ATCHISON
CONSULTANTS

Market Review – March 2020

“Lowlights” in March

- Coronavirus dominated the financial market landscape in March, returns across all asset classes were heavily impacted with extreme volatility
- Central banks cut rates, turned liquidity on and started Quantitative Easing
- Credit spreads have broadened to levels unseen since the 2008 financial crisis
- The bond index was positive, but the sectors mixed
- The AUD declined by 4% on a trade weighted basis in March, to hit its lowest level since 2002
- Australian equities post the largest decline since December 1987
- In Australia, dwelling prices rose 0.7% across the eight capital cities in March

Australian Economy

The world has never been as globalised and interconnected as it is today, so when a pandemic such as COVID-19 hits, it’s an enormous challenge to contain. Government and health policymakers are attempting to stage the human impact by reducing the peak of the virus through ‘social distancing’ and limiting exposure.

From an economic standpoint, this causes a simultaneous demand AND supply shock, so rather than an economic slowdown, we are seeing an economic ‘stop’ in activity in some sectors.

Governments and central banks are scrambling to curtail the economic impact. This crisis is very different to any previous crisis, requiring innovative policy action to fill the short but very sharp contraction in economic growth that nations are about to face.

It’s almost inevitable that Australia as well as other economies around the world will undergo a short, sharp recession, albeit a technical one. In Australia’s case, the first quarter GDP was already reeling from bushfire events and the addition of the sudden economic ‘stop’ means Q2 2020 will likely also be a negative quarter of GDP growth.

The Australian Government have been forced to throw out the fiscal and economic responsible policies that have been in place for the past 40 years.

The Reserve Bank of Australia (RBA) cut interest rates twice in March. First a regular 25 basis point (bp) cut to 0.5%, followed by a mid-month extra-ordinary meeting where the RBA cut by a further 25bp to the effective lower bound of 0.25%.

Over the past 40 years the Australian government has tried to put in place policies that keep it out of the way of the market economy. Creating an Australia that is in budget surplus, has open trade, an industrial landscape that is evolving in a global perspective and supply chains that are economically efficient and "just in time" has been its objective.

In the space of 4 weeks, the rule book for the Australian government has changed. The extent of this change is enormous, as it tries to keep the economy from completely grinding to a halt. The billions of dollars stimulus put forward should go some way to assisting all of us in this most extreme situation, but whether the hibernation is 6 months before some semblance of normality returns or longer is a question no one honestly can answer. The real scary thought, is when we eventually do return to an even keel, from both a social and economic perspective, is how will we pay for it?

However, with the right policies, a peaking in the COVID-19 pandemic around mid-year and with a little bit of luck, we could see the Australian economy rebound towards the latter part of the year, with momentum picking up further through 2021. Critical ingredients for this statement to hold true are the effectiveness of governments' response to flattening infection rates, very targeted liquidity measures by central banks to restore orderly markets and highly targeted and timely fiscal measures that provide a backstop for small to medium enterprises (SMEs) and employees.

Global Economy

Central banks around the world have acted swiftly to implement emergency monetary policy easing, with most getting to their lower bounds in terms of cash rates. They fully recognise that the transmission mechanism of these actions is not through an increase in consumption or economic activity in the very near-term. Rather, it is designed to assist in arresting an already significant market deterioration from getting worse.

Central bank policy is now shifting swiftly from lowering official rates towards providing liquidity to market participants and the broader financial system. This will be a critical factor in how markets behave from here on. We are likely to see more central bank intervention around providing various forms of liquidity.

To summarise action to-date, the US has cut the Fed funds rate by a cumulative 150bps, taking their benchmark interest rate down to 0-0.25%. This brings them in line with numerous other central banks at or heading towards similar levels including, the Bank of England, the Reserve Bank of New Zealand, the Bank of Japan, the Bank of Canada and the European Central Bank (ECB).

Central banks have an acute awareness of liquidity in the post-GFC era where intermediaries such as banks typically have much smaller capacity or inventory on balance sheets. Banks' ability to broker for the investment community has drastically diminished and is an unfortunate side effect of the post-GFC era regulations that came into effect for banks and their trading activities. These developments, coupled with an exogenous shock, are almost the perfect storm that central banks and regulators had feared. It is fair to say that a major contributing factor of the veracity of the market sell-off, in particular risk assets such as corporate debt, has been lacklustre liquidity and poor price discovery.

One of the biggest risks that market participants are facing at present is a liquidity freeze, largely because the banks are not there to provide pricing and liquidity. That's not to say there isn't a weight of money waiting to invest and wanting to buy.

Central banks cognisant of this dynamic are looking for ways to provide much needed liquidity facilities. A number of new categories of securities have become repo eligible, meaning investors can actually sell them to the RBA and purchase back at a later date to access near-term funding. It should be expected that broader liquidity-focused measures to be announced in the coming days and weeks. While liquidity is problematic, central banks are going to be pumping a lot of liquidity into the system. It wouldn't surprise if in the coming month or two the RBA starts acting more like other central banks, such as the ECB previously. Taking an extreme example, the Bank of Japan as part of its remit can even buy equities. The point here is that central banks, including the RBA will need to be innovative and stand ready to act in order to support liquidity. This is the most important tool for the weeks and months ahead where cash rate settings are a secondary consideration.

Currencies

The USD appreciated 1.2% m/m in March. The defensive Swiss Franc (+0.4%), Japanese Yen (+0.3%) and Danish Krone (+0.1%) were the best-performing currencies, while the commodity-driven Norwegian Krone (-9.7%), Australian Dollar (-5.8%) and Canadian Dollar (-4.7%) were the worst performers.

Commodities

Bulk commodity prices were mixed in March. Brent crude declined $27.78/bbl to $22.74/bbl, the lowest in 17 years. Among the bulks, iron ore decreased $0.50/t to $84.00/t, thermal coal prices were largely unchanged, but hard coking coal prices fell sharply. Gold prices were volatile during March, at one point rising to the highest since 2013, before ending the month down $0.90/oz to $1,608.95/oz.

US: With concerns mounting over a global slowdown and the negative impact it could have on US corporate earnings - Goldman Sachs now sees no ‘earnings growth’ for US companies this year - US equity markets ended the month with their worst weekly decline since the Global Financial Crisis in 2008.

With market volatility rising, investors instead opted for perceived ‘safe havens’ such as government bonds, gold and the Japanese yen. With the ten-year US Treasury yield falling to a new low of 1.15%, hopes that US interest rates would be lowered were bolstered by a statement from the US Federal Reserve chair, Jerome Powell.

UK and Europe: Incumbent Bank of England governor Mark Carney has said that coronavirus will hit the UK economy in the months ahead, raising expectations of an interest rate cut and increasing the chances of a difficult economic forecast for the chancellor in the upcoming Budget on 11 March.

Mr Carney suggested that forecasts for the economy would need to be downgraded as the disruption caused by the coronavirus undermines the prospects for a meaningful economic rebound following Boris Johnson’s decisive election victory in December.

Christine Lagarde, President of the European Central Bank (ECB), released a statement that they are “closely monitoring developments and their implications for the economy” and “stand ready to take appropriate and targeted measures, as necessary and commensurate with the underlying risks".

The main problem that the ECB faces is that they have already largely exhausted the monetary policy toolkit. Although interest rates can theoretically be cut even further, the extra boost it provides to the economy is unlikely to be impactful.

China: Travel restrictions, business shutdowns and general anxiety over the epidemic are expected to see a severe contraction in China’s 1Q GDP. However, equity market performance appears to be reflecting expectations that pent-up domestic demand will recover strongly in 2Q with the support of targeted government stimulus if need be.

Emerging Markets: 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 in February despite being the epicentre of the virus (formally known as Covid-19).

The outbreak of new virus cases being reported in Korea had a negative impact on local equities. However, weakness in Thailand and Malaysia – both popular tourist destinations – was also exacerbated by political uncertainties; Thailand’s Constitutional Court ruled to disband the Future Forward Party, the third largest political party with 76 seats; and Malaysia’s prime minister, Mahathir Mohamad, resigned.

In conclusion: We realise that it is almost impossible to turn away from the noise when it feels like the world is crashing down around you, but it is important to rationally put markets into perspective. Far more importantly though, we wish the very best to our clients, readers and your families at what is an exceptionally challenging time for many families across the globe.

Please stay safe and focussed on the long term.

Table 1: Market Performance – Periods to 31 March 2020

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	-20.7	-23.1	-14.4	-0.6	1.4
Australian Shares Small Cap	-22.4	-26.7	-21.0	-1.3	2.5
International Shares Ex-Aus (Unhedged)	-8.0	-8.7	4.8	10.1	8.2
International Shares Ex-Aus (Hedged)	-11.9	-19.3	-8.7	2.3	3.7
Emerging Markets (Hedged)	-12.9	-19.0	-13.0	1.4	2.0
Emerging Markets (Unhedged)	-10.9	-12.2	-4.5	5.9	4.2
Australian Listed Property	-35.1	-34.4	-31.7	-5.1	0.2
International Listed Property ($A)	-10.9	-10.0	-6.1	6.3	4.3
Australian Direct Property*	0.4	0.9	3.1	9.4	11.1
Australian Fixed Interest	-0.2	3.0	6.8	5.7	4.2
International Fixed Interest (Hedged)	-1.5	1.5	5.7	4.4	4.0
Cash (BAUBIL)	0.1	0.3	1.2	1.7	1.8
		Change over the month			
Australian Govt. 10 yr Bond Yield	0.89%	-9 bps			
AUD/USD	$0.61	-$0.04			

*as at 29 February 2020

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

The S&P/ASX 200 Accumulation Index declined–20.7% in March and -14.4% for the 12 months.

Large cap stocks (S&P/ASX 20 Accum Index -19.2%) outperformed the mid-cap stocks (S&P/ASX MidCap 50 Accum Index -22.7%) and small cap stocks (S%P/ASX Small Ords Accum Index -22.4%).

In this sell-off the best performing sectors in the S&P/ASX200 Accumulation Index for the month were Consumer Staples (-3.6%), Health Care (-5.4%) and Utilities (-6.2%).

Not surprising some of the best performing stocks over the month were Woolworths, Coles and Metcash, conversely stocks such as Crown Resorts and SkyCity struggled in this environment.

The index finished trading at a P/BV of 1.6x and a P/E Ratio of 14.0x and equity yield (dividend) of 5.4%.

The VIX was at 35.6 (the average since 01.10.2010 is 16.4) indicating an extreme level of market volatility.

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

The Small Ords Accumulation index fell -22.4% in March as panic selling set in all markets globally due to fears of the coronavirus spreading.

Key detractors over the month was travel company Webjet (down -70.4% q/e 31.03.2020), mining engineering company NRW Holdings (down -60.4% q/e 31.03.2020) and debt collector and personal lender Credit Corp Group (down -54.4% q/e 31.03.2020).

Trailing P/E Ratio was at 13.9x at the end of the month, P/BV is at 1.4x and equity yield (dividend) of 4.1%.

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) -8.3% for March whilst the MSCI World ex Australia Index (Hedged) returned -12.6%.

European markets were hit hard. France lost -17.2%%, Germany -16.4%, the UK -13.4% and Italy dropped -22.9%.

Some of the biggest market declines have been in commodity exporting regions like Latin America, Australia and Canada, where markets have been hard hit by the dual forces of coronavirus concerns and plummeting commodity prices.

Health Care and global gold miners were the best performers in the month (though still produced negative returns). Financial and Energy stocks were the worst performers, with each especially hurt by declining interest rates and oil prices respectively. The broader index ended trading at a forward P/E Ratio of 15.9x and P/BV of 2.0x and equity yield (dividend) 2.8%.

US market: Coronavirus fears continued to send stocks into correction territory in March, as investors grappled with the unfolding story.

The Dow Jones Industrial Average lost -13.7%, while the Standard & Poor's 500 Index dropped -12.5%. The NASDAQ Composite fell -10.1%.

All industry sectors ended lower in March, with declines in Communications Services (-12.7%), Consumer Discretionary (-13.6%), Consumer Staples (-4.1%), Energy (-36.7%), Financials (-19.5%), Health Care (-3.9%), Industrials (-18.2%), Materials (-13.4%), Real Estate (-13.0%), Technology (-7.3%) and Utilities (-7.1%).

UK market: At the end of the month, the UK equity market saw its sharpest weekly fall since the financial crisis in 2008, the UK FTSE Index retreating -13.6%, as fears rose that coronavirus could pose a serious challenge to economic growth.

The market experienced a widespread sell off with travel and mining stocks the hardest hit. EasyJet and International Consolidated Airlines, along with other airlines and hotel groups, saw their share prices fall upon confirmation of the outbreak of coronavirus in Italy, described as a 'tipping point' by medical specialists.

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: Travel restrictions, business shutdowns and general anxiety over the epidemic are expected to see a severe contraction in China's 1Q GDP. However, equity market performance appears to be reflecting expectations that pent-up domestic demand will recover strongly in 2Q with the support of targeted government stimulus if need be.

Emerging markets: 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).

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

Emerging market (EM) equities, in local currency terms, declined in March (-12.9%), as the outbreak of the coronavirus spread across the major economies and returned –10.9% in AUD.

The index ended trading at a forward P/E Ratio of 13.2x and P/BV of 1.9x and equity yield (dividend) 3.0%.

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

The S&P/ASX 200 Property Accumulation index took a huge hit in March returning –35.1% in underperforming the S&P/ASX 200 by a staggering -14.4%.

Some real estate assets were negatively impacted by the Governments decision to impose trading restrictions upon businesses to facilitate social distancing measures. This was particularly evident in the larger shopping centres where discretionary spending (non-essential) is a major driver of earnings.

The best AREIT performers over the month were Rural Funds Group (RFF) at -0.4% and Bunnings Trust (BWP) at -11.6%. Key underperformers were Scentre Group (SCG) at -54.8% and Vicinity Centres (VCX) at -52.1%.

At the end of March, the index was trading on a dividend yield of 6.9% with a P/BV 0.8x and a P/E Ratio 8.9x.

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

Globally, REITs returned -22.3% over the month of March in USD terms. Hong Kong was the top-performing region (-9.5%). The worst-performing region over the month was Australia (-41.9%).

At the end of March, the index was trading on a dividend yield of 5.1% with a P/B 1.3x and a P/E Ratio 16.0x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted +0.9% return over 3-month period to February 2020. Investors should see a downward revaluation of the direct property sector in the coming months 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 Commonwealth Government fixed interest returned +0.23% over the month, Australian government 10-year bond yields fell by 8bps to 0.74%. At this point, the 10-year Australian bonds yield was 8bps above the US 10-year Treasury yield while 3-year “single A” corporate credit spreads widened from blew out.

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

Global bond yields collapsed again in March, with US 10-year bond yields down by 49 basis points to 0.66%. The sharp drop in bond yields was driven by a continuation of global growth fears.

International fixed interest returned -1.97% over the month (in AUD, Bloomberg Barclays). The 10-year US government bond yield fell by 49bps to 0.66% while the US corporate investment-grade credit spread widened from 1.64% to 3.96%.

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