

The latest Ebola outbreak – implications for investors

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Key points

- > The worst Ebola outbreak to date in Africa and fears it will spread is leading to some concerns of a global pandemic.
- > So far there has been little impact on global share markets but if the number of cases continues to rise with more signs of transmission to western countries then nervousness could increase.
- > While there is reason for concern, the experience with SARS, bird flu and swine flu highlight that worst case pandemic fears don't usually come to pass. The key for investors is to be alert, but not alarmed.

Introduction

The last few weeks have seen a range of factors causing volatility in investment markets including concerns that the Fed might start to raise interest rates earlier than expected, worries about the lack of strength in Europe, Russian trade sanctions and the conflicts in Ukraine, Iraq and the Middle East. In the background have also been concerns about the worsening Ebola outbreak in West Africa with the risk it could cause a global pandemic. This has been heightened after the World Health Organisation (WHO) declared the outbreak an "international public health emergency".

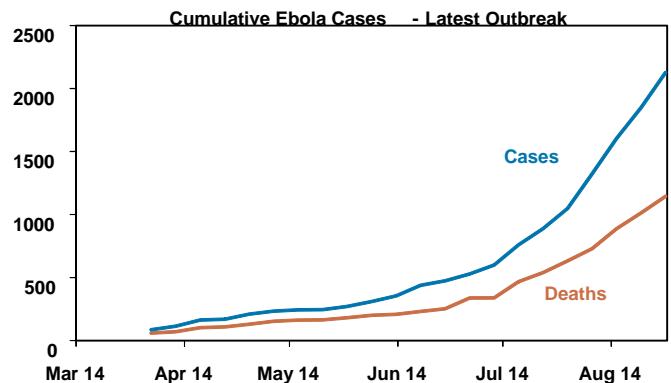
While this is first and foremost a human crisis, understandably there is some concern this could turn into a global pandemic scare first affecting travel related stocks but then having a broader economic impact. That said, recent experiences with SARS, bird flu and swine flu highlight that worst case pandemic fears don't always eventuate.

Some background on Ebola

Here is a summary of information regarding Ebola:

- Ebola virus disease affects humans and other primates. Flu like symptoms appear two days to three weeks after infection and then move on to nausea, vomiting and diarrhoea and reduced function of the liver and kidneys and bleeding. The mortality rate is around 60 to 65%.
- Since the disease was first identified in 1976, there have been several outbreaks which usually start with human contact with an infected animal's body fluids. Transmission between humans occurs via contact with an infected person's body fluids. Airborne transmission has not been observed. As a result the potential for widespread transmission is considered to be low.
- Large scale epidemics have mainly taken place in poor isolated areas of Africa lacking in modern medical support and poor hygiene.
- No vaccine is available and treatment usually involves supporting the patient and the administration of medications to control bleeding and prevent secondary infections but the scale of the latest outbreak appears to have helped clear the way of use of unproven drugs.
- Prevention includes wearing protective clothing around patients, isolating them and quarantining affected areas.

- The 2014 outbreak is the worst to date affecting Guinea, Sierra Leone, Liberia and Nigeria. As of August 13 there were 2127 cases and 1145 deaths although this likely understates the true position.



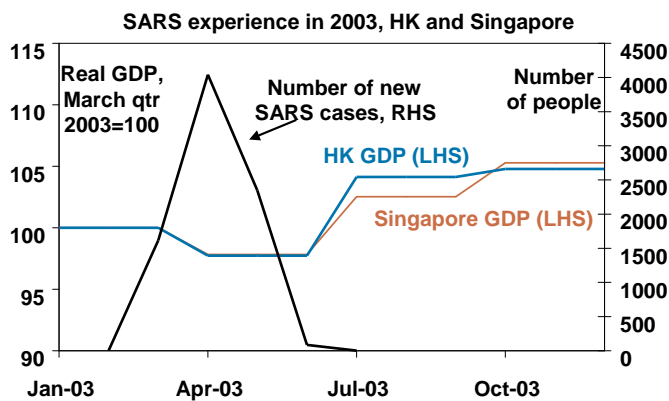
Source: World Health Organisation, AMP Capital

- On August 8 WHO declared the latest Ebola epidemic to be an "international public health emergency" which has the effect of mobilising global resources to combat it.
- Cordoning off affected areas and border closures (eg, Liberia) and screening measures are now becoming common. Flights to affected areas are being suspended.

Past experiences

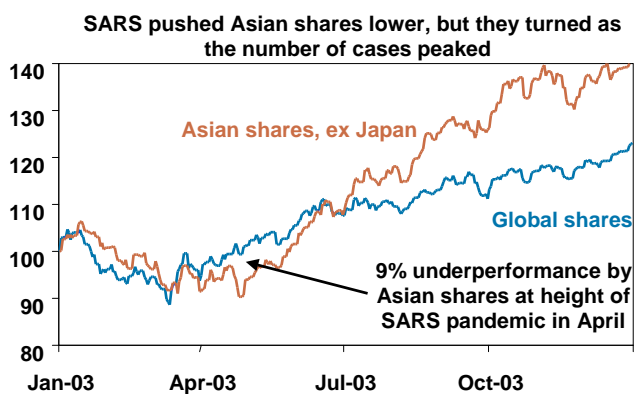
To provide some context it is worth reviewing past pandemics – both real and feared. There were three influenza pandemics in the last century: 1918-19, 1957 and 1968. The 1957 and 1968 pandemics are estimated to have killed up to 4 million people. However, the 1918 Spanish flu pandemic was the most severe. While the mortality rate was low, up to 50 million people died worldwide. With a big proportion of the population staying at home, economic activity was severely disrupted, although this was compounded by the ending of World War I. US industrial production slumped 18% between March 1918 and March 1919. Australian real GDP slumped 5.5% in 1919-20 (but then rebounded 13.6% in 1920-21). The share market impact is hard to discern given the volatility associated with the ending of WWI, however US and Australian share markets rose through much of the pandemic period.

The SARS outbreak of 2003 is perhaps a more useful guide. After emerging in China around February 2003, SARS infected about 8000 people (mostly in Asia) in 30 countries over a five month period and had a mortality rate of about 10%. While the number infected was not that great, SARS had a big negative impact on the countries most affected as people stayed home for fear of catching it. GDP in Hong Kong and Singapore slumped by over 2% in the June quarter of 2003 as retail sales fell, workers stayed home and travel dried up. Growth then subsequently rebounded.



Source: Thomson Financial, AMP Capital Investors

Reflecting SARS, Asian shares fell in April 2003, even though global shares started to move out of a three year bear market from March. The April 2003 low in Asian shares coincided with signs the number of new cases was peaking, and this was well ahead of the economic recovery.



Source: Thomson Financial, AMP Capital Investors

Most pandemics have taken six to 18 months to run their course and usually peter out as measures are taken to slow their spread (eg, hygiene, quarantining, banning gatherings, preventing travel). SARS ended quicker due to the nature of the virus and rapid action by authorities.

In 2005 and early 2006, there was significant concern that a severe strain of bird flu (called H5N1), which was resulting in human casualties, mainly in parts of Asia where people had contact with chickens, would mutate into a form that was readily transmissible between humans. However, this didn't really eventuate and as such the economic impact was modest although it did cause bouts of volatility in share markets in 2005 and early 2006.

Similarly concern that the spread of swine flu would become a global pandemic rattled share markets for a while around April 2009 but quickly faded. The WHO was subsequently criticised for becoming too alarmist as it had declared the outbreak a "public health emergency."

The economic and financial impact

The severity of the latest Ebola outbreak tells us there is reason for concern, but history tells us it might all come to nothing. Given the range of possibilities, the best way to get a handle on the economic and investment market impact of Ebola is to consider several scenarios. We suggest three.

1. Containment to Africa – the number of cases continues to rise for a few months but it remains mainly contained to West Africa.

- The global economic impact would be minor as the affected countries are of minor global economic significance.

- There might be bouts of share market nervousness (particularly airline stocks), but these would be limited.

2. Spread globally but contained – a significant number of Ebola cases appear in western countries from travellers returning from Africa but quick action by health authorities contains the outbreak to, say, a few thousand cases and there is no widespread transmission in western countries.

- News of cases popping up in western countries would cause significant uncertainty which might have a small negative impact on economic activity. The travel industry is most likely to be affected (much as occurred with SARS) as people stop travelling and there may also be some effect on economic activity as people avoid crowds. But the impact should be small and short-lived.

- Share markets are likely to fall on news of a spread to western countries but the fall is likely to be limited to a normal correction after which markets would rebound.

3. Global pandemic – Ebola spreads globally turning into a global pandemic, against which available medicine has little initial impact and attempts at containment are unsuccessful resulting in millions of deaths.

- This scenario would see a major negative impact on economic activity. Global travel would virtually cease. Many would simply not come into work – a reasonable estimate is around 20% of workers, although this might be spread over time. This would see a sharp slump in GDP and the onset of a global recession. Australia would not be immune.
- Share markets would likely fall sharply – maybe by 20% or so – reflecting the huge economic and profit uncertainty. Cash would be the place to be for investors.
- However, if history is any guide economic activity would rebound quickly once it's clear the pandemic is under control. Share markets are likely to anticipate this and rebound even as economic conditions remain bleak.

Conclusion

While there is reason for concern and it is easy to dream up nightmare scenarios, the experience with SARS, the pandemonium over bird flu with "predictions" it could kill as many as 150 million people and the mini panic regarding swine flu (for a while I always packed Tamiflu when travelling overseas!) tell us that the worst case fears of pandemics usually don't come to pass. Hopefully the same will apply to the latest Ebola outbreak. It is not easily transmissible and should be more easy to contain if it makes its way to western countries with modern medical facilities and higher standards (and ease of) hygiene.

As such, our base case scenario (with 90% probability) is that Ebola remains essentially contained to Africa. This suggests that while there might be a bit of short term volatility around Ebola scares there is unlikely to be a major impact on share markets. However, since the risk is not insignificant it will be necessary for investors to keep a close eye on how the latest outbreak develops. The key for investors at this stage is to be alert, but not alarmed.

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