CAUSALITY LINK

Is your portfolio protected against a second COVID shock?

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The first COVID shock rocked the markets starting at the end of February 2020, with a panic moment on March 9, 2020, when asset prices on the public equity markets started to react to the magnitude of the pandemic.

Since that period, we have experienced a strong rebound in equities, with a clear rebalancing in favor of the digital economy. The global outlook improved with the expectation of the rollout of the many vaccines that have been developed at unprecedented speed. Combining the potential numbers of vaccinations with the large number of those who have already survived COVID, markets are already envisioning (and pricing in) the promise of herd immunity.

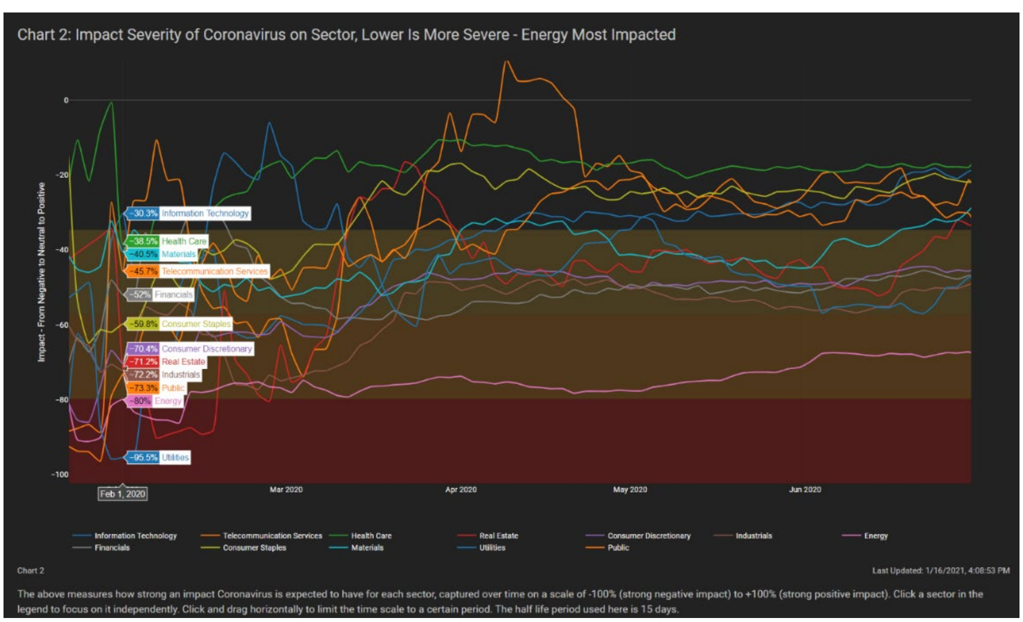
However, we also have growing evidence of rapid mutations of the COVID virus, with recent variants that are both more contagious and possibly resistant to the current vaccines. The news about an emerging variant in the UK prompted a new round of lockdowns in that country, but these efforts did not contain that strain as it has since been detected in many US states.

This was not an isolated event, and now characteristics of the new mutation E484K indicate the potential for an "escape mutant" catastrophe, according to research conducted by ImmunityBio, who is developing a vaccine.

It is therefore timely to ask the question: if a new variant emerged that was immune to current vaccines, and removed the immunization of those who already have been infected, how would markets react?

The worldwide model of the Causality Link Research Assistant platform provides some clues to answer this question.

Our public Coronavirus Dashboard was launched in March 2020 and provides a set of charts refreshed hourly that trace over time the industry-wide impact of the coronavirus pandemic as discussed in a very large corpus of global news.



Sector by sector

As shown in the above chart, as early as January 2020, journalists clearly stated that the coronavirus pandemic would have a negative impact on all sectors of the economy.

Through Causality Link's Coronavirus Dashboard, it is possible to select each individual sector and analyze its historical perspective in the last 12 months of the evolution of our causal impact signal.

In this paper we will highlight just a few of the most notable of these.

1. The utilities sector signal was depressed by worries about the staffing of water treatment plants, notably in China, as well as that of electricity plants. These worries did not last long. *Concerns about the utilities sector should not reappear in a second COVID shock.*

2. The telecommunications sector signal was impacted temporarily by the delays imposed by COVID to the deployment of 5G technology in Asia. It recovered rather quickly and was the only sector which appeared to benefit in the first half of the year from the COVID pandemic, due to the increased demands for bandwidth in the work-from-home movement. *We expect this positive trend to continue in case of a second COVID shock.*

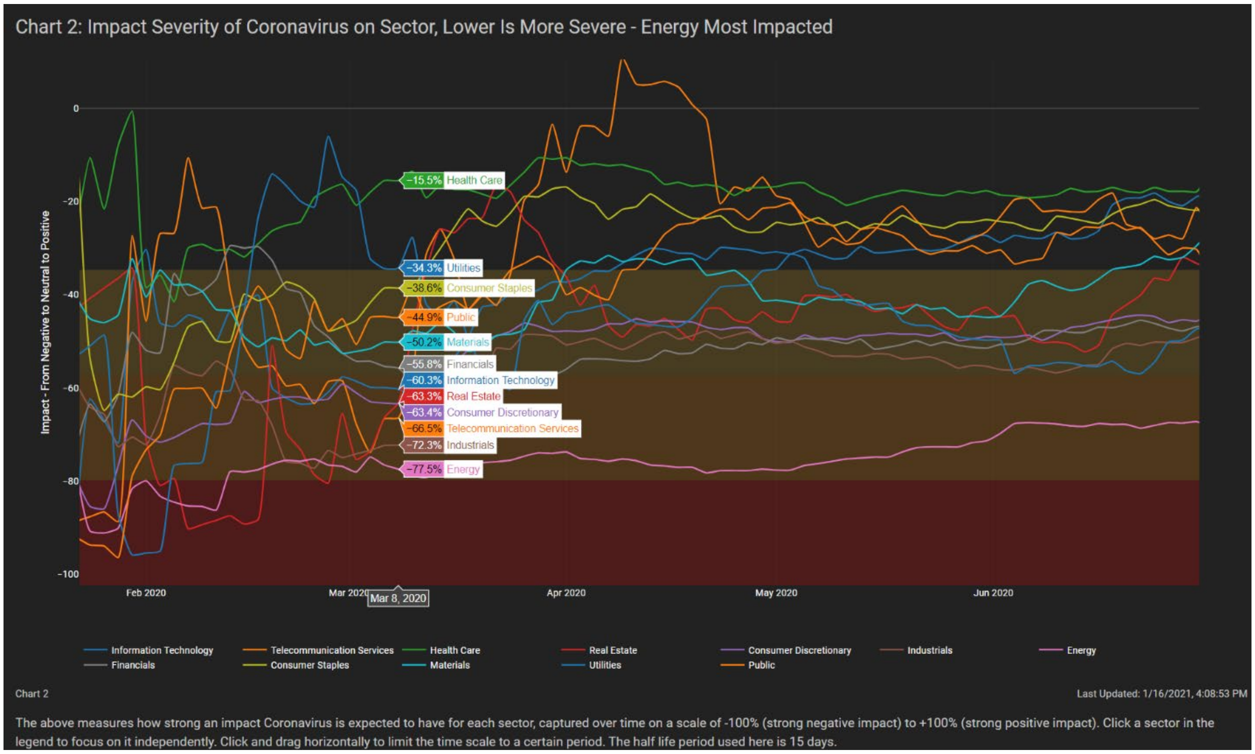
3. The energy sector signal started to see pains in January due to the slowdown of manufacturing and transportation in China and remained the most impacted sector for all of 2020, as manufacturing and transportation slowed worldwide as people were confined. *A new COVID shock is expected to mostly impact energy and transportation, with lower impact on manufacturing.*

4. Consumer staples recovered quickly and always performed better than discretionary, which is not surprising as non-essential purchasing was pushed back. *This trend should continue in case of a new wave of social distancing and lockdowns.*

By March 9, 2020, we had a good picture of the future impact of Coronavirus on the different sectors of the worldwide economy. In particular, real estate was displaying both the impact of the "work-from-home" movement on commercial real estate, as well as the decline of traffic in retail outlets.

The first newspapers to highlight the impact of COVID on commercial real estate were in Asia, from countries geographically close to China and very dependent on the sector. *It should be expected that these forces should apply again to commercial real estate in case of a second COVID shock.*

The above industry-wide statements can be refined with a more detailed analysis on a company-by-company basis, which is possible for about 40,000 public companies using the Causality Link model.



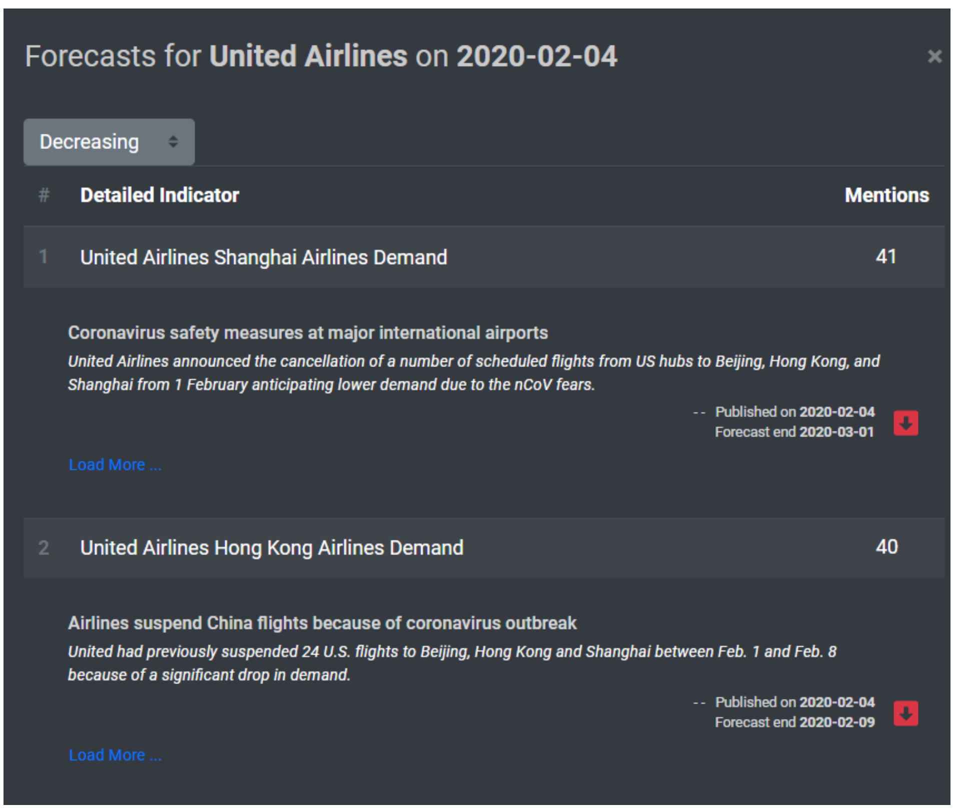
Case study: United Airlines

United Airlines offers a great case study to examine the capabilities of the detailed company-level analysis offered by Causality Link.

Our signal for United (in blue in the chart below) dropped at the end of January 2020, a good month before the market (in orange) turned significantly negative on United.

Focusing on the information that contributed to this drop in our signal, it appears that the most significant factor was *demand*.

And by clicking on the trend count bar for February 4, 2020, we found that the cancellation of many international flights was prominent that day in the news:



Forecasts for **United Airlines** on **2020-02-04**

Decreasing

#	Detailed Indicator	Mentions
1	United Airlines Shanghai Airlines Demand	41

Coronavirus safety measures at major international airports

United Airlines announced the cancellation of a number of scheduled flights from US hubs to Beijing, Hong Kong, and Shanghai from 1 February anticipating lower demand due to the nCoV fears.

-- Published on **2020-02-04**
Forecast end **2020-03-01**

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#	Detailed Indicator	Mentions
2	United Airlines Hong Kong Airlines Demand	40

Airlines suspend China flights because of coronavirus outbreak

United had previously suspended 24 U.S. flights to Beijing, Hong Kong and Shanghai between Feb. 1 and Feb. 8 because of a significant drop in demand.

-- Published on **2020-02-04**
Forecast end **2020-02-09**

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However, it took a whole month for this signal about the future drop in United demand to appear in statements about United revenue, shortly after the plunge of the stock price.

This indicates that the consequences of some bad news about the impact of the coronavirus pandemic on United demand were not considered as significant/material by the markets. Obvious causal deductions, such as the impact on future revenues of a significant drop in demand or the impact on the profitability of real estate linked to social distancing measures, do not appear to have been made in a timely manner.

What happens next?

Given that we know much more today about the significance of the economic impact of such a pandemic, about how our societies and governments act on it, and about the adaptation efforts of companies and individuals, it is important to prepare for a possible second shock, especially if the new variant arrives from a foreign country.

Will we renew the travel bans of the first pandemic and which industries will be most hit? Would a new wave of work-from-home accelerate the success of some tech companies? How will medical personnel react to the disappearance of the hope raised by the current generation of vaccines? Which countries have the credit required to inject another support stimulus in their economy?

Many of the answers to these questions are complex, as they involve the psychology of the consumers of every country, the decisions that each government will take and the attitude that citizens will adopt in light of this potential new wave of hardships.

However, we believe that a detailed analysis of the forces that have been at play in 2020 will provide a useful number of clues.

For example, our future signal for the hotel, resort and cruise line industry has passed 50%, which indicates the market has growth expectations for this sector.

For the specific company Royal Caribbean Cruises, the future signal for the combined revenue and profit data tracks the recovery of the stock price which has nicely recovered to three times its low of March 20, 2020. There is no doubt that a second COVID shock would quickly erase these gains.

Conclusion

Our data is available for analysts through the same software-as-a-service (SaaS) interface we have used to build this paper as well as through our data-as-a-service (DaaS) API that enables quants to build complex queries on any combination of parameters for any public company we track.

The DaaS API can be used to produce a periodic automatic check on a portfolio or provide suggestions for portfolio rebalancing through highly customizable alerts.

We hope this document has drawn your attention to a possible new risk, as well as to the potential of the Causality Link Research Assistant as a tool to mitigate this risk while hoping it never materializes.

If you are interested and want to know more, we can be reached at info@causalitylink.com.