ATCHISON
CONSULTANTS

Market Review – August 2020

Impact of COVID-19 in August

- Australia's record-breaking 29-year dream run of economic growth has officially come to an end, Australia's economy contracted 7.9% in the June quarter, wiping $34 billion off gross domestic product and leaving it 6.3% smaller than a year before.
- The biggest hit came from a 12.1% collapse in household consumption even as government support payments and early access to superannuation actually lifted household income.
- The really good news remains that the second wave of new coronavirus cases in developed countries has continued to be far less deadly than the first wave with deaths running well below their April high whereas new cases have been well above. This is helping to avoid a return to generalised lockdowns in most countries – in favour of targeted measures – and helping confidence hold up.
- The Australian share market capped off its best August since 2009 with local shares buoyed through the month despite divergent results. Despite the rally, the market remains -15.4% off the record high it hit on February 22.
- Australian on-line spending soared to a record 62.6% year-on-year in July – five times the rate of traditional retail sales growth – breaking the previous record 60% growth. According to the monthly National Australia Bank online retail index, online spending rose 6.7% month-on-month in July, fuelled by a surge in spending in Victoria.
- The MSCI World Index was up +3.5%, while the US S&P 500 had its best August since 1986, up +7.2% for the month. on the back of good earnings results, particularly for technology stocks.
- US consumers, who account for about 70% of the country's economy, increased their spending more than expected in July but the savings rate, a barometer of consumer uncertainty, remained elevated well above pre-pandemic level.
- A remarkable feature of the current market is its 'narrowness', with the gains being driven largely by a small number of mega cap technology businesses, illustrated by the fact that the top five performing S&P 500 stocks during 2020 (Apple, Amazon, Facebook, Microsoft and Nvidia) have added approximately 10% to S&P performance, meaning that without these five businesses, the index would have been down almost 3% for the year to 31 August 2020.

Australian Economy

Australia' fifth consecutive record current account surplus driven by a further widening in net exports softened the June quarter GDP contraction to 7.9%, according to some major bank economists.

Australia's economy has just experienced its sharpest three-month contraction, driving it to its weakest growth since the end of World War II. The key damage seen in the national accounts is that consumers did not spend. Spending by families is the largest single part of the economy – more than half of it.

Consumers pulled back at record rates, partly because they could not spend (they were locked down, or stores were closed, or what they were after wasn't on the shelves), and partly because they didn't want to spend (they were scared to step outside, and uncertain what would happen to their jobs and their savings).

Official ABS show exports of services fell by 18.4% in the June quarter, but services imports collapsed 49%. This strengthened the services balance by a record $7 billion, helping drive a record $17.7 billion seasonally adjusted current account surplus – well ahead of market expectations of a $13 billion surplus.

Imports of goods in seasonally adjusted terms fell $1.1 billion or 4% to $25 billion largely because of a fall in vehicle imports during the quarter. However, some of the goods imports more synonymous with consumption saw an improvement, with clothing and footwear up $725 million or 17%, food and beverages up $215 million or 5%, and household electrical items up $181 million or 13%.

CBA economists revised down their forecast for June quarter GDP to a 5.4% contraction, from their earlier forecast of a 6% contraction. This would take annual growth to 4.7%.

The RBA is expected to leave monetary policy on hold. Having provided massive monetary stimulus back in March the RBA is still in "watch and wait" mode, and the policy focus remains largely on fiscal policy. Given the uncertainty around the pace of recovery and the risks flowing from Melbourne's lockdown, the RBA is likely to reiterate its dovish forward guidance on rates and note that it stands ready to do more if required.

Australian home prices at present are being protected by income support measures and bank payment holidays but higher unemployment, a stop to immigration and rent holidays will push prices lower into next year. Home prices are expected to fall by around 10%-15% from their April high. Melbourne is particularly at risk on this front as its Stage 4 lockdown pushes more businesses and households to the brink.

Interestingly, the housing pipeline picked up in July as new home approvals jumped more than expected, with a surge in both detached dwellings and apartments on the back of improving consumer sentiment pushing the monthly total up at its fastest pace in five months. New dwelling approvals rose 12% from June to 13,840 in seasonally adjusted terms, (ABS).

Cash & bank deposits are likely to provide very poor returns, given the ultra-low cash rate of just 0.25%.

The coronavirus crisis continues to twist and turn, so it is hard to know where it heads next. Victoria's case numbers continue to trend down. The next phase of this crisis will, on average, see Australia gradually open up possibly assisted by using the Government's October 6 budget to fast-track its stage two personal income tax cuts, which are legislated to begin on July 1, 2022, and possibly the stage three cuts, from July 1, 2024.

Global Economy

Data released in August pointed to a continued – but uneven – recovery for the global economy. For example, JP Morgan's Global Purchasing Managers' Index showed a recovery for both the manufacturing and service sectors. After falling to historical lows in April, both indices have risen and are now slightly above 50 – a threshold suggesting activities in the global manufacturing and service sectors are now expanding, not contracting. In particular, the strong fiscal supports provided by various governments (for example, JobKeeper in Australia) have allowed households to maintain consumption at levels higher than suggested by the level of unemployment. This is evidenced by the recovery in retail spending in some of the main developed economies.

US: US equities – as represented by the S&P 500 – reached a new peak in August, despite tensions between the US and China escalating. What began as the two nations exchanging trade blows has now developed into restrictions on diplomats and military bravado. However, the ongoing stand-off was overshadowed through the month by economic data, which, while patchy, suggests that the economic recovery continues.

The US Federal Reserve (Fed) also confirmed its readiness to offer further support, while increasing its flexibility to deliver it by adjusting its measurement of inflation. Although the Fed anticipates inflation to remain "soft", it is also adopting "average inflation targeting" to allow temporary tolerance of increases beyond the 2% target.

Year on year inflation (core CPI) rose to 1.6% (in July) from a trough of 1.2%, driven by a continued reversal of gasoline prices – which rose by 5% in July – as well as higher prices for apparel, used cars and airfares. In the meantime, the number of Americans applying for unemployment benefits fell below 1 million for the first time since the pandemic began in March. However, retail sales in July increased by less than expected and consumer confidence remains subdued.

The IT sector was again a notable contributor to the market's overall gains in August. Sectors exposed to an improving economic cycle, such as industrials and consumer discretionary, also rose. Utilities and real estate were weaker areas, as were energy stocks.

UK and Europe: The summer rebound in UK economic activity, helped by fiscal policy support and a relatively milder resurgence in new Covid-19 cases versus some other territories, could set the UK up for a solid recovery over Q3. A potential pick-up in job losses remains the big unknown. While the latest data from the Office for National Statistics confirmed that the UK economy had entered a recession in Q2, the market focused on news that monthly GDP had grown by 8.7% in June 2020, supporting hopes for a reasonably sharp Q3 rebound.

Eurozone data confirmed that the eurozone economy contracted by -10.1% in Q2. However, the German economy's fall was revised to a smaller decline of -9.7% from -10.1% previously. There was continuing unease about rising Covid-19 infections in some countries, notably Spain and France, with various countries imposing some form of travel restrictions. Meanwhile, Germany extended its scheme to top up the pay of workers affected by the pandemic; this was due to expire in March 2021 but will now run until the end of next year.

Recovery momentum slowed, according to the latest purchasing managers' indices (PMIs). The composite index for August reached 51.6 compared to 54.9 in July. (50 is the level that separates expansion from contraction. The PMI surveys are based on responses from companies in the manufacturing and services sectors).

Emerging Markets & Asia: Emerging market (EM) equities recorded a positive return as hopes for a Covid-19 vaccine increased, and as the US Fed's new monetary policy strategy suggested that interest rates could remain low for longer. The MSCI Emerging Markets Index increased in value but underperformed the MSCI World Index.

In Asia, the number of daily new Covid cases rose in India, Indonesia, the Philippines and South Korea but declined in most other countries. In Latin America, the number of new cases remained high although the pace of gains slowed in Brazil, Mexico and Chile, while in the Middle-East and Africa, the number of reported new cases continued to decrease across most of the region.

On the economic front, China continued to draw most of the attention. The Caixin/Markit manufacturing PMI for July came in at 52.8, indicating continued expansion. July economic data generally confirmed that the Chinese economy was continuing to recover, albeit at a slightly more moderate pace. While industrial production and fixed investment picked up by 4.8% and 8.3% (year on year) in July, retail sales came in weaker than expected with a contraction of 1.1%. Unlike in developed market economies, consumption has so far lagged production during this recovery, which is probably due to the lack of government transfers to households.

In conclusion: Over the short term, it is likely that episodic spikes in Coronavirus cases will continue until a vaccine is made widely available. But for now, markets seem willing to tolerate this so long as governments remain equipped to manage the Coronavirus. This suggests the global economic recovery will likely remain patchy, uneven and subject to short-term reversals. While there will be periods of weakness (for example, Australian economic data has yet to reflect Melbourne's Stage 4 Coronavirus restrictions), government policies and low interest rates could maintain the positive momentum. While these policies are likely unsustainable and may have long-term implications, it is too early for markets to focus on the timing of exits from those policies.

One positive surprise that could change market dynamics is progress in the development of a vaccine. Currently, there are five candidates under phase-three clinical trials, and there is a possibility that one or more will be approved by regulators for emergency use by the end of Q4 2020, let's hope so.

Currencies

The USD fell slightly by 1.4% in the month of August, partly driven by the continued accommodative stance of US monetary policy. The Norwegian Krone (+3.5%), Canadian Dollar (+2.7%) and the Australian Dollar +2.3%) were the best performing currencies, while the Japanese Yen (-1.2%), Swiss Franc (+0.4%) and Swedish Krona (+0.5%) were the worst performers.

Commodities

The S&P GSCI (commodities index) registered a positive return. Agriculture was the strongest component, with corn and soya beans recording particularly robust returns. Energy and industrial materials components also delivered strong gains. Energy price rises were driven by increased demand as economic activity continued to pick up globally. Nickel and zinc drove gains in industrial metals, amid increased demand from China. In precious metals, silver continued to generate stellar gains while gold slightly lost ground.

Table 1: Market Performance – Periods to 31 August 2020

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	2.8	6.0	-5.1	6.1	7.5
Australian Shares Small Cap	7.2	6.6	2.1	8.0	10.5
International Shares Ex-Aus (Unhedged)	3.5	2.9	6.7	12.6	9.6
International Shares Ex-Aus (Hedged)	6.4	12.7	15.5	10.4	10.9
Emerging Markets (Hedged)	2.2	18.0	16.4	6.0	10.0
Emerging Markets (Unhedged)	-0.9	7.3	4.3	5.3	7.7
Australian Listed Property	7.9	7.0	-17.7	4.4	5.8
International Listed Property (Unhedged)	-1.2	-2.9	-21.0	2.3	2.4
Australian Direct Property*	0.4	1.8	-0.1	6.8	9.7
Australian Fixed Interest	-0.4	0.3	1.6	5.5	4.4
International Fixed Interest (Hedged)	-0.7	0.8	2.5	4.4	4.6
Cash (BAUBIL)	0.0	0.0	0.7	1.4	1.7
		Change over the month			
Australian Govt. 10 yr Bond Yield	0.89%	+1 bps			
AUD/USD	$0.74	$0.03			

*As at 30 June 2020

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

The S&P/ASX 200 Accumulation Index rose +2.8%, underperforming the DM World's return of +6.3%. In Australia, IT (+15.5%), Consumer Discretionary (+8.7%)and A-REITs (+7.9%) outperformed the most, while Utilities (-4.8%), Communication Services (-3.8%) and Consumer Staples (-0.4%) underperformed. Australian underperformance versus the broader developed markets index was partly due to the lower weighting to Tech in Australia.

IDP Education (+50.9%), Corporate Travel (+11.3%), Afterpay (33.4%), CSL (+5.9%), and Wesfarmers (+2.5%) pushed the local market higher.

Major detractors were; CBA (-4.1%) reporting a 11.3% fall in profit, Telstra dropped (-12.9%), Newcrest (-9.2%) and A2 Milk fell (-11.8%) with brokers warning the outlook for the company looked fragile.

The index finished trading at a P/BV of 1.9x and a P/E Ratio of 19.2x and equity yield (dividend) of 3.7%.

The VIX was at 31.0 (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 rose a hefty +7.2% in August led by industrials, and particularly technology stocks again. This represents a +55% gain since the market low of March 23rd and is only 7% shy of its all-time high reached in late February.

Key contributors to the index return for August were online design and fulfilment provider Redbubble (+49.2%), electronics manufacturer and provider Codan (+32.1%) and infant merchandise retailer Baby Bunting (+30.0%).

Trailing P/E Ratio was at 20.0x at the end of the month, P/BV is at 1.7x 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) +3.5% for August whilst the MSCI World ex Australia Index (Hedged) returned +6.4%.

Equities rallied aggressively, driven by factors including a weakening US dollar (which boosts the dollar profits of US corporations with significant non-dollar revenues), continued fiscal and monetary stimulus, and a number of economic data points indicating that major economies may be on a path to recovery following the easing of the most intense phase of the pandemic in developed markets. European stocks did well, with the Stoxx 600 Index rising +3.9% in USD terms, but the US itself saw the biggest rise among major markets, with the S&P 500 up +7.2%, reaching a fresh all-time high.

The index finished trading at a P/BV of 2.6x and a P/E Ratio of 24.6x and equity yield (dividend) of 2.1%.

US market: US equity markets as represented by the S&P500, reached a new peak in August in spite of tensions between US and China escalating.

The Dow Jones Industrial Average rose +7.6%, the Standard & Poor’s 500 Index climbed +7.0%, and the Nasdaq Composite soared +9.6%. The IT sector was again a notable contributor to the market’s overall gains in August. Sectors exposed to an improving economic cycle, such as industrials and consumer discretionary, also rose. Utilities and real estate were weaker areas, as were energy

The majority of industry sectors closed higher in August, with gains in Communication Services (+12.0%), Consumer Discretionary (+11.5%), Consumer Staples (+4.9%), Financials (+5.6%), Health Care (+2.1%), Industrials (+10.0%), Materials (+4.9%), Real Estate (+1.8%), and Technology (+16.6%). Energy (-1.3%) and Utilities (-2.3%) lost ground.

UK market: UK equities rose over the period as risk appetite recovered generally due to the improving global growth outlook. Signs there could be a solid recovery in the UK economy over Q3 2020 were also supportive of small and mid-cap (SMID) equities. As a result, the market recouped some of its losses from July when fears around a second wave of Covid-19 infections had dominated sentiment.

For the month of July, the UK equity market fell, with the UK FTSE Index returning -3.6%.

European markets: Eurozone equities notched up gains in August but lagged behind other regions. Top performing sectors included economically sensitive areas of the market like industrials and consumer discretionary. The healthcare sector was among the laggards, after a strong performance so far this year, as investors favoured parts of the market deemed more likely to benefit from economic recovery. Within individual industries, automakers were buoyed by data showing rising car sales in China. The Q2 earnings season concluded and was overall better than expected. The euro strengthened further against the US dollar.

The utilities and consumer staples sectors were among the main gainers while energy and financials lagged. The start of the Q2 corporate earnings season saw some better-than-expected numbers, particularly from technology and industrial stocks.

Chinese market: Chinese export growth recovered to +7.2% year-on-year while South Korean exports remained relatively robust. Chinese authorities also announced RMB 50 trillion of stimulus across 25 provinces with RMB 7.6 trillion planned for this year alone.

Emerging markets: Emerging market (EM) equities recorded a positive return as hopes for a Covid-19 vaccine increased, and as the Fed's new monetary policy strategy suggested that interest rates could remain low for longer. The MSCI Emerging Markets Index increased in value but underperformed the MSCI World Index.

Egypt was the best-performing market in the MSCI Emerging Markets Index. China outperformed as stronger-than-expected Q2 earnings results, notably in the e-commerce sector, boosted sentiment. This was despite an escalation in US-China tensions**.**

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

Emerging market (EM) equities (unhedged), fell in August -0.9% but rose +3.5% on a hedged basis.

Emerging markets continued to rise during the month of August, despite the re-emergence of trade tensions. North Asian markets, China and South Korea, rose +7.2% and +4.5%, respectively.

The index ended trading at a forward P/E Ratio of 16.8x and P/BV of 1.8x and equity yield (dividend) 2.4%.

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

The S&P/ASX 300 AREIT Accumulation Index returned +7.9% for the month of August, outperforming the Australian equities market (S&P/ASX 200 Accumulation Index) return of +2.8%. In the past 12 months, AREITs returned -17.2%, underperforming the equities market return by -12.1%.

The best AREIT performers over the month were Stockland Group (SGP) at +24.1% and Charter Hall Group (CHC) at +18.9%. Key underperformers were Unibail-Rodamco-Westfield (URW) at -8.6% and Centuria Industrial (CIP) at -4.2%.

At the end of August, the index was trading on a dividend yield of 5.2% with a P/BV 1.0x and a P/E Ratio 17.0x.

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

Global REITs returned -1.2% over the month of August. The top performing region was Japan (+8.1%) followed by Australia (+7.9%). The worst-performing region over the month was Singapore (-0.8%) and then NZ (+0.3%).

At the end of August, the index was trading on a dividend yield of 4.5% with a P/B 1.4x and a P/E Ratio 20.4x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted +1.8% return over 3-month period to August 2020. Investors should continue to see downward revaluation of the direct property sector. Capitalisation rates across property sectors continued to trend upwards. 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 -0.42% over the month. Australian government 10-year bond yields increased by 17bps to 1.00% (September futures contract). At this point, the Australian 10-year Treasury bond yield was 29bps above the US 10-year Treasury yield.

3-year "single A" corporate credit spreads tightened from 0.75% to 0.66%.

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

Global bond yields rose in August, with the US 10-year Treasury bond yield up 18 basis points to 0.71%. The Aussie dollar moved from 71.42 US cents to 73.77 US cents.

International fixed interest returned -0.74% over the month (in AUD, as per Bloomberg Barclays' benchmark). The US corporate investment-grade (BBB) credit spread tightened from 1.85% to 1.76%.

Contact Details
To obtain further information, please contact Atchison Consultants.

Jake Jodlowski
Principal
Atchison Consultants
Phone: +61 3 9642 3835
Email: jake.jodlowski@atchison.com.au

Alex Wong
Senior Investment Analyst
Atchison Consultants
Phone: +61 3 9642 3835
Email: alex.wong@atchison.com.au