

## REZCO'S POSITION ON THE CORONAVIRUS

MARCH 2020

Late in January, we at Rezco started flagging possible outcomes from the coronavirus outbreak and communicated this to clients. We felt that the risks were asymmetrical – in other words, the potential downside risk was out of proportion to the potential upside in the market, considering that global markets were at record highs. We have been posting regularly on this topic on LinkedIn for several weeks now, but for those clients who may have missed those updates, we want to communicate our thinking on the coronavirus and how we have prepared for the global financial market upheaval of the last two weeks.

From the onset of the outbreak of the coronavirus in Wuhan, it seemed to be very concerning. Tens of millions of Chinese citizens were on lockdown, and about 720 million people in China experienced some form of restricted movement. We saw this as a dangerous situation with potential global implications, despite the markets being at record highs at the time. Rezco's thinking was that there was not a lot of upside in the markets, but if the coronavirus outbreak deteriorated severely then there was a lot of downside. We saw a range of possible outcomes ranging from the worst-case scenario of something similar to the Global Financial Crisis of 2008, to the market being up 5%.

As a result of this, in February, we started taking a lot of risk asset exposure out of our clients' portfolios so that by the time we came to the end of February, clients were largely invested in cash and gold with very low equity exposure and emerging market bonds, including South African bonds. The one area where we increased bond investment significantly was in US Treasuries. Our past experience has been that, in times of crisis, this is one of the few assets that actually appreciate in value.

Therefore, going into the heat of this crisis, our equity exposure has been very low in our balanced funds, namely the Rezco Value Trend Fund, and the Rezco Managed Plus Fund, with these funds currently only having about 13.5% equity exposure. Our Rezco Stable Fund is currently 6.5% invested in equities. The Rezco Global Flexible Fund and ZAR Feeder Fund are 8% invested in equities with 45% in US Treasury Bonds.

Part of the Rezco approach is similar to what we did in 2008 – sometimes you just have to sit on the sidelines, which we do to protect our clients' capital. This is a responsibility we take extremely seriously, and we will continue to do so into the future.

Going forward, we have some thoughts on how this crisis will play out. Clearly the coronavirus spreads quickly, and most virologists believe that the cat is out of the bag, so to speak, with possibilities of containment in the West probably low. China's approach of managing to contain the spread through widespread,



draconian lockdowns probably will not work in the West, so there are likely to be a couple of weeks of fairly severe panic with large drawdowns in the markets.

What still needs to be established with more certainty is the mortality rate of the virus. The WHO says it is 3.6%; credible experts think that this number is closer to around 1%. We tend to lean towards the 1% figure as being better researched.

The exact mortality rate of the coronavirus remains unclear due to uncertainty regarding total infection numbers. This is because of the lack of availability of testing kits and the high percentage of people with very mild symptoms, but the good news is that the virus is probably not as dangerous as initially feared.

The one thing that is clear is that much of the panic stems from the fact that it appears to be tremendously difficult to control the virus. Europe has a problem because they have open borders. Everything is decided by bureaucracy in Brussels, and each country has a veto, so there is no central government that can take measures like locking down a country, which means the spread in Europe will likely go unchecked. We know that it will take a while for economic activity to get back to normal because Western democracies do not have a choice, at this stage, beyond containment and limiting mobility of citizens as far as possible, which causes a severe crimp on economic activity.

We at Rezco are monitoring this situation daily. Our tech team has built incredible tools to monitor statistics in real time. We will continue to look at this very closely because somewhere there is a buy-in opportunity, but one has to be careful and understand what the progression is of the outbreak.

Another large risk that will be tested over the short term is the movement towards and resulting concentration of assets in Passive Funds since the last crash. Many market commentators have been warning for years that this introduces huge risks in the event that too many investors try to exit equity markets simultaneously.

We will continue to update you regularly as the situation changes. If you are interested in more frequent market insights from us, please follow our LinkedIn page for weekly updates.



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