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Market Review – January 2020

Australian Economy

Two major unexpected events are expected to have implications on the Australian economy; firstly 7 million hectares of bush destroyed, more than 25 deaths, significant loss of livestock etc. In the short term there will be negative impact on the domestic economy as the following activities will be impacted; farming, manufacturing, transport, tourism and business generally. Economists estimate a detraction from GDP due to the bushfires of around 0.4% starting in the December quarter but mainly impacting the March quarter before stabilising and then moving into the rebuilding phase. The rebuilding phase should reverse much of the drag on the economy and potentially put additional pressure on the RBA to cut interest rates and also on the Federal Government to speed up the introduction of fiscal stimulus in the form of personal tax cuts.

The escalating concern that a new coronavirus originating from the Chinese city of Wuhan in Hubei province will become a global pandemic is expected to have in the short term a negative impact on the Australian economy. However, based on history most pandemics have taken 6-18 months to run their course and peter out as measures are taken to slow their spread through hygiene, quarantining, preventing travel etc. Given Australia's reliance on China, commodity prices are down, along with the Australian dollar and the number of expected tourists. However, barring a global pandemic, based on experience with SARS, bird flu, swine flu and Ebola, in the short term, share markets and bond yields will fall in response to negative news but rebound once it is clear the pandemic is, under control.

Bulk commodity prices were mixed in January. Iron ore fell $7.06/t to $84.94/t, but both thermal and metallurgical coal prices rose modestly. Brent crude declined $7.84/bbl to $58.16/bbl, the lowest in over a year. Gold prices rose $69.45/oz to $1,584.20/oz, near the highest since 2013.

The USD rose 1.0% m/m in January. All G10 currencies fell against the USD. The Australian Dollar (-4.8%) and New Zealand Dollar (-4.1%) were the worst performing currencies, while the Swiss Franc (-0.2%), Japanese Yen (-0.4%) and British Pound (-0.5%) were the best performing currencies.

Global Economy

Following a stellar 2019, global equity markets began the new decade in a similarly buoyant fashion. The first half of January saw the US and China reaching 'Phase One' of an economic and trade agreement, which provided some much-needed assurance to market participants following months of uncertainty. However, this initial optimism was eventually dampened by a 'black swan' event nobody saw coming: the outbreak of the novel coronavirus that swiftly spread from China to other regions of the world.

China's attempt to contain the virus has led to an unprecedented disruption to its economy, with lockdowns imposed on various cities, while a mixture of travel restrictions, quarantine measures and sheer fear have left bustling cities such as Shanghai unusually quiet. Given China's position within the global supply chain, it is evident that – just as the virus itself – the economic disruption has the potential to spill over to the rest of the world.

As sentiment turned during the month, market participants flocked towards perceived 'safe-havens'. Government and investment grade corporate bonds performed well in this market environment, alongside gold and currencies such as the US dollar and the Japanese yen. Meanwhile, the US equity market maintained its lead against other major equity markets in what was a volatile month for equities.

US: Economic data remained broadly stable. The unemployment rate remains at a 50-year low of 3.5%, but muted wage growth has kept inflation under control. This gave the Federal Reserve the flexibility to leave monetary policy unchanged, although it adjusted its description of household spending growth to "moderate" rather than "strong". Q4 GDP was in line with expectations, growing at 2.1% quarter-on-quarter (annualised).

The US economy expanded at a 2.1% annualised rate in the fourth quarter of 2019. While a smaller trade deficit and increased home construction provided support, business investment continued to deteriorate. Meanwhile, the car workers' strike at General Motors was a drag on the economy.

In the second half of the month, however, mounting fears over the spread of coronavirus, in China and beyond, erased the early stock market progress. The Trump administration has imposed a temporary travel ban upon non-US citizens travelling to the US from China. Investor concerns over disrupted supply chains and weakened demand led to fears that growth could slow.

UK and Europe: The UK equity market reversed its post-election gains, puncturing the 'Boris Bounce' to end January in negative territory. Sterling strengthened on the day that Britain left the EU, while oil and metal prices came under pressure after the first cases of the coronavirus were confirmed in the UK.

Meanwhile, the Bank of England (BoE) held off from an interest rate cut despite a surge in expectations that it would reduce rates for the first time in four years. In Mark Carney's last interest rate decision as Bank governor, the monetary policy committee (MPC) voted 7-2 to keep the main rate at 0.75%. The MPC decided the improvement in business sentiment since the general election made an immediate cut unnecessary.

European markets started off the month well, buoyed by positive economic data releases and the signing of the Phase One trade deal between the US and China. However, increasingly negative news flow from China about the spread and severity of the coronavirus led to a large sell-off across European (and global) stock markets.

In economic news, the euro zone grew by 0.1% in the fourth quarter of 2019, coming in below expectations of around 0.2%. France and Italy, the second and third largest members of the bloc, were both major drags to the figure. Meanwhile, most other countries, including Spain, Belgium and Austria continued to expand robustly.

China: China's fourth quarter GDP growth came in at 6.0% (year-on-year) resulting in the full-year 2019 growth figure meeting market expectations. At the same time, monthly data for December showed a broad improvement across industrial production, exports and retail sales.

Emerging Markets: Buoyed by encouraging economic data and the signing of the Phase One trade deal between the US and China, global emerging equity markets started the year in good spirits. However, sentiment soon turned sour following the outbreak of the coronavirus in Wuhan, China.

In conclusion: China makes up around 16% of the global economy (compared to 4% in 2003 during SARS) and the estimated detraction as a result of coronavirus to the global growth in the March quarter is expected to be 0.3%. However, this negative impact on Australia could well be reversed by the end of 2020 due to Australians deciding to holiday at home, low A$ and decrease in goods and services imported. Even though coronavirus originated in China, the world's largest growth engine, data shows that economic activity that is lost during a viral outbreak is largely recouped once it is contained.

Table 1: Market Performance – Periods to 31 January 2020

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	5.0	6.1	24.7	12.4	9.3
Australian Shares Small Cap	3.4	4.7	18.8	12.1	11.2
International Shares Ex-Aus (Unhedged)	4.4	8.4	28.3	16.3	12.4
International Shares Ex-Aus (Hedged)	-0.4	5.2	18.3	11.2	9.3
Emerging Markets (Hedged)	-3.3	2.9	6.5	8.8	6.4
Emerging Markets (Unhedged)	0.1	5.3	13.1	12.5	7.7
Australian Listed Property	6.4	4.0	19.6	13.2	10.7
International Listed Property ($A)	6.0	3.2	17.4	12.6	8.0
Australian Direct Property*	0.4	0.0	3.4	9.6	11.3
Australian Fixed Interest	2.3	1.5	9.1	5.7	4.3
International Fixed Interest (Hedged)	2.0	1.2	8.0	4.8	4.1
Cash (BAUBIL)	0.1	0.2	1.4	1.7	1.9
		Change over the month			
Australian Govt. 10 yr Bond Yield	0.97%	-42 bps			
AUD/USD	$0.67	-$0.03			

*as at 31 December 2019

Australian Shares (S&P/ASX 200 Accumulation Index)

The S&P/ASX 200 Accumulation Index rose a healthy +5.0% in January with the gain over the year a substantial +24.7%.

Large cap stocks (S&P/ASX 20 Accum Index +5.7%) outperformed the mid-cap stocks (S&P/ASX MidCap 50 Accum Index +4.7%) and small cap stocks (S%P/ASX Small Ords Accum Index +3.4%).

The best performing sectors in the S&P/ASX200 Accumulation Index for the month were Health Care (+12.0%) led by CSL, Information Technology (+11.1%), Telecom (+9.0%) and Consumer Staples (+8.2%) thanks to Woolworths and Coles as German retailer Kaufland is pulling out of Australia. The worst performing sectors included Utilities (+0.6%) and Energy (+0.7%).

Some of the best performing stocks over the month were: Magellan (+18%), Orocobre (+18%), James Hardie (+14%), CSL (13%). Treasury Wines fell (-20.0%) after a surprise earnings downgrade.

The index finished trading at a P/BV of 2.1x and a P/E Ratio of 19.2x and equity yield (dividend) of 3.8%.

The VIX was at 14.9 (the average since 01.10.2010 is 16.4) indicating below average level of market volatility.

Australian Shares Small Cap (S&P/ASX Small Ordinaries Index)

As a collective, Australian small caps (stocks 101-300 in the ASX) benefit from low interest rates, a low currency and availability of equity capital. Add a modest improvement in demand (high employment and some wage inflation) and there is reason to expect continued growth.

The Small Ords Accumulation index rose +3.4% in January. Industrials outpaced resources and large caps performed better than smalls.

With the evidence rising about the scale of the coronavirus, gold started to move up in the back half of the month lifting the sector. Gold stocks rose such as; Silver Lake Resources (+21.3%) and Saracen Mineral Holdings (+19.3%). Other strong performing stocks included EML Payments (+15.9%) and Credit Corp Group (+14.9%) on improved interim profit results. China exposed companies such as Webjet, IDP Education and Corporate Travel had a challenging month.

Trailing P/E Ratio was at 20.3x at the end of the month, P/BV is at 2.1x and equity yield (dividend) of 2.9%.

International Shares (MSCI World ex Australia Index, Net AUD and the MSCI World ex Australia Index, Net LCL)

The MSCI World ex Australia Index (Unhedged) +4.4% for January whilst the MSCI World ex Australia Index (Hedged) returned -0.4%.

Global share markets began the year and new decade in a positive fashion with hopes that a US China Phase One trade deal could lead to stronger growth for major economies. But that optimism was dented from 20th January as investors monitored the spread of the coronavirus.

Overall in January, the US Dow Jones fell by -1.0% but the S&P 500 lost only -0.2% and the Nasdaq actually rose by +1.99%. In Europe, the German Dax index fell by -2.0%, and the UK FTSE lost -3.4%. In Asia, Japan's Nilkkei lost -1.9%, but the S&P/ASX 200 outperformed, up by +5.0% in the month – the beat January gain in eight years.

The broader index ended trading at a forward P/E Ratio of 19.8x and P/BV of 2.5x and equity yield (dividend) 2.3%.

US market: US stock prices were mixed in January as prices surged, thanks to economic news, only to retreat sharply in the second half due to concerns of the potential economic impact of the coronavirus.

In local currency terms the Dow Jones Industrial Average dropped 1%, while the S&P 500 Index lost nearly 0.2%. The NASDAQ Composite, however, managed to post a gain of 1.99%.

On the first day of trading in the new year, the major indices posted record high. Those gains were erased on fears of a potential military conflict following American drone strike that killed Iran's top general.

UK market: UK equities fell over the period. The end of January marked the UK's official departure from the EU and its entry into a transition period. Sterling was volatile, recovering sharply towards month-end after the Bank of England (BoE) kept interest rates unchanged, confounding market expectations which had predicted a cut. The Monetary Policy Committee voted to hold rates steady as indicators of future activity started to recover following the decisive general election outcome in December.

European markets: Eurozone equities had a weak start to the year amid fears over the potential impact of the coronavirus on global economic activity. The MSCI EMU, an index of large eurozone companies, returned -1.7% in January. The flash GDP estimate for Q4 2019 showed growth of just 0.1% quarter-on-quarter in the eurozone, down from 0.3% growth in the previous quarter.

Chinese market: The coronavirus in China increased concerns over global growth. The Chinese authorities responded by imposing travel restrictions and cancelling Lunar New Year events. As the outbreak escalated, the re-opening of factories after the new year holiday was delayed., China slightly underperformed the broader EM index, although the mainland markets were closed for the new year holiday from 24 January to month end. also underperformed.

Emerging markets: Emerging market (EM) equities lost value in January in local currency terms, as the outbreak of the coronavirus in China increased concerns over global growth. South Korea, Thailand and the Philippines, also underperformed.

By contrast, Turkey recorded a positive return and outperformed as the central bank cut its headline interest rate by 75bps, more than expected, to 11.25%. Egypt was the best-performing market in the index, supported in part by currency strength. The central bank left its key interest rate unchanged, against expectations for a 50bps cut.

Emerging Markets Shares (MSCI Emerging Markets Index, Net AUD)

Emerging market (EM) equities, in local currency terms, lost value in January (-3.3%), as the outbreak of the coronavirus in China increased concerns over global growth but returned +0.1% in AUD.

Given the negative implications for Chinese economic growth, global commodity prices came under pressure. Against this backdrop, Brazil, Chile, Colombia and South Africa all underperformed, with currency weakness amplifying negative returns. In South Africa, the central bank unexpectedly cut its headline interest rate by 25bps, amid ongoing weakness in economic growth.

The index ended trading at a forward P/E Ratio of 13.8x and P/BV of 1.8x and equity yield (dividend) 2.7%.

Australian Listed Property (S&P/ASX 200 A-REIT Accumulation Index)

The S&P/ASX 200 Property Accumulation index returned +6.4% in January, outperforming the S&P/ASX 200, which returned +5.0%.

S&P/ASX Industrial AREITs returned +11.2% in January, S&P/ASX Office AREITs returned +7.6%, S&P/ASX Diversified AREITs returned +7.6% and S&P/ASX Retail AREITs returned +1.5%. Key outperformers were NSR (+17.2%), CHC (+16.1%) and GMG (+11.4%). Key underperformers were URW (-8.4%), SCG (+0.8%) and VCX (+2.0%). For the past 12 months rolling, the top-performing AREITs have been CHC (+61.1%) and MGR (+47.2%).

At the end of January, the index was trading on a dividend yield of 4.2% with a P/BV 1.4x and a P/E Ratio 14.4x.

International Listed Property (FTSE EPRA/NAREIT Developed ex-Australia Index, AUD)

Globally, REITs returned -0.2% over the month of January in USD terms and a healthy +6.4% in AUD. Japan was the top-performing region (+3.9%). The worst-performing region over the month was Hong Kong (-7.3%).

At the end of January, the index was trading on a dividend yield of 3.7% with a P/B 1.8x and a P/E Ratio 21.8x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted a flat return over the December 2019 quarter. Capitalisation rates across property sectors continued to trend downwards. Cap rates across office, industrial and retail properties range are 5.0%, 5.3% and 5.0% respectively.

Australian Fixed Interest (Bloomberg AusBond Composite Bond Index)

Australian fixed interest returned +2.32% over the month. Australian government 10-year bond yields fell by 42bps to 0.97%. At this point, the 10-year Australian bonds yield was 53bps (same as Dec) below the US 10-year Treasury yield while 3-year single A corporate credit spreads tightened from 0.76% to 0.75%.

International Fixed Interest (Barclays Global Aggregate TR Bond Index, Hedged to AUD)

Government yields declined in January (meaning prices rose) as investors sought lower risk assets amid an outbreak of coronavirus in China and uncertainty as to the potential economic impact. The Federal Reserve (Fed) and Bank of England (BoE) left policy rates unchanged.

International fixed interest returned 1.97% over the month (in AUD, Bloomberg Barclays). The 10-year US government bond yield fell by 42bps to 1.50% while the US corporate investment-grade credit spread widened from 1.30% to 1.39%.

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