



Market Watch

Virus variant worries

Summary

Risky assets fell sharply and safe-havens gained on Friday amid market fears the discovery of a new COVID-19 'variant of concern' could re-trigger wider mobility restrictions.

Equity markets fell across major regions while oil pulled back sharply. Bond yields moved lower and safe-haven currencies gained, though the USD unexpectedly fell.

Not a time to over-react. While we always viewed a vaccine-evading virus mutation as a risk, relatively little about the Omicron variant's precise risks is known. Assuming widespread lockdowns do not resume, we expect recent trends to resume once one-sided positioning is shaken out.

Background

There was a sharp 'flight-to-safety' across financial markets on Friday 26-November after the World Health Organisation (WHO) announced it had discovered a new 'variant of concern'. In equity markets, the S&P500 fell -2.3%, Euro Stoxx 600 fell -3.7% and the Hang Seng fell -2.7%.

The flight towards safety was also visible outside equities. The 10-year US government bond yield fell 16bps to 1.47% while WTI oil fell -10.2% to USD 70.4/bbl. The JPY rose 1.8% amid safe-haven demand, while the pro-cyclical AUD fell 0.9%. One move that did not fit the pure risk-off narrative, however, was the USD. The USD index fell, instead of rising (as it normally would in a pure risk off environment). After the strong gains seen recently, and the increased reliance on short-term momentum traders, this suggests there was an element of profit-taking as well as pure risk-off.

The most cited factor behind market volatility was the emergence of the fears of a renewed COVID-19 surge and associated mobility restrictions, as the World Health Organisation categorised the newly-labelled 'Omicron' variant as a 'variant of concern'. While several countries moved to swiftly impose varying grades of travel restrictions, the WHO called for a more balanced approach. Reports noted it will likely take a couple of weeks for vaccine makers and labs to test the risks from the new variant more precisely.

Risky assets fell across the board on Friday

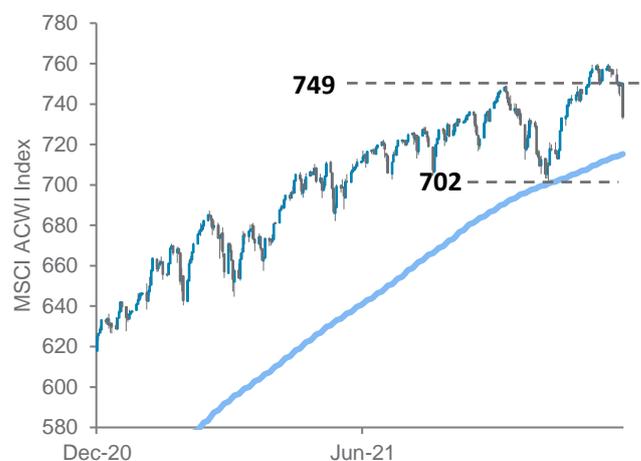
1-day price return (%) on November 26



Source: Bloomberg, Standard Chartered

Upward pressure has faded in the short term

MSCI AC World Index, 200 Day Moving Average



Source: Bloomberg, Standard Chartered

On technical charts, the MSCI All Country World index's break last week below key support at the September high of 749 indicates that the upward pressure has eased in the short term. The break has opened the way towards the October low of 702 (4.2% below Friday's close).

What does this mean for investors?

The possibility of an immunity-evading COVID-19 mutation was always one of the key risks to our constructive outlook on economic growth and risky assets. Against this backdrop, it is understandable markets are worried about the possible impact of a new 'variant of concern', especially with several countries quickly imposing new travel restrictions amid an already-concerning rise in cases in Europe.

However, we believe investors should remain calm. First, there is currently relatively little data quantifying more precisely the transmissibility and immunity-evading risks of the new variant. Second, the recent history of market reactions from previous new variants suggests the negative market reaction should be temporary.

Third, reports hit the market at a time when liquidity was very low given the US Thanksgiving holiday, likely exacerbating Friday's sell-off. Fourth, the disproportionate or counter-intuitive reactions in several markets – such as the large move lower in oil or weakness in the USD, suggest reversal of one-sided positioning may have contributed to the size of the moves.

Therefore, our central scenario is we will not see a dramatic shift towards widespread lockdowns, suggesting previous market trends resume once one-sided positioning is shaken out. That said, it is probably a good time to ensure investment allocations are aligned to your overall risk tolerance. Strong equity returns have likely raised your exposure to equities over the past 18 months and if this is significantly above your risk tolerance, some pruning may be appropriate.

Of course, a scenario where policymakers find sufficient reason to re-introduce mobility restrictions would likely mean a return to COVID-19 market trends. The onset of the Delta variant, for example, led to the outperformance of growth sectors at the expense of value, falling government bond yields and weaker commodity prices. However, this is not our base case for now.

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