Economic & Investment Update – April 2020

Following solid gains across investment markets in 2019, ultra-low global interest rates continued to propel investment returns early in the 2020 calendar year. However, the outbreak of the coronavirus sent shockwaves through global financial markets in late February and March. Since its emergence, the coronavirus has led to significant market declines and heightened equity market volatility, due to its potential to impact earnings across a range of sectors and dampen global growth.

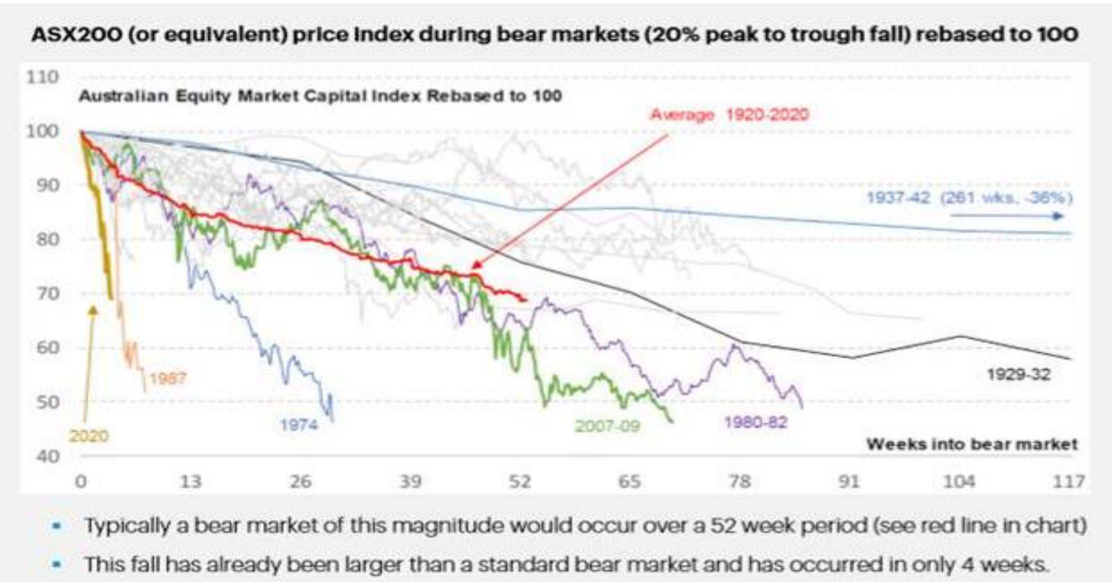
The coronavirus which, according to the International Monetary Fund. has led the global economy into a recession, has severed supply chains, devastated a range of industries and left one-third of the world's population in lockdown.

In response to the coronavirus pandemic, governments and central banks around the world have employed a range of measures to support the global economy. These include unprecedented stimulus packages, record low interest rates and quantitative easing programs.

In the United States, the passing of a US$2.2 trillion-dollar package on 30 March by the US Congress was the largest emergency aid package in US history while the US Federal Reserve slashed interest rates by 1%, to a range of 0%-0.25%. In Australia, stimulus measures worth more than $200 billion have been announced to date and the Reserve Bank has cut interest rates twice to a historic low of 0.25%.

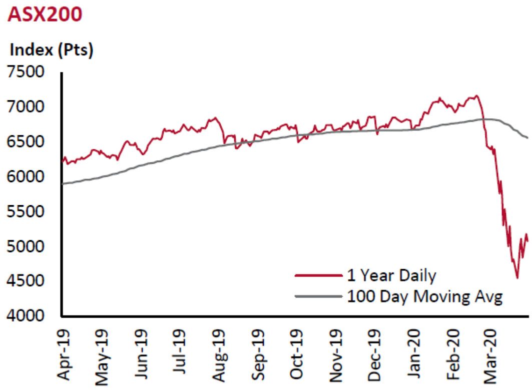
MARKETS

While Asian equity markets took the brunt of the initial impact of the spreading virus, the effects were subsequently felt across global markets with the pandemic causing the fastest collapse in equity markets in the last 100 years.



As a result, global equity markets encountered their worst March quarter on record, and in Australia, the third worst quarter return since 1935.

In Australia, the S&P/ASX 200 Accumulation Index finished down 20.7% for the March quarter while the Small Ordinaries Index (top 100-300 companies) finished down by 26.7%. Within the S&P/ASX 200 Index, stocks which dragged the index lower during the quarter included Commonwealth Bank (down 21%), Westpac (down 32%), BHP Group (down 23%), National Australia Bank (down 32%) and ANZ (down 31%). Bucking the trend was CSL Limited, which finished the quarter up 8%.



Source: Bloomberg

Global equity markets also suffered sharp falls during the March quarter with the MSCI World (ex-Australia) Net Return Index (AUD hedged) down by 21.1%. Regionally, US markets finished down between 14% and 20%, Japan's Nikkei 225 finished 20% lower and London's FTSE 100 was down 25%. China's Shanghai Composite Index was the only major index not to finish the quarter in bear territory (down more than 20%), ending the quarter down by 10%.

Losses on unhedged global equity investments were lower during the March quarter with the Australian dollar depreciating against most major currencies. The MSCI World (ex-Australia) Net Return Index (unhedged) finished 9.0% lower for the March quarter.

Aside from the crash in global equity markets, oil prices posted the biggest quarterly decline on record after a new supply agreement controlling production among nations of the Organisation of Petroleum Exporting Countries (OPEC) and Russia was abandoned in early March. By offering steep discounts to Asian customers and increasing production, Saudi Arabia sparked a 66% slump in the price of Brent crude oil over the quarter as rivals Russia and the US fought to protect market share.

Listed property was unable to avoid the market pain as fears of the impact of the coronavirus hit the domestic commercial property sector (down 34.4% for the March quarter). The dramatic fall in domestic property was worse than that of global peers (down 28.6% for the March quarter) given the local skew to retail, a sector that continues to see a dramatic fall in customers amid significant shop and retail chain closures.

While fixed interest markets were volatile during the March quarter, positive returns were generated. Fears of significant disruption to global economic growth in the short-term, initially led investors to move into safe-haven assets, including bonds. However, a global bond sell-off pushed prices lower, resulting in higher yields, before policy responses from central banks pushed yields to record lows. The Australian bond market (as measured by the Bloomberg Ausbond Composite All Maturities index) gained 3.0% for the quarter while global bonds (as measured by the Bloomberg Barclays Global Aggregate TR Index (AUD Hedged) index) returned 1.5% for the quarter.

The table below (sourced from Lonsec) summarises the returns from a number of market sectors.

Sector	Index	3 mths (%)	1 year (%)	5 years (% p.a.)
Equities				
Australia	S&P/ASX 200 TR (Accumulation) Index	-20.7	-14.4	1.4
	S&P/ASX Small Ordinaries TR (Accum) Index	-26.7	-21.0	2.5
International	MSCI World ex Aust NR Index (AUD)	-9.0	4.4	8.1
	MSCI World ex Aust NR Index (AUD Hedged)	-21.1	-11.1	3.9
Emerging Mkts	MSCI Emerging Mkts NR Index (AUD)	-12.3	-4.5	4.2
Listed Property				
Australian	S&P/ASX 200 A-REIT TR (Accumulation) Index	-34.4	-31.7	0.2
International	FTSE EPRA/NAREIT Dev NR Property Index (AUD Hedged)	-28.6	-24.5	-1.5
Infrastructure				
Global	S&P Global Infrastructure TR Index (AUD Hedged)	-27.9	-20.1	0.8
Currencies				
AUD v USD	Against US Dollar	-12.7	-13.6	-4.2
Fixed Interest				
Australian	Bloomberg Ausbond Composite All Maturities	3.0	6.8	4.2
	Bloomberg Ausbond Credit All Maturities	0.8	4.9	4.3
International	Bloomberg Barclays Global Agg TR Index (AUD Hedged)	1.5	5.8	4.0
Commodities				
Gold	Gold – USD	4.0	22.0	5.9
Oil	WTI Oil $/b – USD	-66.5	-66.0	-15.5

Outlook

While some recent hopeful signs have emerged – including rapid testing and the possibility of a peak in infection rates in some counties – it is unclear how long the coronavirus will shake – and shape – the world. This, despite the world's governments and central banks throwing "kitchen sink" stimulus at it.

From a market perspective, we expect the recent rough ride to continue for some time and a sustained market rebound will ultimately depend on the type of recovery that occurs.

Some predict a V-shaped recovery which could bring the global economy roaring back from its coronavirus-inflicted slump. While the US and global economic output may actually exhibit a slower, U-shaped recovery, as activity takes several quarters to normalize, gross-domestic-product growth and profits could surge to previous highs, much faster.

Recent economic activity data out of China points to a quick GDP rebound. The country's March purchasing managers' index reading jumped 9.8 points, to 50.1, after a 10.8-point decline in February, notching a rapid upswing from lows seen during times of strict containment measures. However, caution is advised in relation to relying on these figures, with many economists suggesting that they be taken with a grain of salt.

Though there are good reasons to be sceptical that other countries will tread China's normalisation path, the early data suggests economic growth can bounce back relatively quickly if virus cases fade and economic activity is able to resume. The risk is the longer it takes for economic activity to resume, the greater the ultimate impact will be on both the economy and financial markets.

In relation to investment portfolios, we recommend investors take a cautious approach. Our thoughts on various asset classes are outlined below.

Australian and International Equities

With earnings downgrades expected across a range of sectors, we recommend investors review their equity portfolio.

Very few companies are expected to be immune to the economic growth slowdown and numerous businesses have already withdrawn their future earnings guidance. As a result, investors are unlikely to avoid a hit to income from a pending decline in dividends.

However, we suggest that investors consider holdings in more defensive sectors, which have less sensitivity to the economic cycle, lower earnings risk and are not overburdened by debt. This may include investments in the healthcare and telecommunications sectors. With solid balance sheets, holdings in the resources sectors could also be considered.

Within International Equities, we feel that investments in the Asian region are currently more attractive from a valuation perspective and in a better position to recover.

Following the recent depreciation of the Australian dollar against most major global currencies, we also believe that consideration should be given to switching to hedged options (where available) on International Equity holdings. Although the US Dollar provides protection as a safe haven in times of extreme volatility, the US Dollar may weaken over the medium to long term, given the increasing levels of Government debt and Quantitative Easing programmes.

While markets have rebounded in recent days, further significant market falls could occur if additional containment measures are required to be put in place, or if the likely duration of the virus threat extends beyond current market predictions. The acute impact of the virus moving through various US States, in varying degrees of readiness, is likely to weigh heavily on US and world investment markets in coming weeks.

Property

We note that the domestic and international property sectors remain under extreme duress, with a great deal of uncertainty remaining.

However, following significant falls in the March quarter, the question now is whether the dramatic market reaction has overshot, leaving a sector boasting strong fundamentals but trading at attractive valuations. Domestic Real Estate Investment Trusts (REITs) are in a significantly better financial position than they were in the Global Financial Crisis. Balance sheets are extremely well-managed, with the average debt in the sector at its lowest level since the late 1990s. The majority of Australian REITs currently sit at the lower end of their target gearing band, with an average debt maturity across the sector of over 5.5 years, with hedging of almost 80%.

We recommend that investors retain their existing holdings but where possible, seek to reduce exposure to the retail sector.

Fixed Interest

Following recent falls in bond yields, we believe that government bonds are expensive. They may rally further if the coronavirus crisis escalates further, however are likely to underperform once the post-virus recovery is underway.

While credit securities appear attractive, following recent falls in prices, the risks in this segment of the fixed interest market are currently elevated.

Alternatives

Despite the short-term fallout from the global pandemic, we are positive about the longer-term prospects for Infrastructure investments. The recent sell off has provided more attractive entry points for those without exposure to this sector.

In the current uncertain economic climate, we also suggest that consideration be given to an allocation to the gold sector with portfolios. Exposure to gold, either through gold producers or via an investment in physical gold, provides additional diversification within portfolios and can act as a hedge against the risk of inflation.

Sources: Lonsec

Please note that the information above is general in nature and does not take into account your personal circumstances, financial needs or objectives. Before acting on this information, you should consider its appropriateness having regard to your objectives, financial situation and needs. In particular, you should speak to Kevin Smith of The Professional Super Advisers on (02) 9955 5800 prior to acting upon this information.