Market Watch

March Review 2020

With COVID-19 taking centre stage in what has become, over a short few weeks, both a medical and market crisis parelleled only by the two world wars and the great depression in the 1930's, markets over March were impacted with the sharpest declines investors have ever witnessed. The sell-off saw some of the highest proportion of assets underperform cash on a monthly basis for the first time in over 30 years.

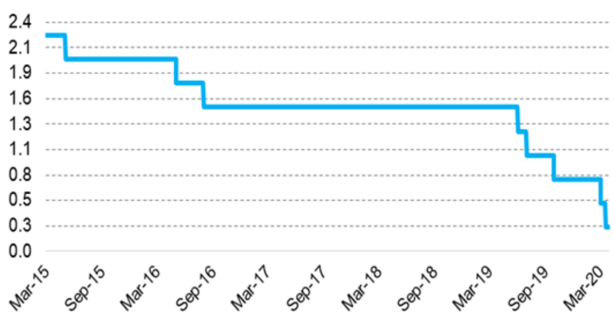
Developments in Global Economy

Australia

The Reserve Bank of Australia (RBA) cut interest rates in its March meeting by 25 basis points to 0.50%. COVID-19 fears pushed the RBA to act out of cycle with another 25 basis point cut in mid-March - taking the cash rate to a new record level of 0.25%. The RBA broke new ground by launching a quantitative easing (QE) program. This central bank initiative involves targeting the Australian 3-year bond yield at "around" 0.25%, rather than buying a specified quantity of bonds. The Australian government has developed broad programs to support the non-financial sector, small lenders and the securitisation markets, regulated by the Australian Office of Financial Management (AOFM).

Housing market data showed signs of promise before the COVID-19 outbreak, however toward the end of March began to show signs of the developing economic downturn. On a positive note, there was an upsurge in dwelling approvals and house prices in March. According to CoreLogic, prices of dwellings rose 0.7% in the collective cities despite disruptions in to the housing market that ramped up in the middle part of the month. On an annual basis, prices rose 8.9% - the fastest since August 2017. Furthermore, building approvals jumped 19.9% in February, reversing the fall in January. Approvals have been volatile the past couple of months, driven by large swings in high-rise approvals.

Chart 1: Australian Interest Rate



Source: BTIS/Bloomberg

The Westpac Consumer Sentiment Index declined 3% month-over-month to a 5-year low of 91.9, compared to 95.5 in the previous month. Retail sales rose 0.5% in February. The data confirms the increase in retail turnover within three months. There was a significant increase in spending in pharmacies, supermarkets and takeaway services. Demand for manufactured food, groceries, and personal/household items had surged. Strict social distancing rules, adopted in March are expected to reverse further the sentiment and retail sales data however.

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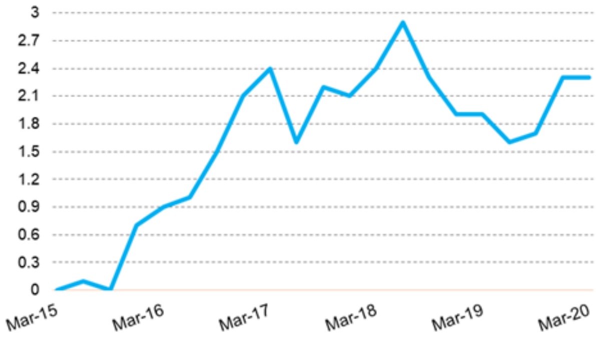
Business conditions deteriorated in February as coronavirus impact quickly began to impact the economy. The NAB business condition index fell 2 points to 0, the lowest since May 2014. Business confidence fell 3 points to -4. Both indices are at historic lows, but remain above the level recorded throughout the GFC. Coronavirus was having an impact on supply chains and service export sectors like tourist and education.

United States

The Federal Reserve announced two emergency rate cuts during March in an effort to cushion the economy from the COVID-19-driven economic slowdown. The Federal Open Market Committee (FOMC) said in a press release that "the fundamentals of the US economy remain strong, however, the coronavirus poses evolving risks to the economy". From 1.10% in the beginning of the month, the effective federal funds rate dropped to 0.05% by month-end.

Chart 2: US GDP (Annualised)



Source: BTIS/Bloomberg

The US congress and the Trump administration reached an agreement of a US$2 trillion stimulus package to protect the economy from COVID-19. The stimulus amounts to 10% of GDP (noting that the current fiscal deficit is around 5% of GDP). Federal Reserve Chair Powell restated the stance that the Fed would do whatever it takes regarding lending, stating that the fed was "not going to run out of ammunition". Powell further added that the Fed was trying to build a bridge over a substantial decline in the economy.

The University of Michigan's consumer sentiment survey was revised down to 89.1 in March from 101 in February. It was the lowest reading since October 2016 and the fourth largest decline in nearly half a century. ISM data showed that employment at US factories contracted at the quickest pace in 11 years. It declined to 49.1 in March from 50.1 in February. The gauge for new orders tumbled by 7.6 points to 42.2. The PMI was confirmed at 48.5. Readings below 50 indicate a contraction in activity.

Initial jobless claims for the 3rd week of March sky-rocketed to an historical high of 6.65 million unemployed. Before the medical crisis, the weekly claims were an average of 250,000. The previous record high was struck during the GFC at 654,000.

Asia

In China, the Caixin manufacturing PMI recovered from 40.3 in February to 50.1 in March. It shadowed a comparable pattern from the official PMI which also bounced back into growth territory (above 50) in the month. The Caixin measure includes smaller firms, showing that businesses were also recovering. Although, overall activity remains weak, and firms will face additional challenges, particularly those which depend heavily on export demand, and the significant impact of COVID-19 affecting all economies in the region.

Chinese industrial profits declined 38.3% from a year ago – the steepest decline in a decade. The decline in profits reflects the sharpest fall in industrial activity. The immediate impact of the COVID-19 pandemic delayed the opening of industrial firms after Lunar New Year holidays.

Japan's Tankan Survey indicated that conditions for manufacturing and non-manufacturing sectors both deteriorated in the first quarter of 2020. Indices for large manufacturing and non-manufacturing were both weaker, falling to -8 and 8, from 0 and 20, respectively. The Jibun manufacturing PMI was confirmed at 44.8 in March, falling well into contraction territory.

Japan announced programs worth US$20 billion, or 0.5% of GDP. The Bank of Japan (BOJ) has doubled its annual equity-buying target to ¥12 trillion (US$112 billion or 2% of GDP) and has rolled out a new lending facility. The BOJ promised to provide ample yen funds and continue buying Japanese bonds. The BOJ opted not to lower interest rates further below zero. The priority was to provide smooth corporate financing and stability to financial markets.

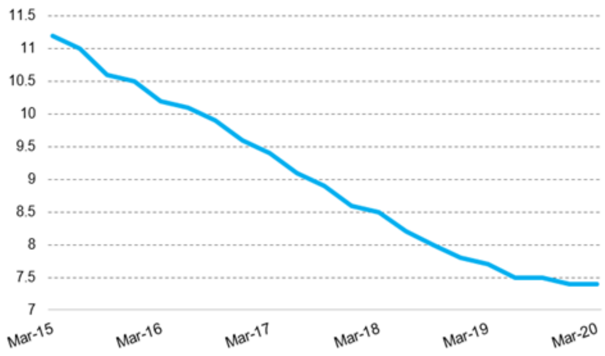
Europe

European countries are bracing for a severe economic impact from the COVID-19 spread. European headline inflation steadied from an annual rate of 1.2% in February to 0.7% in March, the lowest in 5 months. Prices are likely to be held by weak demand and plunging oil prices resulting from the Saudi-Russia production spat. Furthermore, Eurozone producer prices fell by more than expected in February. Producer prices fell 0.6% and 1.3% over the year. Over March the ECB expanded its monetary policy easing measures, which includes additional long term funding / refinancing operations and providing more favourable financing terms.

Italian Prime Minister, Giuseppe Conte announced the most stringent restrictions on freedom of movement imposed in Europe since World War 2. 60 million Italians are only allowed to travel for pressing reasons of work, health or other extenuating necessities (with written permission). Italy became the first country to attempt a nationwide lockdown, which has since been followed globally.

The Bank of England cut its key rate twice over March by 50 basis points initially, then by a further 15 basis points. The current UK cash rate sits at 0.10%. This is a coordinated action to get the British economy ready to fight the impact of coronavirus. The UK Finance minister Rishi Sunak unveiled a £30 billion stimulus package. The package includes a £7 billion to support businesses and individuals with a £5 billion emergency response fund. The U.K. is also scheduling £156.1 billion of bond sales in 2020-21.

Chart 3: Eurozone Unemployment Rate

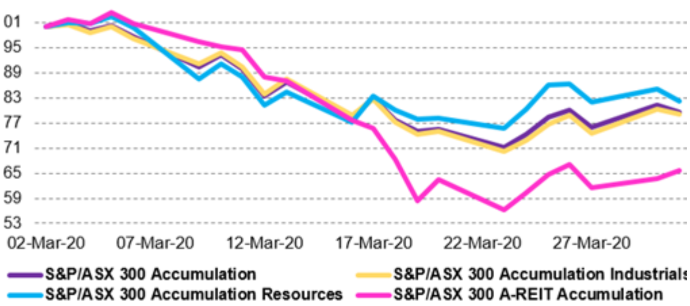


Source: BTIS/Bloomberg

Development in Financial Markets

Australian shares

Chart 4: Australian shares (rebased to 100)



Source: BTIS/Bloomberg

Australian equities fell significantly over March with the ASX 300 down -20.8%, as a result placing the market into a technical Bear market. The largest declines were seen across sectors exposed to the COVID-19 economic impacts, specifically A-REITS (-35.2%), Consumer Discretionary, (- 34.6%) and Energy (-38%). Overall the Australian share market is down approximately -30% from its high that it hit on the 20th February.

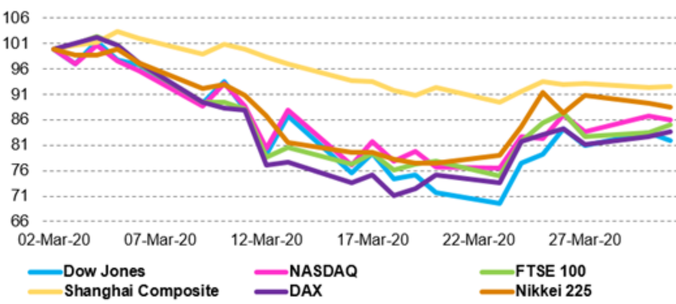
Over the March quarter, the Energy sector remained the most impacted from the pandemic, in addition to experiencing increased supply side pressure causing a dramatic fall in oil prices of -49%. Unsurprisingly, the impacts of the pandemic were felt in the Consumer Services sector, which also fell significantly over the quarter, down -39%. On a more positive note, sectors with exposure to healthcare and consumer staples, posted reasonable by comparison returns over the quarter, with Pharmaceuticals & Biotech up 6.7% (the only ASX sector that was positive over the quarter), Food and Staples, -0.8%, and Health Care services, -9.8%. Interestingly, Banks a sub-sector of the Financial, is now near an 11 year low – down near -32% over the March quarter.

International shares

With the outlook for global economic activity and financial markets undoubtedly worsening over March, it remains still too early for markets to form a definitive view on the trajectory, or timing of any recovery. Global shares unsurprisingly continued their volatile ride throughout March with the US S&P 500 index falling into bear market territory for the first time since the GFC in 2007-2008. All major markets fell, with the biggest falls across Europe, led by the CAC 40 (France) -17.2%, the DAX (Germany) -16.4% and the FT 100 (UK), -12.9%. Of the peripheral, countries that have been deeply impacted by the spread of the COVID-19 pandemic, Italy and Spain, posted index returns of -22.5% and -21.9% respectively.

For now it appears much more likely that the current market crisis could be protracted and therefore have a much more profound impact on global economic activity given the expected contraction in global demand and sustained disruptions to global supply chains. Since global growth was expected to average approximately 3% before the COVID-19 outbreak, it is reasonable to assume global economic growth in 2020 will now fall below 2%. Consequently, the risk to financial markets remains to the downside whilst the market awaits the impact of the historically unseen in size and nature monetary and fiscal policies from the governments and central banks across the globe.

Chart 5: Major Market Indices (rebased to 100)



Source: BTIS/Bloomberg

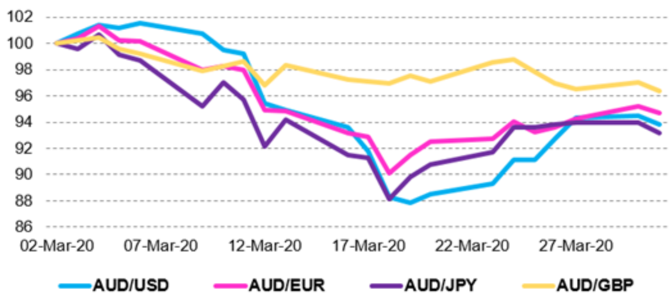
Fixed interest

The stress in global Fixed Interest markets intensified over the month, with market participants shutting primary issuance and driving sell-offs in the bonds particularly of retailers and energy producers. Markets followed the tumble in global stocks with the investment-grade credit option adjusted spreads (OAS) widening from ~100bps to well over 300bps.

The high yield Credit Default Swaps (CDX) plugged to their lowest levels since the GFC, with spreads reaching well in excess of 1000bps. Due to impaired liquidity and market functioning, prices everywhere were no longer about fundamentals or valuation. They were instead being driven by forced risk reduction, margin calls, redemptions, deleveraging and portfolio rebalancing. Defaults at this stage have not materially increased as of yet but we do expect to see a spike in the coming months, specifically in the high yield and the leverage loan market.

Closer to home, the treasury spread between US and Australian 10-year bond yields contracted from -34bps to +8bps as the Australian yield fell much less than its US counterpart.

Chart 6: Major Currencies (rebased to 100)



Source: BTIS/Bloomberg

Currencies

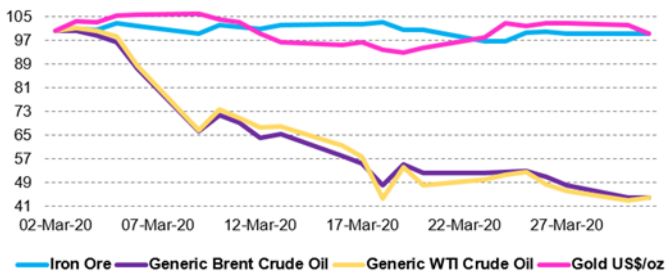
The AUD was caught up in the panic selling on share markets that consequently spread to foreign exchange markets. Under significant pressure over March, the Australian Dollar fell to its lowest level since October 2002 when it hit 55.08 US cents. By close of the month, the dollar had rallied back to US62 cents, however analysts expect selling pressure will return as the trade outlook deteriorates as a direct result on COVID-19. We have now seen the AUD fall 14% against the USD since the start of the year.

Commodities

Oil was again in the spotlight this month following the Saudi – Russia 'price war' that increased supply at a time when demand is supress as the world deals with COVID-19. The result was oil experiencing the biggest one day crash since the 1991 Gulf War, which has seen The Brent Crude fall from US$50.50 a barrel at the start of the month, to US$22.74 by month end.

Over the month we saw Gold fall -0.54%, a surprise being the market conditions at present given many see this as a safe haven asset. However good signs were Iron Ore lifting 2.33%, following is fall of 10.3% last month. Overall the global Bloomberg Commodities Index fell -12.85% adding to the fall over February of -5.15% - an indicator of the overall supply chain disruptions occurring owing to the current market environment.

Chart 7: Major Commodities (rebased to 100)



Source: BTIS/Bloomberg