BARINGS

MARCH 2, 2020

Coronavirus: Navigating the Volatility

Barings experts across fixed income, equities and real estate share their views on how the spreading coronavirus is impacting global capital markets.

MACROECONOMIC & GEOPOLITICAL
ASIAN MARKETS
GLOBAL CREDIT MARKETS
SOVEREIGN DEBT & CURRENCIES
EQUITIES
GLOBAL REAL ESTATE

MACROECONOMIC & GEOPOLITICAL

Keeping Perspective Amid Rising Uncertainty

Markets prefer predictability, but recent headlines about the coronavirus have brought little more than falling price targets, fading earnings forecasts and mounting fear.

As the year dawned, most veteran investors knew that the sunny outlook might be too good to be true, but the data all pointed to solid global growth on the strength of healthy U.S. consumer confidence, supportive Chinese government measures and a wave of central bank liquidity. Even amid initial reports on the disease, most scenarios assumed that China's vigorous quarantines and substantial support measures could still put the country within striking distance of the official 6% growth target by the end of the year.

Now, as cases spread elsewhere in Asia and around the world, the channels of the damage to the global economy are becoming clearer even if the extent of the damage is not.

First, there is the initial direct harm to the Chinese economy, which has been driving more than a third of global growth. Retail sales, travel and energy consumption have all collapsed as the official annual target vanishes in the distance.

Second, countries that depend on exports to China will suffer. Of course, Asian neighbors are hit directly, but German manufacturers and American farmers will be affected, too.

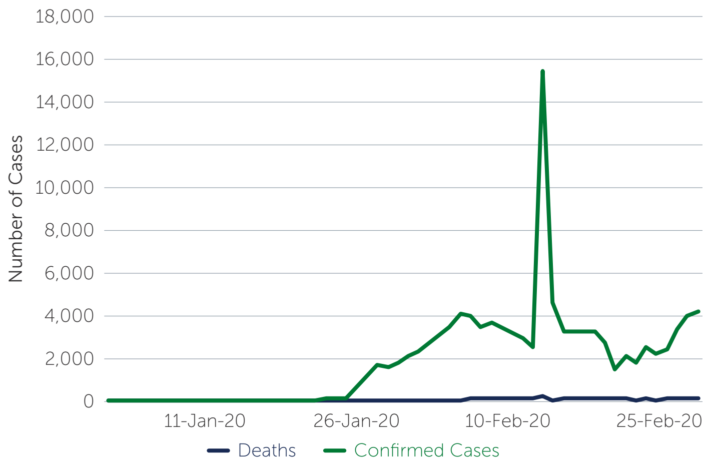
Third, there will be losses from supply chain disruption. Apple has already reduced its guidance, but the impact will ripple far beyond. You can't sell a phone if you don't have all the parts; you can't sell a dress if you don't have the dress.

Fourth, fresh cases of the virus in Korea, Japan and Italy have dealt a direct blow to travel tourism and retail activity in affected areas around the world. Worries center around less-developed countries that don't have the infrastructure to diagnose and contain the disease.

Fifth, equity markets have slumped on mounting uncertainty to any earnings estimates this year. Commodity prices have fallen on weaker demand expectations and government bond yields have set record lows. The 10-year U.S. Treasury seems to be pricing in a dramatic slowdown in the economy that matches only the darkest course of events.

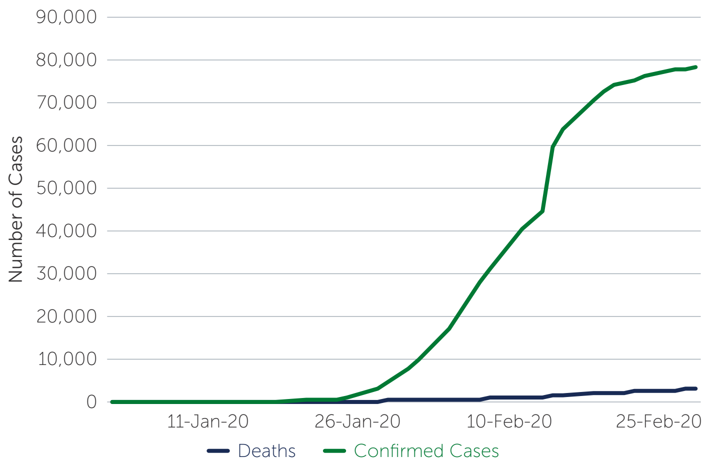
Of course, it's also important not to overreact. The disease seems to be contagious, but generally only deadly to those in frail health. The number of new cases reported in China seems to be slowing, suggesting that it can be contained with the right measures. Public health education and quarantine measures elsewhere should also slow the spread.

Coronavirus (2019-NCOV) Global Outbreak



NOTE: Confirmed coronavirus (2019-nCov) case counts compiled by Bloomberg Newsroom. Counts are subject to change as governments survey and confirm cases. Data are based on reported values as of Midnight EST.
SOURCE: Bloomberg. As of February 21, 2020.

Coronavirus (2019-NCOV) China Outbreak



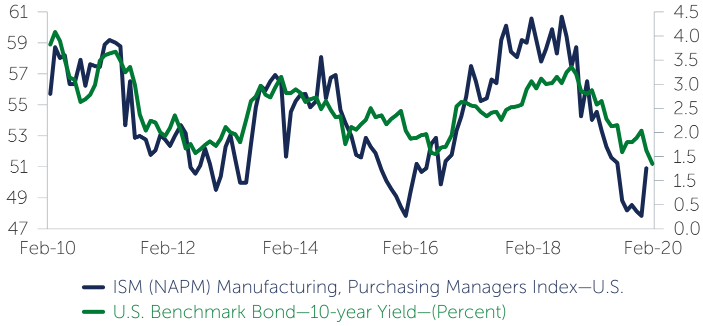
NOTE: Confirmed coronavirus (2019-nCov) case counts in China compiled by Bloomberg Newsroom. Counts are subject to change as governments survey and confirm cases. Data are based on reported values as of Midnight China Standard Time.
SOURCE: Bloomberg. As of February 21, 2020.

MACROECONOMIC & GEOPOLITICAL *CONTINUED*

Meanwhile, economically, governments and central banks are standing by with fiscal and monetary measures to support faltering demand, even if some question how much difference they can make. This may yet trigger the global recession that many have been expecting, but it's still too soon to tell. There's still a reasonable possibility that monetary easing coincides with the containment of the disease, at which point markets may snap back.

Most economists and analysts make terrible epidemiologists, which means that projecting how the disease will drive markets in the near term remains full of uncertainty. Careful investors will be watching closely, moving cautiously and focusing as best they can on long-term fundamentals.

ISM Manufacturing Index and 10-year UST



SOURCE: Factset. As of February 28, 2020.

Christopher Smart, PhD, CFA
Chief Global Strategist &
Head of the Barings Investment Institute

ASIAN MARKETS

Short-term Correction, Long-term Recovery?

While economic interruptions from the coronavirus have been most pronounced in Asia, current data suggests it may be a short-term correction—and that longer-term, some of the hardest-hit economies may be positioned for a strong recovery.

Economic Impact on China, Broader Asia and the World
We believe there is a strong chance China's first quarter GDP will decline substantially quarter-over-quarter, with some economists estimating a 3 to 5% annualized decline. Growth has been, and will continue to be, significantly impacted by China's self-imposed restrictions on the movement of people, goods and services in and out of the country over the better part of the last two months. On top of this, economic activity in January was relatively slow, as millions of people travelled home to China in preparation for the Lunar New Year.

As the daily number of newly infected coronavirus cases has fallen from the thousands to the hundreds, the Chinese government has recently—and gradually—authorized non-quarantined towns and provinces to resume their normal lives. The pace of normalization has been rather slow, however, as a result of continued restrictions elsewhere. This has disrupted tightly-linked production supply chains, not only within China, but also across Asia more broadly as well as the rest of the world. As widespread data on coal consumption and property sales suggests, the resumption of economic activity following the Lunar New Year has significantly lagged past years. While we are hopeful that China has seen the worst of the effects from the virus, we continue to closely monitor the potential repercussions as millions of people return to work—and whether this could cause the epidemic to re-emerge and re-escalate.

The effects of the epidemic and economic interruptions in China have been most severe for countries and/or companies with strong trading, tourist and/or supply-chain production ties to China. As an example, Hong Kong, Japan, Taiwan, Korea, Vietnam and Thailand—through companies' sales of iPhones and iron ore to China—have been, and will likely continue to be, substantially impacted in the short-term. Factories in this region are some of the main suppliers of goods ranging from memory cards to raw materials. In the event that the virus causes some or all of a factory to temporarily shut down, it could create a significant supply chain disruption.

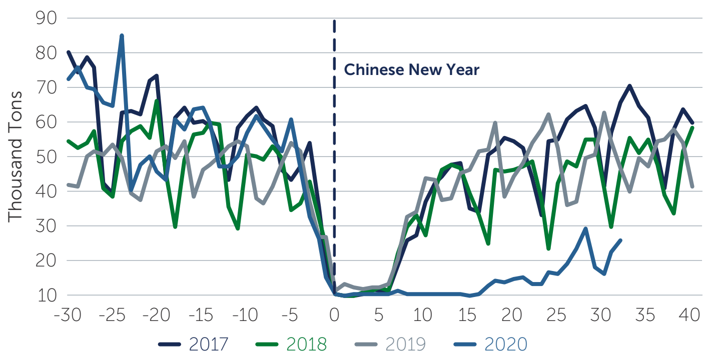
Europe and the U.S. will likely be impacted as well, although likely to a lesser extent than Asia. This is something we are monitoring closely, however, as an escalating global pandemic would have more material implications for growth-sensitive asset classes.

While there is still much uncertainty at play, current medical consensus suggests that the virus may dissipate from April or May onward—which would be consistent with the 2003 SARS epidemic. If this is the case, we think there is strong likelihood for a robust economic recovery in China and other heavily-impacted economies.

Daily Coal Consumption

SOURCES: Wind, AMAP, UBS estimates. As of February 27, 2020.
NOTE: Day 1 is the Chinese New Year (January 28, 2017, February 16, 2018, February 6, 2019, January 25, 2020).

30 Major Cities' Daily Property Sales



SOURCES: Wind, AMAP, UBS estimates. As of February 27, 2020.
NOTE: Day 1 is the Chinese New Year (January 28, 2017, February 16, 2018, February 6, 2019, January 25, 2020).

In many cases, the governments in these countries have already started to implement easier monetary and fiscal policies, with the bulk of that yet to come, and pending the end of the crisis. Hong Kong has already announced a massive fiscal initiative to boost consumption, for instance.

Investment Impact on China and Rest of Asia and the World
In the FX and equities markets, the outperformance of Chinese, Asian and emerging markets vs. the U.S. and developed markets faded with the emergence of the virus. Asian and EM currencies, particularly those associated with smaller indebted nations, fell substantially against the U.S. dollar, a perceived 'safe haven' currency. In the Asian equity markets, early January's positive momentum came to an abrupt halt after the Lunar New Year.

ASIAN MARKETS *CONTINUED*

Nonetheless, economic and corporate fundamentals in China and Asia suggest this recent underperformance may be short-lived. A potential bounce-back in growth in China and the rest of Asia, from the second quarter onward, could boost the relative performance of the region vs. its U.S. counterparts. In addition, if the uncertainty surrounding the U.S. presidential election casts a shadow over the country's financial markets in the second half of the year, global investors may be encouraged to seek growth opportunities elsewhere.

Portfolio Adjustments by Asian Equity and Multi-Asset Teams
Despite the year-to-date volatility, we believe Asian markets remain well-positioned for long-term growth, supported by a number of structural and demographic trends. Above all, we continue to adhere to a fundamental bottom-up investment process—with a focus on holding sustainable growth companies valued at the right price (preferably with a high ESG score).

Based on our views, our Asian equity team remains fully invested and has made only marginal adjustments in response to the coronavirus. To illustrate, our Hong Kong-China equities team reduced its exposure to consumer stocks before the Lunar New Year, as we believed they had become expensive following the strong rally that began in August 2019. When markets fell following the crisis, we used the proceeds to add exposure to companies in the strongly growing online digital sector, as well as in healthcare stocks. Our pan-Asian equities team made few changes, as their preferred sustainable growth stocks did not fall far enough to entice them to add exposure.

On the Asian-based multi-asset side, our portfolio managers reduced exposure to European equities in favor of the U.S., and also added to the technology sector. We also increased exposure to Japanese bonds on an unhedged basis, as the Yen cheapened vs. the U.S. dollar—what we believe to have been a good hedge in volatile times. Our overall strategy remains moderately pro-growth, as we believe that the current sell-off may prove, ultimately, to be a short-term correction.

Khiem Do
Head of Greater China Investments

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GLOBAL CREDIT MARKETS

Staying Focused on Credit Fundamentals

Concerns surrounding the global spread of the coronavirus sharply escalated last week, causing a spike in volatility across the broader corporate credit markets. But history has shown that similar periods of weakness and/or volatility are often followed by recovery.

High Yield Bonds and Broadly Syndicated Loans

High yield bonds and broadly syndicated loans were not immune to the broader capital market weakness experienced last week as fears of the spreading coronavirus took hold. As is often the case, high yield bonds experienced greater trading volatility and spread widening than loans, particularly in the U.S., which was negatively impacted by mutual fund outflows. In the loan market, which is typically viewed as the more defensive of the two asset classes—due in part to its seniority in the capital structure—prices also came under pressure.

It is too early to gauge the full impact of the virus, particularly in the U.S. and Western Europe, where, especially in the former, cases are only now just appearing. That said, it's clear that a number of companies, sectors and regions appear more vulnerable to disruption—the gaming, travel and tourism sectors are prime examples, as well as manufacturing companies whose supply chains may be disrupted. While we haven't made material changes to our portfolios, we have taken steps to mitigate risk while aiming to be in a position to capitalize on opportunities that may emerge if prices decouple materially from fundamentals.

In this environment of uncertainty, and with the potential for further volatility, it is important to reiterate that financial markets have a history of overreacting to headlines—and a tendency to exhibit short-term pricing inefficiency during periods of dislocation or volatility. In the years since the Global Financial Crisis, we have continued to witness risk-on/risk-off periods in response to macroeconomic or geopolitical factors. Lasting anywhere from a few weeks to several months, these dips in the market have typically been followed by periods of recovery and gains. As active managers, we continue to look for value opportunities presented by these market dislocations, while also carefully managing risks.

	Credit Spread (bps)			Total Return	
	Dec. 31	Feb. 21	Feb. 27	MTD	YTD
U.S. Loans[1]	461	453	491	-0.83%	-0.31%
European Loans[2]	413	419	434	-0.33%	0.28%
U.S. HY Bonds[3]	367	374	471	-0.93%	-0.99%
European HY Bonds[4]	323	325	398	-0.83%	-0.82%
CLOs—BB tranche[5]	722	707	720	-0.99%	1.59%
EM Corporate Debt[6]	265	258	293	0.33%	1.88%
EM Corp. HY[6]	488	475	532	-0.50%	0.97%
EM Corp. IG[6]	153	158	176	0.95%	2.55%
U.S. IG Corporates[7]	93	99	116	0.75%	3.12%
U.S. IG Corporates (BBB)[8]	120	126	145	0.56%	2.85%
U.S. ABS[9]	80	63	66	0.48%	1.37%

1. Credit Suisse Leveraged Loan Index. Credit spread represented by the 3-year discount margin.
2. Credit Suisse Western European Leveraged Loan Index (non-USD denominated, hedged to EUR). Credit spread represented by the 3-year discount margin.
3. ICE BofA US Non-Financial High Yield Constrained Index. Credit spread represented by the option adjusted spread.
4. ICE BofA European Currency Non-Financial High Yield 3% Constrained Index (hedged to EUR). Credit spread represented by the option adjusted spread.
5. J.P Morgan CLOIE Index (post-crisis BB-rated tranches). Credit spread represented by the discount margin.
6. J.P. Morgan CEMBI Broad Diversified Index. Credit spread represented by the spread-to-worst.
7. Bloomberg Barclays U.S. Corporate Investment Grade Index.
8. Bloomberg Barclays U.S. Baa Corporate Index.
9. ICE BofA U.S. Fixed & Floating Rate Asset Backed Securities.

Reflects Barings views as of February 27, 2020 and is subject to change. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

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GLOBAL CREDIT MARKETS *CONTINUED*

Investment Grade

Investment grade markets traded off in sympathy with equities last week amid an anticipated coronavirus growth shock. Market reaction has been a classic case of de-risking, with rates moving lower, spreads moving wider, lower-quality credits underperforming, and bid/ask spreads widening. U.S. rates markets have repriced aggressively toward lower yields and flatter curves, as investors now anticipate multiple Fed easings in 2020—with long-term U.S. Treasury yields trading below 2% last week for the first time ever.

Spread widening was most pronounced in the energy and consumer sectors. While we share the market's concern regarding possible consumer damage, much depends on the length and depth of economic disruption. With respect to energy, we are cautious in the short term but expect higher-quality energy companies to hold up reasonably well over time, even in an environment of structurally lower prices. Looking beyond the more obvious primary impacts, our analysts are also analyzing the secondary and tertiary effects on a variety of other sectors and industries.

In the securitized space, we are closely monitoring employment and income trends as a leading indicator of consumer weakness. For example, sub-prime auto borrowers may struggle to make payments if they are unexpectedly furloughed. Restaurants could also suffer—especially those with meaningful international exposure in places like China.

Liquidity has also been challenging in both the primary and secondary markets. New issues in all IG markets were essentially non-existent last week, despite a fairly healthy back-log of deals waiting to price. Wider bid-offer spreads and heightened dealer risk aversion have resulted in diminished secondary activity as well.

Within our portfolios, we have taken additional defensive steps in recent weeks, such as reducing exposure to aviation-related credit and higher beta emerging market issuers. We have also shortened spread durations across the board and raised cash above normal levels. Prudency suggests that we wait for the economic uncertainty to clear a bit before wading back into risk markets, but we should have ample dry powder when that time comes.

Emerging Markets Corporate Debt

EM corporate debt, too, saw a notable uptick in volatility last week, with spreads widening across the market. From a regional standpoint, Asian corporates showed resilience, while Europe, Africa, Latin America and Central & Eastern Europe ended the week in wider territory as the virus spread to these areas; commodity producers were particularly hard hit. Investment grade credits outperformed high yield, but started to show signs of weakness late in the week. Asia gaming, metals & mining, airlines and real estate were the worst performing sectors.

As we look ahead to the coming weeks, there is much uncertainty (and concern) around a potential downward revision in the global growth forecast and weak PMI data. If there is consensus that the coronavirus will negatively impact global growth beyond 2020, we would expect to see further sell-off. On the bright side, many EM commodity issuers are low-cost producers, meaning they have some room to absorb lower commodity prices for a period of time.

In terms of managing our portfolios, we have generally refrained from making material changes, except to reduce slightly our exposures to issuers whose bonds were already trading relatively tight and who had outperformed amid the recent volatility. Rather, we continue to adhere to our bottom-up approach, and focus on those issuers we believe have adequate liquidity and the potential to outperform over the medium to longer-term.

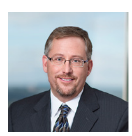
Private Credit

Private credit, while certainly not immune to the effects of the coronavirus has—by its nature as a private asset class—been less directly impacted by headlines to date. That, said, weakness in broadly syndicated markets would likely feed through to private middle market loan values if sustained. The middle market is generally more insulated from global risk factors than larger, multi-national companies as many of these businesses focus primarily on their domestic markets. However, given the integrated nature of the global economy, there are certainly idiosyncratic risks among middle market companies that we continue to monitor closely. Companies that are in or exposed to travel-related businesses, for instance, may experience adverse effects. Companies that import raw materials or other products from regions impacted by the virus are another example, as they may experience supply-chain disruption in the near-term.

In this environment, and as we discussed in detail in our recent 2020 outlook, we see the most attractive value in the traditional, true middle market—particularly in first lien senior structures that are backed by junior capital. In this segment of the market, we believe the potential return relative to the amount of risk looks more attractive today relative to lower parts of the capital structure or more highly leveraged deals.

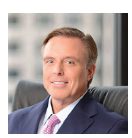
Martin Horne

Head of Global Public Fixed Income & Head of Global High Yield



Dave Nagle, CFA

Portfolio Manager, Investment Grade Credit



Ian Fowler, CFA

Co-Head of Global Private Finance

Omotunde Lawal, CFA

Head of Emerging Markets Corporate Debt

SOVEREIGN DEBT & CURRENCIES

Vigilance in the Face of Volatility

The global spread of the coronavirus has resulted in sizable moves across interest rate, currency and sovereign debt markets, but for now, we do not see evidence that sovereign default risk has moved materially higher.

Coronavirus: Rippling Effects Across Rate, Currency and Sovereign Debt Markets

The world's recognition last week that the spreading coronavirus was quickly turning into a global epidemic—as opposed to a regional one contained in Asia—led to a swift reaction across markets.

Global rates experienced a fast and furious rally (yields fell) with fairly dramatic moves lower in both the U.S. and Europe, following on from earlier moves in Asian markets. These moves have affected EM rates, which for the most part have gone down but with bouts of volatility both in countries deemed to have credit risk (South Africa, Indonesia, Brazil) as well as countries where rates should be moving up (Poland and Czech Republic) under more benign global market conditions.

In **sovereign hard currency debt**, high yield sovereign spreads widened ~62 basis points (bps) in February, substantially more than investment grade sovereigns (~13 bps), with ~20 bps of the spread move driven by the fall in U.S. Treasury yields.[1]

Currencies have been weaker across emerging markets through this recent bout of market volatility (down ~2.5% in February), while major developed market currencies have strengthened against the U.S. dollar in the past week, including the Yen, Euro and Swiss Franc.

The Path Forward

Because we view the multiple shocks of lower growth, less tourism and lower commodity prices as temporary and likely to be confined to 2020, we don't see this as elevating default risk in the countries where we currently have exposure. As a result, we have not made material changes to our emerging markets sovereign and local currency portfolios based on the events of last week.

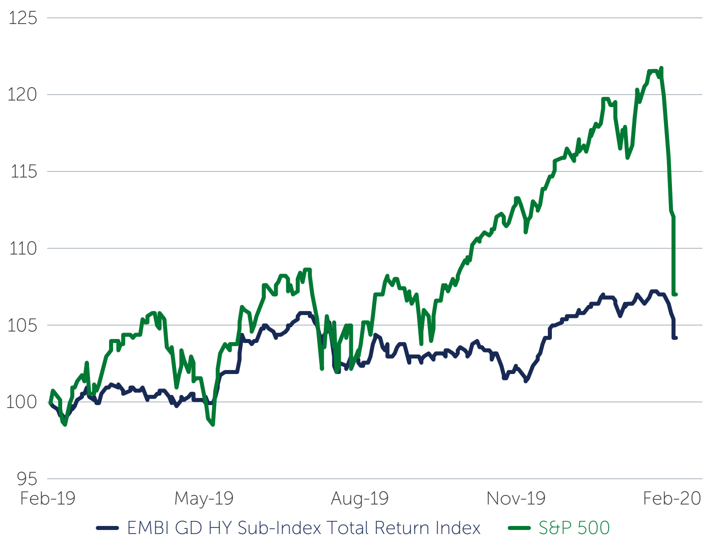
That said, our base case scenario is not without (very thick) tail risks. Most notably, a harder landing in China than we currently envisage could have a material impact, cascading across the globe and impacting the growth outlook, global trade and commodity prices.

As such, we are closely monitoring the coronavirus situation as we look for evidence that it may be contained. Chinese figures suggest that it may have peaked there, but the expected global disruption appears likely to be significant.

GBI EM Yield vs. UST 10-year Bond Yield

SOURCE: Bloomberg. As of February 28, 2020.

EMBI GD HY Sub-Index Total Return Index vs. S&P 500 (Index=100)



SOURCE: Bloomberg. As of February 28, 2020.

1. All market data is from Bloomberg and J.P. Morgan. As of February 27, 2020.

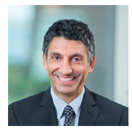
SOVEREIGN DEBT & CURRENCIES *CONTINUED*

Global governments turned a corner over the last week and are now taking the threat very seriously, as are large corporations. This may prove critical in slowing the advance of the virus, but policies enacted to do so are simultaneously likely to lead to less trade and slower economic growth. We therefore expect the global economy to suffer a significant slowdown, tourism to contract, commodity prices to fall, and global rates to continue falling. Credit, in turn, will potentially come under further pressure, especially for weaker, high-yield countries concentrated in producing and exporting commodities, and those heavily dependent on tourism.

We are also somewhat skeptical that global central banks are positioned to effectively execute a coordinated monetary policy response in the fashion of that which was implemented during the Global Financial Crisis. Confrontational rhetoric between world powers and sanctions issued by the U.S. (as recently as last week) make U.S. leadership in this crisis appear unlikely. The U.S. also may be limited in terms of a fiscal response in the run-up to the November elections.

In summary, risks have certainly elevated in recent weeks, but we do not yet see anything that leads us to believe sovereign default risks have risen materially within our EM sovereign and local currency portfolios. We continue to monitor markets in an effort to mitigate risks as well as to recognize value opportunities as they emerge.

Dr. Ricardo Adrogué
Head of Global Sovereign Debt & Currencies



Cem Karacadag
Head of Emerging Markets Sovereign Debt

BARINGS

EQUITIES

Mitigating Risk While Seeking Attractive Entry Points

Recent indiscriminate selling in global equity markets has been driven by fear of the coronavirus spread. As active long term, bottom-up investors we remain focused on identifying attractive entry points on individual companies.

Coronavirus Sends Equity Markets on a Rocky Ride
Equity markets declined sharply last week as new cases of infection accelerated outside of China including South Korea, Italy and the rest of Europe. The spread of the coronavirus outside of China caused investors to worry about the negative effect on the global economy and on corporate earnings with some countries potentially entering into technical recession.

Economic growth data is likely to show a sharp slowdown in the first quarter this year given the importance of China and the likely disruption to supply chains and demand. Markets had expected that the measures China took to contain the outbreak were working but were disheartened as the rate of new cases outside of China are now outstripping those in China. This has resulted in a negative reaction for developed markets where new cases are accelerating on worries about further supply disruption and demand destruction. The sectors negatively impacted are broad and extend from energy and commodities to sectors such as travel, tourism, entertainment and retail, all of which are likely to experience the largest impact in the near term.

Governments around the world have already confirmed that steps have been taken to provide stimulus to counter the effect of the outbreak and to fight it. Examples include Singapore, which is vowing to provide a budget support of 1% of GDP for both households and companies. Investors are anticipating that central banks will support markets through the provision of liquidity to help counter volatile conditions. The People's Bank of China has already moved on this front, confirming that they will provide abundant liquidity to money markets in order to counteract the downside risk to economic activity. As such, we expect that monetary and fiscal policy will likely remain expansionary.

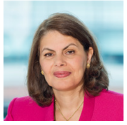
Identifying Pockets of Value Amid Volatile Markets
Some of the companies that have experienced sharp declines enjoy secular growth drivers such as technological shifts, disruptive business models, supportive demographics and expanding middle class consumption. Despite the current bout of volatility, these growth drivers should remain intact over the medium to long term. Through our fundamental, bottom-up investment process, we continue to look for opportunities in areas such as financial services—particularly pensions and life insurance—as well as companies creating sophisticated financial savings products, which are creating opportunities in the insurance and banking sectors. We also see opportunities in private health care, private education and across the technology space, including hardware, software, social media and e-commerce.

At this point in time, where fear seems to be gripping markets, we are aiming to be opportunistic on behalf of our clients in these sectors and others, particularly when market prices diverge from what we believe to be their fundamental value. Our disciplined approach to portfolio construction and risk management helps to decrease the vulnerability of our equity strategies relative to their benchmarks. We will continue to be guided by our bottom-up investment process and look to identify attractive entry points in companies where the long-term earnings delivery potential remains intact despite the near-term challenges posed by this outbreak. This will remain the case for all markets where over the medium to long run, we believe corporate earnings should drive equity prices. We view the recent correction and any further volatility as presenting potentially attractive entry points for opportunities across our investible universe.

Equity Market Returns

	MTD	1 Year	YTD
MSCI AC Asia ex Japan	-0.59	1.64	-5.01
MSCI AC Asia Pacific ex Japan	-1.53	2.27	-5.17
MSCI AC ASEAN	-6.12	-9.74	-10.86
MSCI China	3.06	4.65	-1.89
MSCI China A Onshore	2.4	11.75	2.11
MSCI ACWI Total Return (Net)	-6.44	5.36	-7.48
MSCI EAFE Total Return (Net)	-6.13	2.36	-8.09
MSCI Europe (Gross)	-5.96	3.78	-8.31
DAX (Gross)	-6.15	3.81	-8.96
EAFE Small Cap (Net)	-7.1	1.77	-9.79
Europe ex UK Small Cap (Gross)	-5.4	4.96	-7.96
Resources (Customized, Gross)	-10.12	-14.23	-16.97
S&P 500	-7.53	8.16	-7.61

SOURCE: As of February 27, 2020.



Dr. Ghadir Cooper
Global Head of Equities

GLOBAL REAL ESTATE

A Flight to Quality

In commercial real estate markets, Asia is feeling the pain of the coronavirus most acutely, but Europe and the U.S. face material challenges across tourism and other industries.

From a China Crisis to a Global One, With Tourism Stoking the Fire

For commercial real estate, the most immediate and severe impact from the coronavirus outbreak will stem from the hit to tourism and travel, which is already affecting the lodging sector in major travel hubs around the world. Marriott International, which operates 375 properties in China, reported a 90% year-over-year decline in revenue per available room (RevPAR) from its China hotels. Clearly, markets across Asia will be hardest hit, but the global impact will be compounded by the fact that China is a much bigger share of everything in the world economy today, including travel. According to Tourism Economics, Chinese outbound departures increased to more than 73 million in 2019 from about 7 million in 1999, giving China a nearly 7% share of all departures globally.

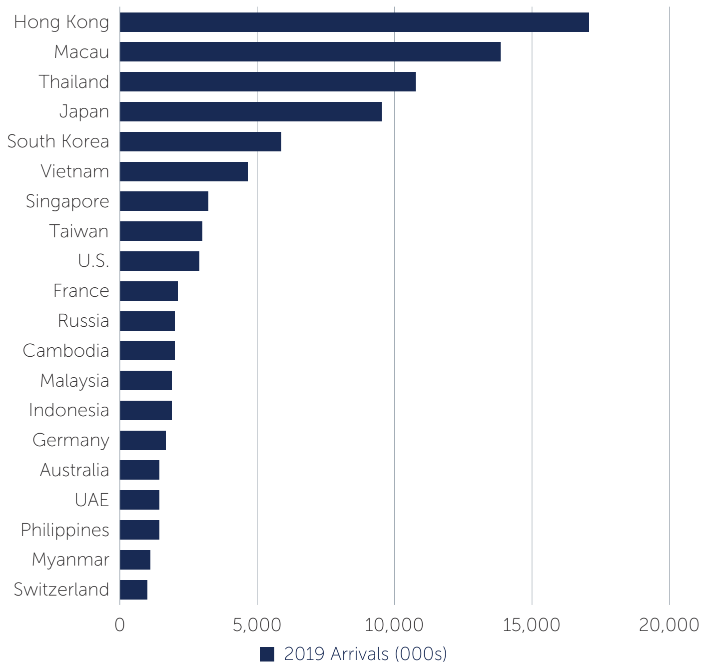
Barings real estate strategies do not have any property holdings in China. However, the impact will not be limited to China or Asia. The impact will be particularly pronounced in Hong Kong, which is the top destination for outbound (mainland) China travel and was already suffering from a sharp decline due to the civil unrest in 2019. The cumulative effects of the protests and virus outbreak will put further pressure on hotel occupancies and retail sales. Anecdotal reports indicate that Hong Kong office leasing activity and rents have fallen sharply since the year began, and vacancy rates are rising.

Lodging Most Immediately Impacted in the U.S., But Impact Will be Much Broader

For the U.S., the markets most exposed to the sharp fall in Chinese arrivals include LA and New York City, the primary ports of entry for Chinese travelers, receiving roughly 1.2 million and 1.1 million overnight visits, respectively.[1] Other major markets that see a substantial share of their overseas visits from China include Seattle, San Francisco, Boston and Philadelphia. While the impact on U.S. hotel performance is not readily apparent in the monthly data yet, the outbreak is expected to shave more than 4 million room nights off the total room demand forecast for 2020 and another 3.6 million room nights from 2021–2024.[2]

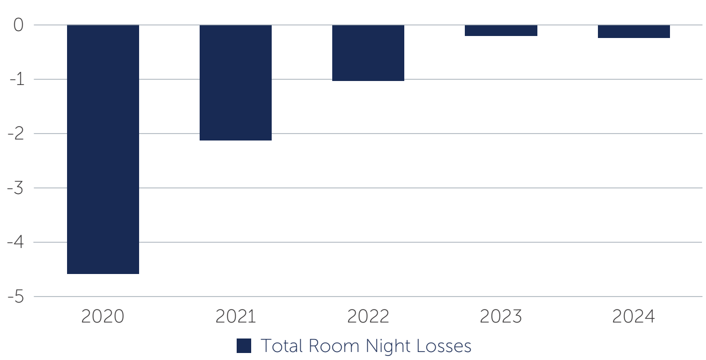
Although the lodging sector will bear the brunt of the impact, the likely hit to consumer sentiment will also take a toll on consumption of goods and services, particularly in those markets most affected. Store-based retailers will be most directly exposed—after hotels—to the fallout, and in the near term will likely lose market share to online platforms. Whether this proves temporary or accelerates the ongoing shift toward non-store purchases is difficult to predict, but it clearly

China Outbound Travel: Top 20 Destinations



SOURCE: Tourism Economics.

Impact On U.S. Room Night Demand From Chinese Visitors
Total Room Night Losses (Millions)



SOURCE: Tourism Economics.

adds to the challenging environment facing brick-and-mortar stores. Demand for industrial and office space should be somewhat insulated near term, but we expect businesses and investors will retreat to the

1. Source: Tourism Economics. Data for 2019.
2. Source: Tourism Economics.

sidelines until the outlook for the economy is less uncertain. Leasing activity is expected to slow, but the bigger impact could be felt in the transaction market, where investors are likely to delay committing to new acquisitions.

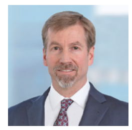
Broad-based Implications Across European Cities and Industries
In Europe, the region's export-orientated economy was already beginning to struggle on the back of rising global trade tensions. The problem is now amplified by the outbreak. Oxford Economics recently downgraded their GDP forecasts to just 0.8% for 2020, with the impact to be felt as soon as Q1. The most impacted real estate sectors will likely be those that are travel, tourism and trade orientated —hotels, serviced apartments, restaurants, leisure, sea and airport logistics immediately spring to mind; supply chain disruption will impact retail, should the crisis persist. But e-commerce might see a boost to the benefit of urban logistics operators, should consumption shift away from public spaces.

The worst affected country in Europe thus far has been Italy, and the most impacted city is Milan. Milan is where the contagion first emerged in Europe; the city was more vulnerable to the virus with its significant tourist appeal and exceptionally strong trading linkages with China via the shoe and clothing fashion business. The already structurally weakened Italian macro economy is always particularly exposed to exogenous economic shocks. However, the downside impact on real estate is probably more limited than one might initially think. This is because reduced property market transparency and liquidity tends to heavily insulate Italian property valuations from short-term macro volatility. Given that Italy is also a glaring soft spot in the Euro single currency, should a stalling economy reignite Italian public debt market fears (public debt sits at ~135% of GDP), the ECB's new president, Christine Lagarde could have her appetite for ultra-accommodative monetary policy tested very soon.

Germany, Sweden and the Netherlands are all export growth engines and exposed to the global economy. Should yet more QE arrive via the ECB, that has tended to be more supportive of the best 'bond-like' core real estate asset prices in the past, less so for secondary stock. Prime property yields could actually tighten even further across all the major European cities—probably ex retail assets where pricing looks soft across the board. Another possible under appreciated vulnerability, albeit a small one, could be Helsinki. While the Chinese travel numbers lag behind other larger European cities in sheer quantum, great efforts have been made in recent years to grow the location as hub for Asian travelers seeking streamlined European visa applications. Overnight and two day stays are increasingly common, and thus hotel and retail might struggle in the coming weeks here.

In summary, the commercial real estate sector is fortunate to some degree, in that property market fundamentals are generally healthy across most sectors and markets, and lower interest rates should help to support asset values and demand for cash-flowing assets. But in the near term we expect a flight to high quality, core properties.

Paul Stewart
Head of Real Estate Research—Europe



Philip Conner
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