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Market Review – February 2020

Australian Economy

The Australian economy looks to have been soft in the December quarter even before the intensification of the bushfires and coronavirus hit in the current quarter. Construction data showed another sharp fall in housing investment and non-residential construction in the December quarter with the latter resulting in another sharp fall in business investment. While business investment plans for 2020-21 are up 8.8% on plans made a year ago it is narrowly based on a big lift in mining investment with non-mining investment set to remain weak.

Meanwhile, credit growth remained weak in January at 2.5% year-on-year, but it did edge up from a near ten year low of 2.4% helped by a pick-up in business lending and monthly growth in housing credit is holding above its lows but remains weak as the rapid rate of debt paydowns continues to offset growth in new loans.

The December half profit reporting season is now wrapped up and while better than feared it was a bit mixed and the share market reaction in the last week was overwhelmed by global coronavirus concerns. The good news was that more companies saw profits rise than fall, dividends are strong, guidance was generally good and consensus expectations remain for modest profit growth this year.

Commodities were firmly lower as concerns over global economic growth continued to mount. The energy component was the main contributor to negative returns. Brent crude oil posted a double-digit decline as the demand outlook further deteriorated. In agricultural commodities, cotton recorded the largest decline. Precious metals also lost value, with gold and silver both moving lower. Industrial metals posted a more modest decline. Zinc and nickel were notably weak, but copper recorded a small gain, following a sharp sell-off in January.

Global Economy

Concerns over the spread of coronavirus and its potential impact on global growth dominated financial markets in February. Equity markets fell sharply, and government bond yields were broadly lower (meaning prices rose).

Financial markets are now expecting central banks to respond aggressively to the economic impacts of the virus by reducing policy rates, even as doubts emerge as to effectiveness of monetary policy.

- Pressure has been placed on the US Federal Reserve (the Fed) to act quickly. In an unusual move, Chairman Powell issued a press statement on 28 February stating that while it was too early to gauge the full impact of the coronavirus, the Fed was closely monitoring developments and would use its “tools to act as appropriate to support the economy”. Financial markets are now pricing in a rate cut at the FOMC March meeting.
- Following record low manufacturing data (which was lower than during the GFC) for Australia’s largest trading partner, China, and after the Reserve Bank of Australia (RBA) previously cited global developments as an “important driver” of policy outcomes, the RBA lowered the official cash rate in early March.

- Meanwhile, the European Central Bank has also said it is prepared to cut rates if necessary, in addition to the economic support package announced by the Italian government in response to the virus.

US: Employment data in particular was strong. Non-farm payrolls, which measure job creation outside the farming sector, showed that 225K jobs were created in January and wages edged up 0.1% (year-on-year) to 3.1%. US unemployment did tick up from 3.5% to 3.6% but remained near a 50-year low. The increase was due in part to a pick-up in the labour participation rate from 63.2% to 63.4%.

Even so, concern over supply chain disruption and economic growth sent shares lower by month end. Amid a broad market sell-off, all areas of the market were lower, with energy and financials among the hardest hit. Utilities – traditionally more defensive – also struggled. Real estate and healthcare suffered less dramatic declines but still fell.

UK and Europe: The latest round of economic data and indicators of future UK economic activity pointed to ongoing recovery following the decisive general election result in December 2019. The latest monthly GDP data revealed the economy grew by 0.3% in December, suggesting a recovery in activity post the election, up from -0.3% month-on-month in November. The Office for National Statistics (ONS) also reported that UK retail sale volumes had increased by 0.9% in January, bouncing back from falls in the previous two months.

The preliminary estimate of the IHS Markit/CIPS composite purchasing managers' index (PMI) for February was unchanged from January's reading of 53.3, holding above the 50 mark. The PMI is a survey of companies in the manufacturing and services sectors; a reading above 50 indicates expansion. A number of other forward-looking surveys also pointed to further improvement in business and consumer confidence as well as better sentiment in the UK residential housing market. It is worth noting that these forward-looking indicators published in February were based on surveys conducted before the global coronavirus crisis escalated.

Eurozone equities experienced a sharp fall in February with coronavirus worries weighing on shares. The MSCI EMU Index of large eurozone companies returned -7.9%. There were concerns that the coronavirus and its impact on travel and business activity could send the fragile eurozone economy into recession. Data showed the eurozone economy grew by just 0.1% in Q4 2019 with zero growth in Germany.

In response to the coronavirus worries, European Central Bank President Christine Lagarde said the central bank is monitoring the situation. She added that the crisis is not so far having a lasting impact on inflation and so does not require a central bank response as yet. In early March, the Italian government announced a €3.6 billion stimulus package to mitigate the impact of the outbreak.

China: China recorded a modest gain as coronavirus infection rates in the mainland appeared to stabilise and some activity indicators started to improve. Taiwan, where the spread of the new coronavirus has so far been more limited, and Egypt were the only other countries to outperform.

Emerging Markets: Emerging market equities fell in February as coronavirus concerns put shares under pressure. US dollar strength was also a headwind to returns. The MSCI Emerging Markets (EM) Index decreased in value but outperformed the MSCI World

In conclusion: News on the coronavirus outbreak will no doubt continue to dominate in the weeks ahead as investors attempt to assess whether the number of new cases has actually peaked as data is suggesting and how bad the hit to economic activity will be. For market sentiment to improve there needs to be evidence that the outbreak is coming under control or will have a limited economic impact. At this point this is still lacking. Policy stimulus and support for badly hit businesses (to prevent insolvency) is necessary to minimise the economic fallout and super charge the eventual recovery.

Table 1: Market Performance – Periods to 29 February 2020

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	-7.7	-5.2	8.6	8.6	6.2
Australian Shares Small Cap	-8.7	-5.9	1.6	8.3	7.4
International Shares Ex-Aus (Unhedged)	-4.9	-1.6	15.6	13.9	10.2
International Shares Ex-Aus (Hedged)	-8.1	-6.3	5.3	7.0	6.3
Emerging Markets (Hedged)	-3.8	-1.7	1.3	6.8	4.9
Emerging Markets (Unhedged)	-1.6	1.8	8.3	11.2	6.8
Australian Listed Property	-4.9	-3.3	11.8	9.9	8.8
International Listed Property ($A)	-4.6	-2.1	9.4	10.3	7.2
Australian Direct Property*	0.4	0.0	3.4	9.6	11.3
Australian Fixed Interest	0.9	1.5	9.0	6.0	4.4
International Fixed Interest (Hedged)	1.2	2.8	9.2	4.9	4.4
Cash (BAUBIL)	0.1	0.2	1.3	1.7	1.8
		Change over the month			
Australian Govt. 10 yr Bond Yield	0.81%	-17 bps			
AUD/USD	$0.65	-$0.02			

*as at 31 December 2019

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

The S&P/ASX 200 Accumulation Index declined–7.7% in February but still returned +8.6% for the 12 months. For the first three weeks of the month investors seemed confident that the supply side disruptions caused in China by COVID-19 would be localised. But in the final week of the month it became evident that containment of the virus had failed in South Korea, Iran and Italy. Investors anticipated a major demand shock and global markets plunged.

Large cap stocks (S&P/ASX 20 Accum Index -6.3%) outperformed the mid-cap stocks (S&P/ASX MidCap 50 Accum Index -9.7%) and small cap stocks (S%P/ASX Small Ords Accum Index -8.7%).

In this sell-off the best performing sectors in the S&P/ASX200 Accumulation Index for the month were Utilities(-3.6%) led by Telstra, Health Care (-3.7%). The worst performing sectors included Information Technology (-17.3%) and Energy (-17.2%).

Some of the best performing stocks over the month were the gold miners: Evolution (+10.8%) and Northern Star (+6.8%) as well as retirement operator Ingenia Communities (+5.6%).

The index finished trading at a P/BV of 2.1x and a P/E Ratio of 17.6x and equity yield (dividend) of 4.3%.

The VIX was at 15.9 (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)

The Small Ords Accumulation index fell -8.7% in February as panic selling set in all markets globally due to fears of the coronavirus spreading. The steep selloff occurred almost entirely in the last week of the month, making it the worst week since the GFC.

Key detractors over the month was payment solutions provider EML Payments (-31.2%) and utilities services company Service Stream (-20.2%). Other stocks that retreated during the month were telco Over the Wire Holding (-37.9%) and consumer lending company Wisr (-35.8%).

As in January, China exposed companies such as Webjet, IDP Education and Corporate Travel had another challenging month.

Trailing P/E Ratio was at 18.0x at the end of the month, P/BV is at 1.9x and equity yield (dividend) of 3.3%.

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) -4.9% for February whilst the MSCI World ex Australia Index (Hedged) returned -8.1%.

In February, the US Dow Jones fell by -10.0% while the S&P 500 lost only -8.4% and the declined -6.3%. The FTSE fell nearly -10%. Shanghai did well, falling only -3.3% but has lagged global markets for some time.

The broader index ended trading at a forward P/E Ratio of 17.9x and P/BV of 2.2x and equity yield (dividend) 2.5%.

US market: Coronavirus fears sent stocks into correction territory in February, as investors grappled with the unfolding story.

The Dow Jones Industrial Average lost -10.0%, while the Standard & Poor's 500 Index dropped -8.4%. The NASDAQ Composite fell -6.4%.

No industry sector escaped the sell-off in February, with losses in Communication Services (-7.7%), Consumer Discretionary (-6.0%), Consumer Staples (-6.7%), Energy (-17.7%), Financials (-8.7%), Health Care (-7.7%), Industrials (-9.2%), Materials (-8.8%), Real Estate (-5.3%), Technology (-7.8%), and Utilities (-5.7%).

UK market: At the end of the month, the UK equity market saw its sharpest weekly fall since the financial crisis in 2008, as fears rose that coronavirus could pose a serious challenge to economic growth.

It was a dramatic shift in sentiment from earlier in the month when there were encouraging signs about the direction of the UK economy and strong grounds for optimism, although clearly risks remained.

It was reported that UK real GDP growth (inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year) was close to 1.5% in 2019. This was similar to 2018 and higher than in most of the other major European economies. Evidence from an increasing number of sources had pointed to a pick-up in economic activity in the early part of 2020.

European markets: European equities fell sharply over the month as news emerged that the spread of the coronavirus was accelerating outside of China. It was the sudden surge of cases in Italy, which eventually resulted in entire towns being locked down, that spooked investors and led to frenzied selling in equities and a rally in the German Bund (viewed as a 'safe haven' asset).

Chinese market: Asian equity markets were generally weak over the month as the spread of the coronavirus outside China accelerated, raising concerns over the potential impact on global economic growth.

However, China's equity market proved surprisingly resilient and was the only market in the region to end February with a positive return, as reported cases of the virus peaked on the mainland.

Emerging markets: In a volatile month for emerging equity markets, initial gains were soon wiped out by concerns of a global growth slowdown as fears grew that the coronavirus could be more widespread than first thought.

All equity markets in the EMEA (Europe, Middle East and Africa) region lost ground with Greece, Poland and Turkey performing the worst. Due to expectations of weaker demand, the slump in oil prices (Brent crude oil fell 13.1%) had a negative impact on Russian equities, particularly energy stocks.

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

Emerging market (EM) equities, in local currency terms, declined in February (-3.8%), as the outbreak of the coronavirus in China spread but returned -1.6% in AUD.

While all regions in emerging equity markets fell in value, losses in Asia were less pronounced due to the outperformance of China. The latter was the only country to record a gain last month despite being the epicentre of the virus (formally known as Covid-19).

The index ended trading at a forward P/E Ratio of 13.4x and P/BV of 1.7x and equity yield (dividend) 2.9%.

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

The S&P/ASX 200 Property Accumulation index returned -4.9% in February, outperforming the S&P/ASX 200, which returned -7.7%.

S&P/ASX Industrial AREITs returned +0.5% in February, S&P/ASX Office AREITs returned -4.3%, S&P/ASX Diversified AREITs returned -5.5% and S&P/ASX Retail AREITs returned -8.0%. The best A-REIT performers over the month were Ingenia Communities (INA) at +5.5% and Shopping Centres Australia (SCP) at +4.2%. Key underperformers were Vicinity Centres (VCX) at -15.0% and Unibail Rodamco (URW) at -10.8%.

At the end of January, the index was trading on a dividend yield of 4.6% with a P/BV 1.2x and a P/E Ratio 13.8x.

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

Globally, REITs returned -7.5% over the month of February in USD terms. Hong Kong was the top-performing region (-6.4%). The worst performing region over the month was the UK (-11.5%).

At the end of January, the index was trading on a dividend yield of 4.0% with a P/B 1.6x and a P/E Ratio 20.3x.

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 +0.86% over the month. Australian government 10-year bond yields fell by 16bps to 0.81%. At this point, the 10-year Australian bonds yield was 34bps below the US 10-year Treasury yield while 3-year “single A” corporate credit spreads widened from 0.75% to 0.78%.

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

Global bonds collapsed in February, with US 10-year bond yields down 37 basis points to 1.14% The sharp drop in bond yields was driven by global growth fears emanating from coronavirus.

International fixed interest returned 1.24% over the month (in AUD, Bloomberg Barclays). The 10-year US government bond yield fell by 35bps to 1.15% while the US corporate investment-grade credit spread widened from 1.39% to 1.64%.

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