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Market Review – June 2020

2019-20 (FY20) Financial Year

It is time to say farewell to one of the most historic and astonishing financial years in the history of the Australian financial market. It is unlikely investors will witness a repeat of what happened in the space of six months, the share market went from a full-blown bear market to a full-blown bull market.

Looking back, in comparison with the second half of FY20, the financial year started with some "normality" with "minor" distractions such as the continuation of political risks, for example US Congressional investigation into President Trump's dealings with the Ukraine to Brexit. The first three months of FY20 saw the Australian share market return a modest +2.4%, whilst US stock market was up +1.4% and China +0.9%.

However, late 2019 saw share markets rally as central banks enacted a "U" turn on monetary policy and US-China trade tensions eased, triggering a global manufacturing recovery. The Australian share market was up +3.1% for the six months to December 2019, with the US stock market returning +10.3% and China +8.7% over the same period.

Then came COVID19 – a microbe has delivered the biggest peacetime shock to the global economy since the 1930s Depression – and a challenge to the globalisation that has driven Australian prosperity over the past three decades. Initially, markets brushed off the threat of COVID-19. However, the month of March 2020 saw the sell-off become a stampede as countries shut down large parts of their economy with lockdowns in order to contain the virus. Risk aversion measures skyrocketed to levels not seen since the Financial Global Crisis. Over FY20 the Reserve Bank of Australia (RBA) cut the official cash rate from 1.25% to 0.25% and the US Federal Reserve rate fell from 2.25-2.50% to 0.00-0.25%.

Markets finally began to stabilise in the final three months of FY20 and then began a very sharp rally that gathered momentum as the intensity of the virus receded and economies opened-up as lockdowns eased.

The Australian share market returned -7.7% in the year to June 2020 (relatively modest compared to the panic and turmoil that gripped investors in March when the index was down 36% from its peak). International shares fared better in FY20, on an unhedged basis returning +5.2% and +1.3% on a hedged basis. Whilst Australian bonds had a positive year in the sharp falling interest rate environment returning +4.2%.

Australian Markets

The roller coaster ride for equities through FY20 resulted in glaring differential in the investment performance between equity markets and at the sector level.

Surprisingly the Australian stock market substantially underperformed despite a relatively less severe progression of the virus, the S&P/ASX200 Accumulation Index (including the benefit of dividends) returned -7.7% in FY20.

Generally, defensive sectors outperformed cyclical ones. The best performing sector in FY20 was Health Care, up +27.4%, followed by Information Technology +19.4%. Whilst the worst performing sector was Energy returning -28.7%. Financials (i.e. Banks) and A-REITS (listed property trusts) also performed poorly weighed down by closures of retail malls and office buildings.

Australia's underperformance in FY20 was to a large extent a function of its sector mix, heavily overweight underperforming Banks and underweight the outperforming Technology sector, led by payments company Afterpay +150.4% and accounting software company Xero +47.3%. Fischer & Paykel Healthcare has also been a big winner from the pandemic, up +110.06% with demand for respiratory devices surging. Also, Mesoblast returned +108.4% for the year after it revealed its stem cell therapy showed promise in treating critically ill COVID-19 patients.

Heading into the new financial year, the Australian share market is expected to be challenging, with investors forecasting the market will remain turbulent at least for the remainder of the year.

Global Markets

Global shares (excluding Australia) for the year returned +5.2% on an unhedged basis while the hedged return of +1.3% due to the weakened Australian dollar against the world's major currencies.

FY20 started strongly for global markets despite concerns and uncertainty surrounding the world's two largest economies US and China. Meanwhile, a significant, if short-lived, rotation swept through financial markets globally. It was the biggest rotation out of relatively expensive stocks exhibiting low corporate earnings volatility and strong share price momentum and into cheaper, unloved sectors offering attractive valuations versus history since the financial crisis. Investors sold out of defensive low volatility stocks and higher growth technology companies which had propelled the decade-long bull market in the US. They opted instead for value stocks, which includes energy and financial stocks that had underperformed in the broader market in recent years. For the month of September 2019, the MSCI World ex Australia Growth Index (Hedged) returned +0.7% versus the equivalent Value index (Hedged) of +4.1%.

By the end of December 2019 due to the easing of monetary conditions (central banks around the world consistently cutting interest rates) all asset classes rose in value. Investors were richly rewarded for taking risks in 2019. For the six-months to December 2019, the benchmark for developed market equities, the MSCI World ex Australia (A$) Index to deliver a +9.1% and the hedged version of this index returned +9.3%. Global sovereign bonds (hedged) also delivered a solid, if muted +1.6% to investors for the six months – impressive considering around 1/3rd of the global sovereign bonds universe comprises negative-yielding bonds. Further out on the risk curve, listed real estate assets benefited from falling bond yields and generated returns above +7.1%.

As we headed into 2020 optimism appeared unsustainable. The scale and speed of the correction to markets as the coronavirus pandemic rapidly paralysed large sections of the world economy broke many historical records. The swift response from governments in terms of fiscal stimulus, combined with aggressive monetary easing and other unconventional policies, did appear to offer some support. Equities partially recovered towards the end of a tumultuous March 2020 quarter. Despite this, for the quarter ended March 2020 the MSCI World ex Australia (A$) Index to deliver -8.9% and the hedged version of this index returned -19.9%, reversing all the gains made to December 2019.

To compound issues, a stand-off between Saudi Arabia and Russia and breakdown in OPEC supply restraints battered oil markets, plus the negative impact on demand for oil due to COVID. Energy was the worst performing sector during the March 2020 quarter followed by areas either directly impacted by the virus (most notably, transport and leisure) or less directly via the impact on global growth and interest rates, namely Financials and cyclical sectors such as Materials and Industrials. But more defensive areas of the equity market, namely Health Care, Consumer Staples, Utilities and Communications declined by less than the broader market. It was also notable that the US market held up well on a relative basis, driven by the continued outperformance of a small group of large-cap stocks.

The final quarter of FY20 witnessed a market recovery on hopes of a V-shaped economic rebound increased. The MSCI World ex Australia (A$) Index to deliver a +6.1% and the hedged version of this index returned +18.7% for the three months to June 2020. The appetite for risk was evident in the solid gains posted by predominantly cyclical and high-beta sectors whilst defensives such as Utilities, Staples and Health Care lagged.

The Technology sector was, once again, the standout performer during the final quarter, beating the broader index by almost 12%. The bounce back has clearly been concentrated in the same popular index heavyweights that have dominated performance in recent years. Apple gained almost +44% over the quarter whilst Amazon was up +41%, followed by Facebook (+36%) and Microsoft (+29%). However, the strong performance of technology was relatively broad based and extended to other beneficiaries of the “stay-at-home” theme as well as areas geared into the global recovery, such as semiconductors. One of the strongest trends during the June quarter was the large gains posted by many technology stocks with little to no earnings support, particularly those favoured by a large influx of retail investors.

In conclusion: The outlook for global shares in general for FY21 is likely to remain uncertain and volatile due to COVID-19 and the subsequent lack of earnings guidance from many of the major companies to assist analysts to compute rationale valuations. Added to the mix of unknowns is the complications of a US November 2020 presidential election and more recently the souring relationship and escalating tensions between China and the US (and its allies).

Currencies

The big currency story of FY20 was the rise of the US Dollar on safe-haven buying. The Australian Dollar plummeted to a 17-year low of US$0.57 in March before recovering to finish FY20 at US$0.69, approximately where it had started the year.

Commodities

The big commodity story of the year was the collapse in the oil price (down -30%), particularly in March on lockdown induced demand destruction. A headline grabbing event was the collapse in West Texas Intermediate (WTI) oil futures contract price to negative US37.63 a barrel – the first ever negative oil futures settlement in history. However, an agreement in April between oil producers on production cuts, as well as easing lockdowns, kicked off a sharp rally in the oil price for the rest of FY20.

Outlook

The global pandemic recession is far deeper than feared but Australia is deemed to be a standout performer as the only advanced economy to have its economic outlook upgraded by the International Monetary Fund (IMF).

The IMF forecasts the Australian economy to contract a still hefty -4.5% this year, less than the massive -6.7% fall it tipped in April. Economic growth is projected to recover 4% in 2021. But this recovery, to an extent, will be dependent on the Australian government carefully unwinding the stimulus packages put in place such as the JobKeeper program to avoid sudden income losses and business bankruptcies.

The macroeconomic picture will be based on the level of COVID-19 restrictions and will be the main feature over the course of FY21. The secondary key risk event on the horizon that will cause some volatility across markets will likely be the US November 2020 presidential election, and the US taking a more hard-line approach to China in the lead into the election.

The $AUD could range trade between as low as $US0.65 and as high as US$0.74, the upper range supported by a global economic recovery and iron ore prices remaining firm.

Ultimately the outlook for FY2020-21 hinges on the global race by a combination of private investment and government research to find a vaccine, or even a much-improved treatment to fight the virus that threatens all.

Given the unique position the world finds itself it is very difficult to predict a FY21 return for a suitably diversified investment strategy. However, should a vaccine be discovered for COVID-19 before the calendar year end then a return of around +5% is feasible.

Table 1: Market Performance – Periods to 30 June 2020

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	2.6	16.5	-7.7	5.2	6.0
Australian Shares Small Cap	-2.0	23.9	-5.7	6.1	7.9
International Shares Ex-Aus (Unhedged)	-1.1	5.9	5.2	10.8	9.4
International Shares Ex-Aus (Hedged)	2.3	17.8	1.3	6.3	7.3
Emerging Markets (Hedged)	6.7	16.9	1.7	2.0	6.4
Emerging Markets (Unhedged)	3.6	5.1	-1.2	5.6	5.5
Australian Listed Property	-1.4	19.9	-21.3	2.3	4.4
International Listed Property ($A)	-1.0	-2.4	-13.4	2.2	3.9
Australian Direct Property*	1.1	1.6	-0.8	7.2	9.8
Australian Fixed Interest	0.3	0.5	4.2	5.8	4.8
International Fixed Interest (Hedged)	-0.1	2.3	5.2	4.7	4.8
Cash (BAUBIL)	0.0	0.1	0.9	1.4	1.7
		Change over the month			
Australian Govt. 10 yr Bond Yield	0.89%	-2 bps			
AUD/USD	$0.65	$-0.02			

*As at 30 June 2020

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

The S&P/ASX 200 Accumulation Index had another strong month, up +2.6% in June but down -7.7% for the 12 months.

For the month of June, in Australia, Information Technology (+6.0%) and Consumer Discretionary (+5.4%) outperformed the most, while Small Industrials (-2.3%) and Energy (-2.0%) under-performed.

The index finished trading at a P/BV of 1.8x and a P/E Ratio of 16.9x and equity yield (dividend) of 4.1%.

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 poor month down -2.0% in June and -5.7% for the 12months. Resources outperformed Industrials helped by the 85% bounce in oil prices.

Key contributors to the index return for June were online design and fulfilment provider Redbubble, Saracen Mineral Holdings Wizr.

Trailing P/E Ratio was at 16.0x at the end of the month, P/BV is at 1.6x and equity yield (dividend) of 3.6%.

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) -1.1% for June whilst the MSCI World ex Australia Index (Hedged) returned +2.3%. For the 12 months to June the indices returned +5.2% and +1.3% respectively.

Chinese stocks had a strong month up +9.0%, US +2.3% and European stocks returned +0.4%.

The index finished trading at a P/BV of 2.4x and a P/E Ratio of 20.4x and equity yield (dividend) of 2.3%.

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

Emerging market (EM) equities, in local currency terms, rose June +6.7%, and +3.6% in AUD. For 12 months June the indices returned +1.7% and -1.2% respectively.

The index ended trading at a forward P/E Ratio of 14.5x and P/BV of 1.9x and equity yield (dividend) 2.6%.

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

The S&P/ASX 200 Property Accumulation index returned -1.4% in June again underperforming the S&P/ASX 200 by -4.0%. For the 12 months to June the index returned -21.3%.

S&P/ASX Office AREITs returned +6.0% in June, S&P/ASX Diversified AREITs returned -1.3%, S&P/ASX Industrial AREITs returned -2.1% and S&P/ASX Retail AREITs returned -3.4%. Key outperformers were CMW (+14.8%), ABP (+7.3%) and CQR (+5.5%). Key underperformers were VCX (-11.2%), MGR (-6.4%) and SCP (-4.7%).

At the end of June, the index was trading on a dividend yield of 6.0% with a P/BV 0.9x and a P/E Ratio 13.4x.

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

Globally, REITs returned -1.0% (Unhedged) over the month of June and -13.4% for the 12 months to June.

In USD terms, Hong Kong was the top-performing region (+11.9%). The worst-performing region over the month was Japan (-4.0%).

At the end of June, the index was trading on a dividend yield of 4.7% with a P/B 1.4x and a P/E Ratio 17.4x.

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 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 +0.31% over the month. Australian government 10-year bond yields decreased by 2bps to 0.89% (September futures contract). At this point, the Australian 10-year Treasury bond yield was 23bps above the US 10-year Treasury yield.

3-year "single A" corporate credit spreads tightened from 1.29% to 1.07%.

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

Global bond yields hardly moved in June, with the US 10-year Treasury bond yield up 1 basis point to 0.66%. The Aussie dollar moved from 66.69 US cents to 69.04 US cents.

International fixed interest returned +0.65% over the month (in AUD, as per Bloomberg Barclays' benchmark). The US corporate investment-grade (BBB) credit spread tightened from 2.44% to 2.07%.

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