies and the World Health Organisation (WHO) declaring it a global pandemic, markets have been falling significantly - pricing in a worse economic outcome than had been originally envisaged. In recent days, market prices have collapsed, rallied collapsed and rallied again as newsflow caused market opinion to swing wildly.

Figure 1: Global equity markets & the new cases of Coronavirus



Source: Bloomberg 24.03.20

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Economic impact

The impact of Covid-19 and its secondary effects have set the global economy back onto a weakened trajectory. The many negatives that are playing out at present, point to a certainty of recession in developed economies in the first half of 2020 with the coming quarter likely to show a substantial drop. While impossible to predict with accuracy, our view is, that this will be followed by recovery later this year as disrupted supply and demand normalise.

On the assumption that the Chinese pattern of a 2-3 month timeframe for the virus to peak repeats, the worst impact in advanced economies will hopefully be relatively short-lived (even if it proves somewhat longer given the greater challenges western societies may face). While that outlook is heartening, concerns remain whether we will yet see further secondary impacts that could tighten financial markets - all the more reason why the actions by Central Banks and governments are now so critically important to financial markets. Central Bank rate reductions began with the Chinese Central Bank 0.1% cut, and the Bank of England's 0.5% cut. As of Sunday 15th the Federal Reserve cut rates to zero and increased Treasury and agency securities purchases by $700 billion. Then on Monday 23rd, the Federal Reserve made its most substantial announcements to date. It promised unlimited buying of bonds and a variety of new lending measures including lending facilities for large employers: one for bond and loan issuance and one for outstanding corporate debt (an area markets have been focussed upon in recent times) amongst other measures.

However, cuts and liquidity measures can't do anything to slow a virus, what they do is create a backstop for financial markets and lessen the risk of further tightening of financial conditions. What was clear from the European Central Bank (ECB) president Lagarde's "Fiscal First" comments, was that the scale of fiscal policy reaction from governments is now critical and markets are clearly signalling this is needed to avoid a deeper recession emerging. The scale of commitments being made has been increasing with the most notable being the US $1.2 trillion stimulus package (at time of writing it had yet to pass the US Senate, but we expect that a deal will be struck in the coming days).

A downturn distinguished more by speed than scale

The impact in markets stands out amongst the history of market downturns more for its speed than its scale. Markets have moved exceptionally quickly to price in a very high probability of recession resulting from the virus and its secondary impacts. By comparison to downturns in equity markets in the past half century, we can see from the table below how rapid this retrenchment has been (and obviously we do not yet know where the trough is, so we are using the level hit on 23rd March):

Table 1; Downturns in MSCI World Equities index 1970-2020

Peak	Low	Recovery	Peak price	Trough price	Fall	Days to trough	Days to recovery
26/10/1973	04/10/1974	01/08/1979	128.03	73.15	-42.9%	343	2105
19/11/1980	12/08/1982	02/03/1983	163.86	118.38	-27.8%	631	833
27/08/1987	04/12/1987	09/01/1989	495.87	381.87	-23.0%	99	501
16/07/1990	16/01/1991	01/04/1993	539.82	439.09	-18.7%	184	990
27/03/2000	09/10/2002	22/11/2006	1448.76	703.7	-51.4%	926	2431
12/10/2007	03/09/2009	22/04/2014	1675.29	688.64	-58.9%	692	2384
07/07/2011	04/10/2011	02/01/2013	1352.39	1074.5	-20.5%	89	545
21/05/2015	11/02/2016	10/02/2017	1810.84	1468.9	-18.9%	266	631
26/01/2018	25/12/2018	01/11/2019	2248.93	1795.28	-20.2%	333	644
19/02/2020	23/03/2020	-	2431.23	1602.11	-34.1%	33	-

Source: Bloomberg 23.03.20

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Have we seen the end of this?

If markets have fallen with unprecedented speed, is it reasonable to expect the rebound to happen at breakneck speed also? Perhaps but it is, on balance, unlikely.

Equity markets have oscillated wildly in recent days with heavy losses being followed by notable rallies repeatedly.

However, as we have not seen the peak outside China, we are likely to see a great deal of weak macro data in the coming weeks. Some of the hard data emerging so far is showing the Chinese economy to have suffered a worse impact than had been anticipated. It now looks likely that the Chinese economy will contract in Q1 for the first time since records started in 1989.

So despite market volatility and heavy losses in equity markets, it is the evidence in the data that really counts, not just the sentiment. Is all of this already priced in? Perhaps a good deal is, as we know it's coming, but perhaps the magnitude will yet surprise us, as it already did with the Chinese data. Equally the starting point in equity markets wasn't a cheap early cycle one, quite the contrary – we came into this shock on the back of the strongest year in a decade, creating an added vulnerability. That uncertainty and downside risk is a recipe for continued volatility for some weeks and months to come. The same applies as the wave of bad data emerges in western economies.

What sort of market are we facing into?

We have reached the 20% loss level that characterises bear markets. But what type of bear? Goldman Sachs has characterised 'bear markets' into 3 types: –

1. **Structural bear markets** – the nastiest of the three types with 50%+ losses, these bears start with structural imbalance in the economy and are the deepest and longest lasting. The Great Financial Crisis of 2007-09 was one such event, so too was the Oil crisis of 1973
2. **Cyclical bear markets** – a more normal style downturn, usually interest rate increases and falling earnings are prominent features. 30% type downturns with recovery still taking a number of years
3. **Event-driven bear markets** – as the name suggests these tend to occur because of a shock to the system, such as a conflict or a viral outbreak. Losses are typically c.30% in equity portfolios but the period of losses tends to be shorter (on average 9 months) and the recovery period being 15 months (in nominal terms). (The numbers here relate to equity portfolios – most investment portfolios included other assets which are generally not as impacted in the downturn).

At this juncture we see this as the third type – as it is very clearly directly a result of the pandemic nature of the virus. That sets a base case for how long before we see a resolution of this, and recovery periods for investors (15 months nominally is the historic average). As with all 'base cases', there are risks that it proves more challenging especially if secondary effects impact on the financial system more than is being prepared against. We have already seen a second economic shock with the Saudi/Russian breakdown although the impacts of this will be a mix of negatives for the sectors and countries impacted and a broader positive for consumers. A lengthening and deepening of the downturn – and a more structural style bear market – would result if the inevitable recessionary conditions create a knock on effect that leads to high debt default rates, structural unemployment or other such outcomes.

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What do markets need to see this turn around (sustainably)

Our view is that markets need to see four components in evidence for a sustained recovery and reduced volatility:

(a) A decline in the rate of growth in infection rates in developed economies

Given the evidence from both China and Italy's experiences, estimates are varying between 2-4 months before we see a decline in the rate of infection from the virus in western economies. That probably takes us until May/June.

(b) Fiscal policy action

There has been considerable commitment from governments to increase fiscal spending but markets continue to look for implementation of this. Most notable was Germany which made a 'whatever it takes' style commitment, breaking with decades of budget balancing. The full scale of this response may need to be of this character globally. With $1.2 trillion on the cards in the US, it seems probable we'll see this sort of spending.

(c) Sustained Central Bank support for liquidity

For some time, we have commented on the declining marginal effectiveness of monetary policy and ECB President Lagardes comments ("Fiscal First") gave a very clear indication of where the ECB sees the onus landing (and markets seem to agree). However Central Bank actions to protect the financial system are vital and we have seen very considerable actions taken to ensure liquidity is available to the financial system; with the Federal Reserve pulling out all the stops; cutting rates to effectively zero and resuming purchases of Treasuries and Agency mortgage backed securities. This was then followed by the ECB's announcement of plans to buy €750bn of debt. The Federal Reserve has since gone 'all in' with an undertaking to buy unlimited amounts of US Treasuries and Agency mortgage backed securities. Very clearly this is being done to avoid a third economic shock coming into play – a deeper dislocation in financial markets, and it seems probable that the Central Bank actions will achieve this.

(d) Strong evidence of a return to work & normality in China

According to the World Health Organisation (WHO), China is no longer the epicentre of the virus, as that unwelcome title has passed to Europe. Nonetheless hard data of the impact is now emerging from China and appears to have been worse than anticipated. Industrial output for January and February was down 13.5% year on year, retail sales were down by 20.5% and fixed asset investment dropped 24.5%.

Contrasting that however there is some evidence coming through that Chinese industry is getting back to work. The Chinese government has indicated that 78 million migrant workers are now back to work (that's 60% of those who had gone home for the Lunar New Year) and Hubei recommenced normal production.

Implications for investors

The following comments are general in nature, and cannot be applied to all cases, so please ensure that you take professional investment advice based around your individual circumstances.

Review your original objectives with a long term focus

When you invested first you will have given consideration to the returns you expect to achieve and the level of risk or volatility you are happy to experience. The events of recent weeks are very unwelcome for any investor, but, as a general point, staying invested through periods of volatility is the best long term approach to take. This may also mean extending the length of time you invest for, and given the scale of losses in this downturn, this may be a necessary consideration. The main circumstances in which an investor should consider changing tack is (a) if your objectives have changed or (b) your tolerance for loss is changed.

Review your portfolio for diversification

Being diversified in your portfolio across asset classes and strategies is dull but reliable and usually comes to the fore at times like this. Well diversified, conservatively focussed portfolios have not suffered losses anything near the headline stock market falls, in particular as government bond markets have performed reasonably well. For example, our iFunds 3 or PRIME 3 funds have seen losses, but with higher bond and cash holdings, combined with actions taken to de-risk such funds, the losses have been significantly lower than in equity markets.

Recognise that these near term circumstances will influence your thinking

When facing a downturn in investment values, especially one so rapid, we can all start to change how we think about long term investments. Some of this can be an emotional response and a very understandable one; most experienced investors train themselves to avoid making decisions in such circumstances.

This document contains details of historic and forecast market and index performance.
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