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MONTHLY UPDATE ON THE INVESTMENT ENVIRONMENT

March 2020

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MARKET UPDATE

March 2020 will go down in the annals of global economic history. The spread of the COVID-19 virus has now overwhelmed several nations, becoming the most severe global pandemic in over a century.

By early April, there were over 1.5 million confirmed COVID-19 cases and over 85,000 lives lost. While coming under control in its country of origin, China, the virus has spread rapidly across western Europe and the US. Australia has thus far been spared the worst of the disease, with a raft of measures contributing to a slowing infection rate.

Indeed, for many countries the key economic impact from the pandemic stems not from the health impact of the virus itself, but rather the severe measures necessary to mitigate the speed and degree of its spread. With the pandemic still in its early stages, its impact on the global economy remains uncertain, although it is undoubtedly expected to be severe. Global supply chains have been disrupted, while the services sector has been decimated by the restricted movement of individuals. Revised economic forecasts of 2020 GDP growth now vary significantly, ranging from a high of around 0% to under -7% for both the Eurozone and US.

As a result of the pandemic, equities markets experienced sharp falls, with many plummeting around 25% from late-February peaks, The depreciation of the Australian dollar did, however, provide support for unhedged overseas equities.

Implied volatility gauges also soared. The VIX Index, which measures the expected level of US equities market volatility, reached a record high of 82.7 in mid-March, eclipsing the prior record of 80.7 in November 2008. As an indication of the severity of the uptick, the index had oscillated between 10 and 20 points in the months prior to the crisis. By early April, however, it had eased to under 50.

Fixed interest performance, meanwhile, was hindered by an initial selldown of government bonds as investors sought liquidity for rebalancing, while credit spreads soared to their highest levels since the GFC.

Aside from the COVID-19 pandemic, global markets were also impacted by Russia-Saudi oil production tensions, with an anticipated spike in supply seeing oil prices plummet by nearly 70% – although they had started to improve by early April.

AUSTRALIA

The policy response from the RBA and Commonwealth Government has been swift and significant. The RBA cut the cash rate to a record-low of 0.25% and commenced its first-ever round of quantitative easing, purchasing relatively short-dated Commonwealth and semi-government bonds. It also commenced yield curve control, targeting a three-year Commonwealth bond yield of 0.25%, and provided banks with access to low three-year term funding, with incentives to on-lend to small-to-medium businesses.

Fiscal stimulus was also sizeable, with the federal government announcing over $190 billion in support, including for unemployed and furloughed employees, plus the early release of superannuation for qualifying individuals. The measures will lead to substantial budget deficits for years to come, and saw Australia becoming the first (although unlikely last) of Standard & Poor's AAA-rated nations to be given a negative outlook.

The nation's housing sector remained seemingly unaffected by COVID-19 for the time being, with prices continuing to increase to end-March across the five major capital cities, rising 0.7% over the month and taking the annual gain to 9.1%. Sydney and Melbourne, the two largest markets, continued to be the best performers, with annual prices soaring by 13.0% and 12.0%, respectively. Record-low rates and the introduction of yield curve control are likely to provide some support for both current and would-be mortgagees. That said, policy tailwinds are likely to be countered by soaring unemployment and more stringent borrower credit risk analysis by lenders.

UNITED STATES

The US economy is grappling with by far the largest number of active cases of any nation. Congress passed a US$2 trillion support package to aid businesses, plus welfare and tax concessions for individuals.

The Federal Reserve made its first inter-meeting rate cuts since the GFC, cutting the target rate by a total of 1.5% to the current range of 0% to 0.25%. It also launched an unlimited program of quantitative easing, as well as measures to boost market liquidity for municipal bonds, asset-backed securities, money market funds, and investment grade credit.

As March economic data starts to trickle in, perhaps the most telling indicator of the severity of the economic impact of the pandemic has been the rise in weekly US initial jobless claims, which increased from 282,000 to 3.3 million in one week in late March, and then to 6.6 million the following week. For context, the historical weekly record was 695,000 in 1982. The figures are in stark contrast to the historically low unemployment rate just three months earlier.

On the political front, Democratic primaries for the November 2020 Presidential election have seen Joe Biden emerge as candidate, with his main rival, the highly-progressive Bernie Sanders, withdrawing from contention in early April. Biden is considered a centrist and popular among working class voters; a strength that should serve to benefit the Democrats' attempts to win back rust belt states lost to Donald Trump in 2016. Nonetheless, President Trump is currently favourite to win the election.

EUROPE

The European economy has had to contend with major outbreaks of the virus, especially in Italy, Spain and France. The ECB announced over €1 trillion in net asset purchases in response. The EU meanwhile, temporarily suspended the Stability and Growth Pact, removing the requirement for EU members to limit budget deficits to 3% of GDP. A number of European nations announced fiscal packages, including the usually frugal German government.

Eurozone inflation disappointed in March. Core CPI came in at a reduced 1.0%, while the headline figure fell from 1.2% to 0.7% due to a decline in energy and food prices. Eurozone employment data for February, released early April, recorded a decline to a twelve-year low of 7.3%; a figure that will no doubt soar in coming months.

As would be expected given current economic conditions, sentiment data deteriorated significantly. The IHS/Markit PMI Eurozone composite index recorded its largest-ever monthly decline, falling from 51.6 to a record low of 29. The decline was above all due to services PMI, which fell to 26.4 as incoming new work, workloads and business confidence plummeted. Manufacturing PMI meanwhile, fell from 49.2 to 44.5, with manufacturing confidence falling to its lowest on record.

UNITED KINGDOM

The COVID-19 pandemic's severe impact on the UK economy mirrored that of other developed nations. It also has the unfortunate honour of becoming the first nation to have its leader diagnosed with the virus, with Prime Minister Boris Johnson requiring intensive care treatment.

The Bank of England implemented a number of measures to address the pandemic, cutting the cash rate to 0.1% and announcing targeted funding for small-to-medium enterprises. It removed banks' countercyclical buffers, freeing up around £190 billion of capital for lending, and also added £200 billion to its quantitative easing programme (taking the total size to £645 billion) to support liquidity and prices for government and corporate bonds.

A raft of fiscal measures were also introduced; furloughed workers were to have up to 80% of their salary covered for the next three months, welfare payments were increased, tax deferrals granted, and £330 billion of guarantees and business grants made. The anticipated deterioration in public finances, coupled with post-Brexit trade uncertainty, led ratings agency Fitch to downgrade the UK's credit rating from AA to AA- with a negative outlook.

CHINA

In China, the effects of the pandemic have started to abate, with lockdowns lifted and sentiment indicators more optimistic. However, the risk of a re-infection remains a threat, prompting the government to close its borders to foreign nationals in late March.

Similarly, sentiment indicators rebounded from record lows. The Caixin China manufacturing PMI increased from 40.3 to 50.1, suggesting an overall expansionary outlook despite declines in new export orders. The official manufacturing PMI gauge also improved from 35.7 to an above-expected 52.0. Additionally, the Caixin Services PMI figure also improved from a record low 26.5 to 43.0, and the official reading also increased from 29.6 to 52.3.

While government officials have yet to revise down their forecast of 5.6% GDP growth over 2020, consensus suggests the first decline in GDP since 1976. Indeed, industrial output experienced a contraction of 13.5% over the first two months of the year (its sharpest ever decline), urban unemployment reached a record 6.2% in February, and retail sales plummeted by an annual 4.5%.

Table: Index Returns to 31 March 2020

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	-20.8	-23.4	-20.9	-14.5
S&P/ASX Small Ordinaries Accumulation Index	-22.4	-26.7	-23.9	-21.0
International Equities				
MSCI World (ex Australia) Index (hedged A$)	-13.4	-21.1	-14.0	-11.1
MSCI World (ex Australia) Index (unhedged A$)	-8.3	-9.0	-0.7	4.4
MSCI Emerging Markets Index (unhedged A$)	-10.9	-12.3	-6.2	-4.5
Property				
S&P/ASX 200 A-REIT Accumulation Index	-35.1	-34.4	-34.4	-31.7
Australian Fixed Interest				
Bloomberg AusBond Composite Index	-0.2	3.0	3.6	6.8
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	0.0	3.9	5.1	8.1
Barclay's Global Capital Aggregate Bond Index (hedged A$)	-1.7	1.3	2.8	5.6
Cash				
Bloomberg AusBond Bank Bill Index	0.1	0.3	0.8	1.2
Commodities				
Gold (US$ per ounce)	-1.8	5.1	13.2	24.0
Copper (US$ per metric tonne)	-12.1	-19.8	-17.4	-23.6
WTI Crude Oil (US$ per barrel)	-54.2	-66.5	-65.0	-65.9
RBA Index of Commodity Prices (A$)	3.5	7.4	-2.0	0.7

Table 1: Australian Dollar versus Foreign Currencies to 31 March 2020

AUSTRALIAN DOLLAR VERSUS	AS AT 31 MARCH 2020	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.61	-6.4	-13.1	-13.0	-14.0
British Pound Sterling	0.49	-2.5	-7.4	-10.8	-9.0
Euro	0.56	-5.8	-11.0	-9.6	-11.9
Japanese Yen	66.17	-6.5	-13.1	-12.3	-15.7