Market Watch

COVID-19 chaos prompts unprecedented support

End-March 2020

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Economics overview

- During March, Covid-19 was classified as a global pandemic.
- The disease spread further and more rapidly than had previously been anticipated. The rapid spread of coronavirus saw authorities take drastic measures, in some cases shutting down entire countries to try and slow the spread of the disease.
- These closures and disruptions will have a negative impact on economic activity, likely resulting in a global recession in the next few months.
- Risk assets including equities and credit sold off sharply, as investors priced in the likelihood of lower corporate profitability.
- Sentiment improved a little towards month end, as governments and central banks announced unprecedented fiscal support packages to minimise the economic impact of the shutdowns.
- These measures should help, but quarterly declines in global GDP appear likely to be the worst since World War II.

- **US**: The US now has more cases of the virus than anywhere else. As the situation worsened, President Trump approved a US$2.2 trillion support package – the largest in history.
- This bill received bipartisan support, passing through the Senate with a vote of 96-0. US officials appear determined to minimise the impact of the slowdown and are trying to ensure the world's largest economy bounces back hard after an inevitable slump.
- As well as providing direct payments to most Americans to help support spending, the package includes tax deferrals and a range of financing including loans and grants to US businesses.
- US interest rates were lowered to almost zero; a reduction of 1.5 percentage points over the month.
- The Federal Reserve also implemented the largest ever 'quantitative easing' program to help support financial markets. The central bank is pumping unlimited levels of liquidity into US financial markets, primarily by buying bonds.
- The extent of the economic slowdown will be unknown for many months, but the first impacts are already starting to be seen.
- During February, there were ~5.8 million unemployed people in the US. In the week ending 27 March alone, this number jumped by more than 3 million. How high the unemployment rate climbs will have an important influence on the speed and extent of the economic recovery.

- **Australia**: The Federal Government encouraged Australians to stay at home where possible, but stopped short of introducing more formal lockdowns. In most cases, schools and shops remained open, unlike in many other countries.
- Some criticised the response, suggesting it was inadequate and potentially confusing. Australians were told they could not eat at cafés, for example, but that it remained possible to get a haircut.
- Three separate support packages were announced, designed to minimise the economic impact of coronavirus-related shutdowns. Please refer to our *Chart of the Month* on page 3 of this document for details.
- Separately, Australian interest rates were lowered twice during the month. Now at 0.25%, interest rates have never been lower.

- **New Zealand:** New Zealand went a step further than Australia, implementing a full lockdown of all non-essential activities and services for a minimum of four weeks.
- The Reserve Bank of New Zealand announced it will buy up to NZ$30 billion of government bonds to help provide liquidity in the financial system. This was a significant program – there are only ~NZ$78 billion of NZ government bonds on issue in total.
- The RBNZ also lowered interest rates to 0.25%, a drop of 0.75 percentage points over the month.

- **Europe**: Like elsewhere, authorities in all European countries grappled with two main questions: 1) how to limit the spread of the virus so reduce the risk of overwhelming healthcare resources; and 2) how to limit the severity of economic impacts.
- In response to the first question, several governments in Europe announced full lockdowns of their countries. All non-essential services and activities were closed down and citizens' movements were severely restricted.
- The European Central Bank increased the size of its existing asset purchase program. Importantly, it also abandoned a previous rule where it was unable to purchase more than a third of individual issuers' debt.
- In the UK, interest rates were lowered to 0.10% from 0.75% previously.
- The UK also announced a 'job keeper' scheme similar to the one introduced in Australia, whereby the government is subsidising wages to maintain employment and support income.

- **Asia/EM:** Earlier restrictions in China are starting to be wound back as the number of new coronavirus cases has slowed markedly. That said, borders remain closed to foreign nationals.
- The Chinese government is believed to be working on a comprehensive range of measures to help support the economy as activity levels start to ramp up again after the shutdowns. Further interest rates cuts are also anticipated.
- The number of new virus cases in South Korea has also tailed off, suggesting the country's method of tackling the disease has been effective. Rather than implementing lockdowns, South Korea has sought to maximise the number of tests and then isolate affected individuals and their known contacts, as required. Other countries might consider turning to this 'trace, test and treat' approach if widespread closures do not have their desired impact in reducing the spread of the disease.

Australian dollar

- The 'risk off' sentiment extended to the Australian dollar, which is widely perceived to be a proxy for global growth.
- Having started March around 65 US cents, the 'Aussie' dollar fell to around 61 US cents by month end – close to record lows. The A$ traded as low as 57 US cents during the month.
- The Aussie depreciated by 4.0% against a trade-weighted basket of international currencies.
- Over time, the weaker Australian dollar should help support demand for Australian exports, which become more competitively priced internationally.

Commodities

- Most commodity prices moved lower, primarily reflecting demand uncertainty against the backdrop of the coronavirus pandemic.
- Industrial metals including aluminium (-12.6%), copper (-12.5%), nickel (-8.5%) and lead (-8.4%) all declined.
- Oil bore the brunt of negative sentiment. The price more than halved, with Brent Crude closing March -55.0% lower following a breakdown in negotiations between Saudi Arabia, Russia and other OPEC members.
- Iron ore (-4.7%) also lost ground, despite signs of a turnaround in Chinese manufacturing and China's stimulus plans.
- Gold (-2.9%) was again among the better performers, although still finished the month in negative territory.
- Silver (-18.4%) and platinum (-15.9%) proved less resilient.

Australian equities

- The combination of an oil price collapse and the continued spread of the coronavirus saw the Australian share market follow global peers lower. The S&P/ASX 100 Accumulation Index experienced its fastest -30% decline from a recent peak (20 February 2020), taking just 17 days, but recovered somewhat from these lows to end the month -20.6% lower.
- Given the market weakness, sectors perceived to have greater earnings stability generally outperformed, such as Consumer Staples (-4.6%), Health Care (-5.2%) and Utilities (-6.2%). Consumer Staples benefited from surging sales at supermarkets as consumers stocked up on various food and sanitary products as they prepared to self-isolate.
- Several Health Care constituents, such as Fisher & Paykel Healthcare (+17.3%) and ResMed (+1.0%), rallied on news that the businesses are experiencing surging demand for their respiratory products, which are being used to treat seriously ill coronavirus patients – particularly in heavily affected countries.
- With investors increasingly concerned over the health of company balance sheets, Australia's larger cap businesses were the preferred exposure given their perceived maturity and earnings resilience. As a result, small companies underperformed their large cap peers, with the S&P/ASX Small Ordinaries Accumulation Index declining -22.4% over the month.

Listed property

- Global property securities plunged as investors grappled with the drastic government and central bank responses to COVID-19 and how they might impact real estate markets.
- The FTSE EPRA/NAREIT Developed Index fell -22.5% in local currency terms and -18.5% in Australian dollars.
- Every major listed property market posted significant losses for the month. The best performers included Hong Kong (-10%), Germany (-14%) and Singapore (-17%). Australia (-35%) was the worst performing market.
- Government-imposed travel restrictions and widespread lockdowns, including the closure of non-essential businesses, bodes poorly for hotel and retail landlords in the near term. These measures will have a direct impact on tourism, shopping centre visitation, retail vacancy rates and discretionary expenditure.
- Social real estate sectors – including childcare, aged care facilities and student housing – are also at risk of rising vacancies due to the pandemic.
- Hospitals, data centres and logistical warehouses are all expected to be material beneficiaries of the policies.
- In Australia, unsurprisingly Retail was the worst performing sub-sector, falling a staggering -46%, led by Scentre Group (-55%) and Vicinity Centres (-52%).
- A-REITs with material exposure to the childcare sector also sold off heavily, with Charter Hall Social Infrastructure REIT plunging -45% and Arena REIT dropping -44%.

Global equities

- Facing a deep economic recession and the apparent inability of the US Congress to agree on a fiscal rescue package, global markets were on track to record the worst month and quarter on record. The MSCI World Index plunged almost -24% in local currency terms in the first 23 days of the month.
- The combination of unlimited quantitative easing promised by the US Federal Reserve on 24 March and the eventual approval of a US$2.2 trillion fiscal package by US Congress saw markets recover around half of their losses by month end. The MSCI World finished the month down 'only' -12.8% in local currencies and -8.5% in Australian dollars.
- The Japanese Nikkei was the strongest performer, down -7.4% in yen. Falls in Japanese shares were addressed around the middle of the month as a series of support packages were announced by the Bank of Japan.
- The weaker performers across developed markets were Australia (-20.7%) and Germany (-16.4%). European stocks struggled as countries imposed ever-increasing restrictions on movement in an attempt to contain the spread of the virus.
- Emerging markets underperformed their developed peers for a 22nd consecutive month. Latin America was the weakest region – pulled down by Brazil as commodity prices tumbled.

Global and Australian Fixed Income

- There were extraordinary developments in sovereign bond markets. With liquidity drying up, central banks were forced to intervene with enormous capital injections.
- The Federal Reserve announced 'unlimited' support. The ECB also increased the size of its existing asset purchase program.
- Returns from bond markets were mixed. Yields moved in enormous ranges, whipsawing as investors digested news flow and announcements from governments and central banks.
- Ten-year US Treasury yields fell 48 bps, to 0.67%, while 10-year gilt yields closed 9 bps lower in the UK.
- Conversely, German Bund yields rose 14 bps, to -0.47% and Japanese government bond yields rose 17 bps, moving back into positive territory.
- In Australia, 10-year CGS yields declined 6 bps, to 0.76%. This modest move masked a month of exceptional volatility in the market – like elsewhere, Australian government bond yields traded in very wide ranges as the coronavirus outbreak caused chaos in the market. The 10-year domestic bond yield traded as low as 0.52% during the month.

Global credit

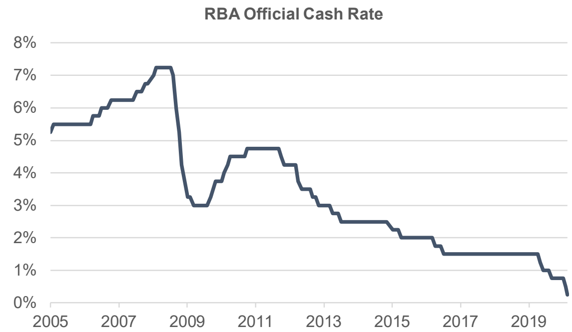
- Credit spreads widened significantly, reflecting the 'risk off' tone in global markets. Both investment grade and high yield credit funds also experienced sizeable redemptions as investors de-risked portfolios, which exerted further pressure on valuations.
- Corporate bond spreads – as measured by the Bloomberg Barclays Global Aggregate Corporate Index – closed March at 2.75%. To put that into context, credit spreads were <1% at the end of 2019 and 1.23% at the end of February 2020.
- Shutdowns associated with the coronavirus are certain to have a meaningful impact on corporate profitability globally and will likely result in an uptick in default rates in some sectors. For now, the length and extent of the shutdowns remain unknown. It is not therefore possible to extrapolate the likely impact on profitability and/or default rates. Instead, market pricing in March was driven primarily by fear.
- That said, spreads contracted towards month end from their mid-month wides, which was encouraging. In many cases, central banks are including corporate securities as part of their enormous asset purchase programs – this is providing support for credit markets and should continue to do so.

Chart of the Month – The RBA's Bazooka AND the Kitchen Sink

In these bulletins, we aim to share interesting observations from global investment markets. This month we review the extraordinary range of monetary and fiscal support programs recently introduced in Australia and consider some possible ramifications of these moves.

Some commentators have suggested that easing monetary policy is largely ineffective during periods of economic stress. Ultimately, if people lose their jobs or are worried about doing so, they are unlikely to increase discretionary expenditure just because their mortgage repayments have been reduced. In fact, subdued retail sales growth over the past few months since the Reserve Bank of Australia started cutting interest rates in June 2019 suggests homeowners are choosing to make overpayments on their mortgage, rather than increase their spending on goods and services.

Nonetheless, in a renewed effort to support consumption, policy makers lowered Australian interest rates even further in March. The official cash rate was reduced by a further 0.5 percentage points, to a new record low of 0.25%. In various formal communications, officials have suggested that Australian interest rates will not be lowered any further. The Reserve Bank of Australia has wasted no time in cutting interest rates almost as low as they can possibly go, following the lead of other central banks including the Federal Reserve and the Bank of England. It's a 'Bazooka', directly targeting consumer spending as and when Australian businesses reopen their doors.



Source: Bloomberg, 1 January 2005 to 31 March 2020

Separately, the RBA started engaging in more unconventional policy measures – specifically a Quantitative Easing (QE) program. This involves buying large quantities of bonds on the open market, supporting the functioning of the local bond market and providing much-needed liquidity into the financial system. The QE program is similar to those seen previously in the US, Europe and Japan.

Concerned that further measures might be required to prevent an economic meltdown, the Federal Government has also announced significant fiscal spending to combat the virus-related slowdown. The scale of these packages is enormous and unprecedented in the history of this country. The Treasurer is throwing the 'Kitchen Sink' at this problem.

Three separate packages were announced in March as the COVID-19 situation worsened both domestically and internationally.

1) An initial package was announced early in the month targeting business investment, providing stimulus payments to the most severely affected households and temporary financial support to small- and medium sized businesses. These initial measures were not expected to jeopardise the targeted budget surplus.

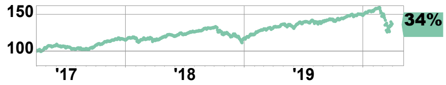
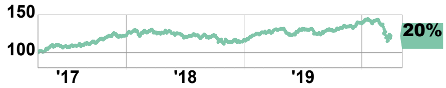
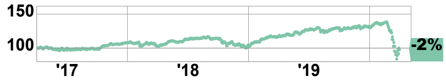
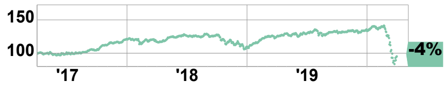
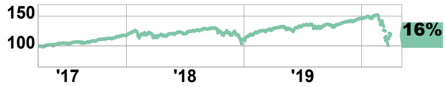
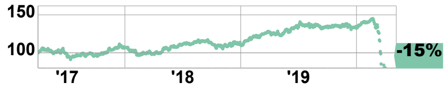
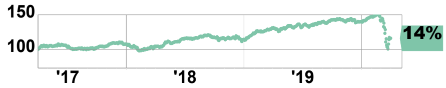
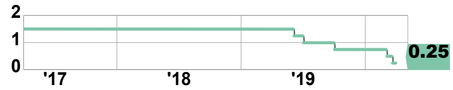
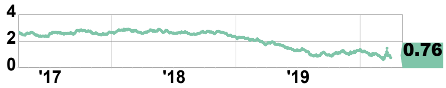
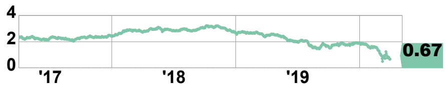
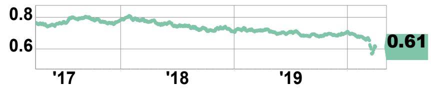
2) As the situation worsened, it was subsequently announced that small businesses would receive cash payments of up to $100,000 and that commercial loans would be partially guaranteed. Welfare payments were also doubled. The budget surplus, a long-term target for the Coalition, was effectively abandoned at this time. Additionally, workers whose income has been significantly reduced are also able to apply for early access to their superannuation; $10,000 this financial year and a further $10,000 next.

3) Towards month end, the Treasurer announced a 'job keeper' subsidy to be paid to businesses to assist with staff costs and minimise layoffs. The scheme will last for six months and cover $1,500 per fortnight per eligible employee, or ~70% of the average wage. Around six million Australian workers are expected to be eligible for the payments, which were welcomed by businesses.

Collectively these measures could cost the Government more than $300 billion, or more than 16% of GDP. The scale of the spending is significant and it will take many years for it to be repaid. Some of the cost is expected to be met by a substantial increase in government bond issuance. This is likely to have meaningful implications for the domestic bond market, both in terms of outright yields and the shape of the yield curve. The RBA's QE program is also likely to have significant implications for domestic bond yields and the curve. Over time, this is expected to provide opportunities to implement active duration and curve positions in actively managed fixed income portfolios.

Whether or not the unprecedented level of stimulus will be sufficient to offset the coming downturn remains an open question; the official economic data is likely to take some time to reflect what is happening. The country's increased indebtedness might also prompt rating agencies to review Australia's coveted AAA credit ratings. Any downgrades would likely increase the overall cost of debt repayments, as future bond issues would likely have to be offered with slightly higher yields to compensate investors for the slight increase in perceived credit risk. Yields on AAA-rated State Government bonds could then suffer a similar fate, given that their ratings are tied to that of the sovereign.

MARKET WATCH DATA SHEET

		1 Month Return/Change	3 Month Return/Change	12 Month Return/Change	3 Year Annualised Return/Change	3 Year Chart
EQUITIES						
MSCI World (Gross of withholding tax, in AUD)	3,390.17	-8.53%	-9.19%	4.60%	10.30%	
MSCI Emerging Markets (AUD)	1,001.02	-10.86%	-12.22%	-4.09%	6.27%	
ASX 200	5,076.80	-20.65%	-23.10%	-14.42%	-0.56%	
ASX Small Ordinaries	2,105.10	-22.38%	-26.72%	-21.02%	-1.33%	
S&P 500 (USD)	2,584.59	-12.35%	-19.60%	-6.98%	5.10%	
REITs						
ASX 200 A-REIT	1,022.00	-35.14%	-34.37%	-31.73%	-5.10%	
FTSE EPRA/NAREIT Developed (AUD)	3,088.72	-18.48%	-17.69%	-10.88%	4.48%	
CASH and FIXED INCOME						
Official Cash Rate Australia	0.25%	-0.50%	-0.50%	-1.25%	-	
10-year yield Australia	0.76%	-0.06%	-0.61%	-1.02%	-	
10-year yield US	0.67%	-0.48%	-1.25%	-1.74%	-	
Foreign Exchange						
AUD/USD	0.6121	-5.07%	-12.93%	-13.84%	-7.08%	

Source: Factset and Bloomberg, at 31 March 2020