Is Ebola a risk to the market?

Joelle Anamootoo, *Credo's Investment Strategist*

Global equity markets have been very volatile in the past month, with all of this year's gains being wiped out in some regions. While this is being attributed to several factors ranging from slower global economic growth to falling inflation expectations in the US, some market commentators have ascribed the change in investor psychology to the rising Ebola scare across various countries. Indeed, in recent weeks Ebola has been making more and more headlines in the international press. The outbreak originated in Guinea in December 2013 and has since spread to several other African countries but public opinion in the West has been alerted since the confirmation of Ebola cases in the US and Europe (Spain). The questions we pose at this stage are whether the outbreak will become a global pandemic, what the economic consequences are likely to be and whether investors should be concerned.

Official estimates suggest that the virus has infected over 8000 people, killing more than half, however when adjusting for under-reporting the CDC suggests that the actual number of Ebola cases may be closer to 20000. New cases continue to emerge in the three worst affected countries (Liberia, Sierra Leone and Guinea) but interestingly it seems that Nigeria and Senegal- where the outbreak has been on a significantly smaller scale- may be close to getting the all-clear from the WHO for being Ebola-free in coming days.

The arrival of Ebola to the US and Europe, via infected US and Spanish citizens sent home for treatment, is raising concerns globally on the virus' potential to spread further and become a global pandemic. This currently seems like an unlikely outcome. While more deadly than the SARS virus which hit various regions in 2003/04, Ebola is in theory less contagious being transmitted through direct contact with infected bodily fluids and is not airborne. SARS which, by contrast, killed "only" 10% of infected people could be transmitted by close human contact, via respiratory droplets produced when an infected person coughs or sneezes and when a person touches a surface contaminated with infectious droplets. Of course the current risk with Ebola is mutation from its original form - a recent study has found 341 mutations- in ways that would make it more dangerous, including increasing the likelihood of transmission.

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The absence of a cure for Ebola makes it impossible to draw the boundaries in terms of potential victims. While some patients treated in the US have been cured with the drug Zmapp, the latter remains at an experimental stage, has not been approved by the FDA and is in very limited supply. Meanwhile, pharmaceutical companies are actively looking to develop a vaccine against the virus. New Link Genetics is moving into Phase I trials in Maryland while GlaxoSmithKline is testing its Ebola vaccine in Mali, which has remained untouched by the disease. This may sound promising but the results and eventual implementation remain to be seen.

At this point it is fair to assess the potential economic costs of the Ebola outbreak and whether this epidemic represents a threat to the global economy.

Impacted countries in West Africa are facing escalating direct costs associated with medical care provision and the indirect costs are also mounting. The World Bank estimates that by the end of 2015 the cost of Ebola could reach $33bn for West Africa if it cannot be contained. In the affected areas businesses are closing down, people are not showing up for work and parents are not sending their children to school. Some countries in Africa have closed borders and many commercial airlines have suspended activities in Guinea, Liberia and Sierra Leone. While the latter two countries have registered double-digit GDP growth rates in 2013, it is likely to be much lower this year and next.

The potential impact on the global economy is obviously more difficult to frame since it depends on how far and how fast the virus spreads. Estimates of the cost of the 2003/04 SARS outbreak go up to $11bn with tourism in several countries being particularly hit. Fear of contagion of the Ebola virus will likely discourage people from travelling, making tourism-dependent economies most vulnerable once again. Reduced (business) travel also slows down investment, further adding to economic pressures. At a more local level people are less likely to socialise, eat and drink out which in turn exerts pressure on the consumer services industries.

The scope for Ebola to spread further and have an economic impact beyond Africa seems to be, at least partially, reflected in current investor sentiment. Despite a very rapidly falling oil price which should help lift airlines earnings, global airlines stocks have for example sold off by more than the broader market in the past month (and conversely Health Care stocks have done better than the broader market). In our considered opinion, it is simply too early to tell whether the recent sell-off represents a buying opportunity or whether the Ebola scare could cause further market downside (which may be likely if the virus is discovered in more countries and turns into a global pandemic).

As an aside, it is worth bearing in mind that in addition to SARS (referred to earlier), the world has also seen other pandemic scares in the recent past (e.g. avian flu in 2004/05 and swine flu in 2009). In each instance, the market responded with increased volatility and much circumspection at the time. Investors should take some comfort from the fact that, with the benefit of hindsight, we now know that these did in fact end up being buying opportunities on each occasion.

We will continue to monitor the situation and assess the market impact accordingly. In the meantime, we advise clients not to over-react to short term volatility in the financial markets but to continue following a cautious investment approach, including an appropriate weighting to risk assets.