ATCHISON
CONSULTANTS

Market Review – July 2020

Impact of COVID-19 in July

- The Australian Federal Government has revealed that the recent fiscal response to COVID-19 has created a budget deficit of circa $86b for the financial year just closed. This is an outsized shift from the 'return to surplus' of $5b that was widely expected when the budget was first set.
- Australian shares eked out a rise+ 0.5% for July held back at the end of the month thanks to concerns that the lockdown in Melbourne will be intensified and extended.
- Global stock markets were mixed over the month with Chinese stocks +13.5% and US stocks up +5.9% on the back of good earnings results, particularly for technology stocks.
- Bond yields generally fell again over the week, with US bond yields hitting a record low. Oil prices fell, but metals and iron ore rose and gold made it to a new record high, as the US dollar fell further.
- The rising trend in new coronavirus cases globally still shows no let up. This is primarily driven by emerging countries, with developed countries showing some signs of stabilisation over the last few weeks.
- The stabilisation in new cases in developed countries reflects some slowing in the US – notably in southern and western states, suggesting that the return of some restrictions and the mandated use of masks in many states may be working.
- Against this, Europe is seeing new cases edge up again, as is Canada; and Japan has seen a big rise. Even China has seen a pick-up in new cases (albeit it remains very low).
- All of this highlights how hard it is to contain the coronavirus, as well as the importance of maintaining social distancing.

Australian Economy

Australia saw its biggest quarterly bout of deflation in the 72-year history of the Consumer Price Index (CPI) and its biggest annual decline since 1997 – expect a rebound in the current quarter but underlying inflation is likely to remain weak. The 1.9% plunge in the CPI was basically due to government decisions to provide childcare, pre-school (in some states) and before and after-school care for free, as well as a plunge in petrol prices. With free childcare having ended and petrol prices back up, the CPI is expected to rebound this quarter (probably by around 10.5% quarter-on-quarter).

Underlying inflation fell to just 1.25% year on year, which is its lowest on record and reflects the plunge in demand in the economy and huge amounts of spare capacity. With spare capacity likely to be with us for some time to come, expect underlying inflation and the trend in headline inflation to remain weak, notwithstanding volatility driven by government decisions and changes in petrol prices.

Australian economic data was on the soft side, with payroll jobs falling over the three weeks to mid-July, particularly in Victoria (although this data has a tendency to get revised up), the terms of trade falling slightly in the June quarter (although this was after a huge surge in the March quarter), private sector credit contracting further in June and home building approvals plunging again. Fortunately, approvals for alternations and non-residential building rose and the HomeBuilder scheme, along with increased stamp duty concessions for first home buyers of new property, should provide some support for home building.

Meanwhile, the July ABS Business Impacts of COVID survey found 42% were receiving some form of government assistance, but more businesses expect to raise headcount rather than cut it.

Global Economy

The World Bank's June 2020 Global Economic Prospects describes both the immediate and near-term outlook for the impact of the pandemic and the long-term damage it has dealt to prospects for growth. The baseline forecast envisions a 5.2% contraction in global GDP in 2020, using market exchange rate weights—the deepest global recession in decades, despite the extraordinary efforts of governments to counter the downturn with fiscal and monetary policy support. Over the longer horizon, the deep recessions triggered by the pandemic are expected to leave lasting scars through lower investment, an erosion of human capital through lost work and schooling, and fragmentation of global trade and supply linkages.

The pandemic is expected to plunge most countries into recession in 2020, with per capita income contracting in the largest fraction of countries globally since 1870. Advanced economies are projected to shrink 7 percent. That weakness will spill over to the outlook for emerging market and developing economies, who are forecast to contract by 2.5% as they cope with their own domestic outbreaks of the virus. This would represent the weakest showing by this group of economies in at least sixty years.

In the face of this disquieting outlook, the immediate priority for policymakers is to address the health crisis and contain the short-term economic damage. Over the longer term, authorities will need to undertake comprehensive reform programs to improve the fundamental drivers of economic growth once the crisis lifts.

US: GDP contracted by an annualized rate of 32.9% in the second-quarter GDP. Whilst the unemployment rate declined in June to 11.1% percent (from May's 13.3%) as the economy added 4.8 million jobs. Retail sales based on consumer spending rose 7.5% in June, aided by the reopening of malls and restaurants. Sales were largely driven by autos, clothing, furniture, and electronics.

Industrial production as represented by US manufacturers, utilities, and mines increased by 5.4%. Manufacturing jumped by 7.2%.

Housing starts leaped by 17.3% though, new construction remains behind last year's pace. Posting its largest monthly jump ever, existing home sales soared 20.7% in June and new home sales rose 13.8%, touching its highest sales pace in 13 years.

US consumer inflation jumped 0.6% in June, which economists attributed to a snapback in prices from COVID-19-related declines in the previous three months. Petrol prices soared 12.3%, accounting for more than half of the month's increase in the CPI.

Durable goods orders increased 7.3%, as an 86% as orders for new cars and trucks offset a sharp drop in aircraft manufacturing.

As expected, the US Federal Reserve left its benchmark interest rate unchanged at its two-day meeting, which ended July 29. The Fed also reiterated its commitment to bond purchases and the lending and liquidity programs it currently has in place.

UK and Europe: The measures put in place in the UK to contain the spread of Covid-19 and support household and corporate cash flow during lockdown have resulted in sharply higher levels of government borrowing. Having risen to £57 billion in the financial year 2019-20, government borrowing reached its highest level on record in May. This was the highest monthly borrowing figure since records began in 1993.

To help support household and corporate cash flow during the pandemic, the Bank of England has been buying government debt through its quantitative easing programme to inject money directly into the economy. Mid-June the Bank of England's Monetary Policy Committee voted unanimously to expand its bond buying programme by a further £100 billion - taking the total since March to £300bn - and to maintain interest rates at a record low of 0.1%. This is in addition to its post financial crisis QE package which totalled £445bn.

While slashing both growth and inflation forecasts, the ECB added a further €600bn to its QE programme by expanding the PEPP (Pandemic Emergency Purchase Programme) to a whopping €1.35 trillion and extending its term until at least June 2021.

Elsewhere in Europe, the German coalition government agreed on a second fiscal stimulus package worth €130bn or 3.8% of GDP (Gross Domestic Product), taking the total direct fiscal response to 12% of GDP. 'We need to get out of this crisis with an oomph,' said Finance Minister Olaf Scholz. Meanwhile, soft economic indicators continued to surprise on the positive throughout the month. Euro Area industrial production fell 17.1% compared to the previous month, however, this was less than expected by many economists.

China: In China, the equity market rose as economic monthly data indicated that the V shaped recovery was getting back on track with the production side of the economy returning to pre-Covid-19 levels while consumer spending also showed signs of recovery. This momentum in economic activity has been backed by policy support, such as the announced 25 basis point cut in re-lending rates to businesses and the introduction of a higher-than-expected fiscal support package

Emerging Markets: The advance in Asian equity markets was driven by China where the Covid-19 spread seems to be contained. Further evidence that the Chinese economy is recovering was reflected in data showing production activity and consumer spending rising. Although coronavirus-related distancing measures have been lifted in some places, the number of new Covid-19 cases being reported in the region continues to rise, particularly in Brazil. While economic news on Brazil was negative, with steep falls being seen in industrial production and retail sales, the data overall was not as bad as consensually expected. With the economy contracting, interest rates were cut to 2.25%, a new record low.

Economic news was also sombre in Mexico with closed shops accentuating the sharp fall in retail sales although online sales grew. The Bank of Mexico cut interest rates to 5.0% from 5.5%.

In conclusion: Investors ready themselves for what is expected to be an eventful August reporting season, markets have maintained their positive stance despite the continuing global fallout from COVID-19. While still trading behind pre COVID19 levels.

Expect companies to take this opportunity to write down asset values particularly in relation to previously revalued assets, ageing assets, intangibles and capitalised spend.

Geopolitical relationships remain at the fore with recent escalations, primarily involving China, culminating in sanctions and consulate closures. Domestically, investors should remain cognisant of the ramifications of mounting debt levels as the Government considers the most prudent and necessary steps required to stimulate economic activity.

Currencies

The USD fell by 4.2% in July, with all major currencies recording rises. The Swedish Krona (+8.0%), Norwegian Krone (+7.4%) and the British Pound (+7.1%) were the best performing currencies, while the Canadian Dollar (+1.9%), Japanese Yen (+2.9%) and New Zealand Dollar (+4.3%) were the worst performers.

Commodities

Global commodity prices continued their recovery in July. Brent Oil prices rose $2.15/bbl to $43.30/bbl, partly driven by the improving global economic outlook and a depreciating USD. Iron ore prices rose further to $109.50/t, but coal prices continued to trend lower. Gold prices surged $196.80/oz to a record high $1964.90/oz, driven by the 34bp fall in US real yields to -1.03%.

Please stay safe and focussed on the long term.

Table 1: Market Performance – Periods to 31 July 2020

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	0.5	7.6	-9.9	5.4	5.2
Australian Shares Small Cap	1.4	-9.9	-8.5	6.5	7.9
International Shares Ex-Aus (Unhedged)	0.6	3.0	4.0	12.2	8.7
International Shares Ex-Aus (Hedged)	3.5	11.1	6.5	8.3	8.0
Emerging Markets (Hedged)	4.7	7.7	2.8	7.0	7.1
Emerging Markets (Unhedged)	8.2	16.2	11.1	5.9	8.1
Australian Listed Property	0.7	6.1	-22.8	2.2	3.4
International Listed Property ($A)	1.2	3.6	-17.1	-2.6	0.8
Australian Direct Property*	1.1	1.6	-0.8	7.2	9.8
Australian Fixed Interest	0.4	1.0	3.6	5.6	4.6
International Fixed Interest (Hedged)	3.5	10.7	-1.0	2.6	5.5
Cash (BAUBIL)	0.0	0.3	0.7	1.5	1.7
		Change over the month			
Australian Govt. 10 yr Bond Yield	0.82%	-5 bps			
AUD/USD	$0.71	$0.02			

*As at 30 June 2020

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

The S&P/ASX 200 Accumulation Index eked out a return of +0.5% in July but down -9.9% for the 12 months.

Resources (+4.5%) led the market way in July, with Metals and Mining (+7.1%) the best performing sector of the market. This was driven by ongoing strength in commodity prices, attributable to a weaker USD as well as ongoing supply disruptions, while demand remained robust, principally driven by China. Strong performances from Catapult (+45%), Orocobre (+28%), Mineral Resources (+21%), Kazia (+16%), Mesoblast (+16%), Goodman Group (+14%) and Saracen Minerals (+10%). Vista fell (-11%) while Carbon Revolution eased (-16%) due to pandemic related issues.

The Gold sector was another highlight, with the rally in the gold price seeing strong performances from Northern Star Resources (+15.7%), Newcrest (+11.6%), St Barbara (+6.3%) and Evolution Mining (+4.1%).

The index finished trading at a P/BV of 1.9x and a P/E Ratio of 17.1x and equity yield (dividend) of 4.0%.

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 had another positive month rising +1.4% in July and only -8.5% for the 12months. Once again led by Resources and to a lesser extent IT.

Key contributors to the index return for July were online design and fulfilment provider Redbubble (+27.2%), funds management group Pinnacle Investment Management (+28.8%) and Mineral Resources (+21.6%).

Trailing P/E Ratio was at 16.3x at the end of the month, P/BV is at 1.6x and equity yield (dividend) of 3.5%.

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) +0.6% for July whilst the MSCI World ex Australia Index (Hedged) returned +3.5%.

Japanese stocks had a stellar month (Unhedged) the MSCI Japan Index (Unhedged) returning +4.5%. US +4.5% and European stocks returned +3.2%.

The index finished trading at a P/BV of 2.5x and a P/E Ratio of 16.3x and equity yield (dividend) of 2.2%.

US market: US equity markets rallied in July as further development of a COVID-19 vaccine and better than expected corporate financial reports encouraged investors.

The S&P 500 gained +5.5%, while the Nasdaq Composite picked up +6.8%. The Dow Industrial Average, which has lagged much of the year, rose +2.4%.

As of July 31, more than half of the companies comprising the S&P 500 Index reported their earnings. Of these companies, 84% reported earnings in excess of analysts' estimates, with the Health Care and Technology sectors leading the way.

Industry sectors were uniformly higher in July, except for a loss in the Energy sector (-4.4%). Gains were made in Communication Services (+6.1%), Consumer Discretionary (+6.7%), Consumer Staples (+7.0%), Financials (+3.8%), Health Care (+6.1%), Industrials (+4.8%), Materials (+7.01%), Real Estate (+4.3%), Technology (+3.1%), and Utilities (+7.6%).

UK market: UK equities fell over the period as fears around a second wave of Covid-19 infections weighed on a number of regional stock markets. The UK was among certain European countries to report rising numbers of Covid-19 infections. In response, the government tightened lockdown measures in parts of northern England, postponed plans to re-open certain leisure venues and advised against all non-essential travel to Spain.

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

European markets: July saw a decline for eurozone equities (in euro terms). The MSCI EMU (Economic & Monetary Union) Index returned -1.4%. Economic data confirmed the severity of the downturn in activity during the second quarter.

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: In China, the equity market rose as economic monthly data indicated that the "V" shaped recovery was getting back on track with the production side of the economy largely normalising and consumer spending and exports showing signs of recovery. This momentum in economic activity occurred against a backdrop of increasing US-China tensions, with the US ordering the closure of a Chinese embassy and China responding in kind.

Emerging markets: Emerging market equities Emerging markets continued their recovery during the month of July as the US Dollar posted material declines. The MSCI Emerging Markets Index rose +8.2%. Travel-related names were the key detractors during the month as increasing Covid-19 cases and deaths in various regions have resulted in an extension of lockdown policies. Minor International fell -11.1%, despite the successful completion of a BHT 9.9 billion capital raise during the month. Turkish Airlines also declined -16.1%. While domestic flights have restarted, international flights are recovering but remain low in absolute terms.

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

Emerging market (EM) equities, in local currency terms, rose in July +8.2%, and +4.7% in AUD.

North Asian markets rose considerably with China, South Korea and Taiwan up +9.3%, +7.2% and +16.8%, respectively. Chinese GDP growth rebounded from -6.8% year-on-year in the first quarter to +3.2% year-on-year in the second quarter of 2020, above expectations.

The index ended trading at a forward P/E Ratio of 14.1x and P/BV of 1.9x and equity yield (dividend) 2.8%.

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

The S&P/ASX 300 AREIT Accumulation Index returned +0.7% for the month of July, marginally outperforming the Australian equities market (S&P/ASX 200 Accumulation Index) return of +0.5%. In the past 12 months, AREITs returned -22.8%, underperforming the equities market return of -12.9%.

The best AREIT performers over the month were Goodman Group (GMG) at +14.0% and Charter Hall Group (CHC) at +8.6%. Key underperformers were Unibail-Rodamco-Westfield (URW) at -10.4% and Vicinity Centres (VCX) at -8.7%

At the end of July, the index was trading on a dividend yield of 5.9% with a P/BV 0.9x and a P/E Ratio 10.8x.

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

Globally, REITs returned +1.2% (Unhedged) over the month of July. New Zealand was the top-performing region (+10.8%) followed by UK (+8.5%). The worst-performing region over the month was again Hong Kong (-6.3%).

At the end of July, the index was trading on a dividend yield of 4.7% with a P/B 1.3x and a P/E Ratio 17.6x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted 1.6% return over 3-month period to June 2020. Investors should see a downward revaluation of the direct property sector in the coming months 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 +0.37% over the month. Australian government 10-year bond yields decreased by 6bps to 0.83% (September futures contract). At this point, the Australian 10-year Treasury bond yield was 30bps above the US 10-year Treasury yield.

3-year "single A" corporate credit spreads tightened from 1.07% to 0.75%.

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

Global bond yields fell in July, with the US 10-year Treasury bond yield down 13 basis points to 0.53%. The Aussie dollar moved from 69.04 US cents to 71.42 US cents.

International fixed interest returned +1.23% over the month (in AUD, as per Bloomberg Barclays' benchmark). The US corporate investment-grade (BBB) credit spread tightened from 2.07% to 1.85%.

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