ATCHISON
CONSULTANTS

Market Review – May 2020

Impact of COVID-19 in May

- Stocks recovered globally to levels last seen in early March on fresh stimulus measures and hopes that economies are on the mend as lockdowns ease.
- The reopening of economies has been a common theme across the markets in recent weeks, as they largely shrugged off concerns over renewed tensions between the US and China after the US said that it no longer considers Hong Kong autonomous from China.
- But has this market rally come too far, too fast?
- Australia experienced negative growth in the March quarter, and June quarter results are likely to place Australia in its first recession since 1991.
- However, Australian economy is not nearly as bad as expected in the RBA's central forecast, though further job losses are likely, and it will take a prolonged, multi-year period to reduce unemployment rates back to normalised levels.
- Australian employment will fall further in the near term - meaning May and June - and unemployment will continue to rise until restrictions are lifted and businesses reopen.
- But remember most of the economic damage experienced is as a result of the COVID-19 pandemic shutdown not-lack of consumer spending power or confidence in the economy. An economic rebound may already be underway.
- Risks do remain, mainly a potential second wave of COVID-19 infections.

Australian Economy

The outlook for the Australian and global economies is being driven by the COVID-19 pandemic. The necessary social distancing restrictions and other containment measures that have been in place to control the virus have resulted in a significant contraction in economic activity, but it is anticipated that economic conditions will improve as the pandemic is brought under control and containment measures are relaxed.

The Australian economy is expected to record a contraction in GDP of around 10% over the first half of 2020; total hours worked are estimated to decline by around 20% and the unemployment rate is forecast to rise to around 10% in the June quarter. Headline inflation is likely to be negative in the June quarter largely as a result of lower fuel prices and free child-care; underlying inflation is expected to decline notably.

Household consumption is forecast to decline by around 15% in the June quarter. Reduced spending due to social distancing measures accounts for over half the decline. Because of social distancing restrictions and precautionary behaviour, household consumption is expected to decline by more than household income, which will be supplemented by increased social assistance payments, and the saving rate is expected to increase sharply.

Dwelling investment and business investment are also expected to contract in the June quarter. The fall in non-mining machinery and equipment investment is expected to be particularly sharp, as firms seek to preserve cash flow in response to the actual and expected falls in private demand.

Headline CPI is expected to fall by around 2.25% in the June quarter and headline inflation is expected to be negative in year-ended terms for the first time since the early 1960s. This is mainly driven by the large fall in oil prices in the quarter-to-date and the introduction of temporarily free child-care.

Global Economy

Global GDP is expected to fall sharply in the first half of 2020. The declines in the March quarter were driven by a contraction in Chinese and euro area activity as well as the rollout of containment measures elsewhere late in the quarter. A further fall in global GDP is expected in the June quarter, with many countries expected to record quarterly declines in GDP.

Apart from China, where the recovery is already underway, the contraction in activity is expected to be concentrated in the June quarter. In the major advanced economies, GDP is expected to contract in 2020 by 3 to 7% in year-average terms with peak-to-trough declines in GDP of 10 to 15%. For economies in the Asian region that have so far used targeted containment measures, the decline in domestic activity is expected to be smaller, but weaker external demand will slow growth in the region.

Unemployment rates in advanced economies are expected to increase significantly and are likely to take longer than GDP to return to their pre-COVID-19 levels. More of the labour market adjustment is likely to take place through reduced hours worked and earnings in economies that have expanded or created wage subsidy programs. This includes many euro area economies, the United Kingdom, Canada and New Zealand. In Germany, which has a long track record with such programs, the unemployment rate is expected to increase by less than 1%, while Spain's central bank expects the unemployment rate to increase by 4 to 8% in 2020.

Global inflation is expected to be subdued. In the short term, weaker demand and very low oil prices will reduce inflation despite the disruptions to global supply chains and the temporary upward price pressures on staple goods. In the medium term, spare capacity in the labour market will lead to ongoing downward pressure on inflation.

US: Economic data released during the month was mixed with total nonfarm payroll employment increasing by 263,000 in April, sending the overall unemployment rate to 3.6%, from 3.8% a month earlier. Wage growth remained steady at 3.2% compared with a year earlier. The US manufacturing purchasing managers' index (PMI) fell two points to 50.6, while the new orders component declined to below 50, indicating that the sector is contracting. However, US consumer confidence remains robust, with a reading of 134.1 in May, compared with 129.2 a month earlier.

The US administration blacklisted Chinese tech giant Huawei on security fears and said it will impose a new tariff of 5% on all Mexican imports in a bid to force Mexico's government to stem the flow of migrants entering the US across its southern border. The technology, energy and industrial sectors were among the weakest performers in May as investors became nervous about the prospects for global growth. Utilities, Healthcare and Consumer Staples, whilst also lower, proved to be more resilient. The real estate sector outperformed.

UK and Europe: The Office for National Statistics reported that the UK economy had contracted by 2% in Q1 2020 as lockdowns in response to the Covid-19 pandemic took their toll on activity towards the end of Q1. The preliminary estimate was less negative than consensus estimates, though it does represent the largest fall in GDP since the fourth quarter of 2009 and the global financial crisis.

The UK government began to ease lockdown measures with people encouraged to return to work where possible and a phased reopening of the retail industry and schools confirmed. Meanwhile, the UK's departure from the EU returned to the agenda as the end of June deadline to extend the Brexit transition period, which expires on 31 December 2020, came into view.

Many European countries began to ease out of lockdown. European Commission president Ursula von der Leyen called for the power to borrow €750 billion for a recovery fund to support those EU regions that have been worst affected by Covid-19. This would be in addition to the €540 billion rescue package agreed in April.

China: In China, the monthly economic data indicated that the domestic recovery was beginning to get back on track with the production side of the economy returning to pre-COVID-19 levels while, at the same time, the annual National People's Congress meeting announced a higher-than-expected fiscal support package.

Emerging Markets: Emerging equity markets took comfort from the reopening of virus-hit economies around the world despite the rate of infections in Brazil, Russia and India continuing to rise. Supported by stimulus efforts from governments and central banks, as well as optimism that a coronavirus vaccine will eventually be developed, the asset class generated positive, albeit modest, returns last month.

To soften the impact of Covid-19, interest rates were cut in several countries, including Brazil, Mexico, South Korea, India and South Africa. Commodity prices bounced back somewhat, led by energy prices, with metals such as gold and silver also recording price gains. Commodity-sensitive currencies strengthened in value against the US dollar with the Mexican peso and Russian rouble appreciating the most.

In conclusion: A stronger economic recovery is possible, however, if further gains in controlling the virus are achieved in the near term, allowing most containment measures to be phased out over coming months and with more limited damage to business and household confidence and balance sheets. In this scenario, it is expected that much of the near-term decline in GDP growth and the rise in the unemployment rate would be reversed over the next few years.

Currencies

The USD depreciated by 0.7% in May. The defensive British Pound (-1.5%), Japanese Yen (-0.6%) and the Canadian Dollar (+0.9%) were the worst performing currencies, while the commodity driven Norwegian Krone (+5.9%), Swedish Krona (+4.1%) and Danish Krone (+2.4%) were the best performers.

Commodities

Bulk commodity prices were strong in May. Brent crude rose $10.06/bbl to $35.33/bbl. Among the bulks, iron ore prices increased substantially, increasing $18.00/t to $101.50/t, while thermal and hard coking coal prices remained stable. Gold prices rose by $25.95/oz to $1,728.70/oz. The rise in iron ore prices was driven by a combination of robust demand and supply constraints in Brazil.

Please stay safe and focussed on the long term.

Table 1: Market Performance – Periods to 31 May 2020

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	4.4	-9.9	-6.7	4.3	4.3
Australian Shares Small Cap	10.6	-1.9	-2.9	7.5	6.6
International Shares Ex-Aus (Unhedged)	3.5	-1.3	12.5	10.4	9.1
International Shares Ex-Aus (Hedged)	4.8	1.6	7.7	6.3	6.2
Emerging Markets (Hedged)	0.7	-4.6	-0.5	2.8	3.3
Emerging Markets (Unhedged)	-0.6	-9.6	-0.2	3.7	3.8
Australian Listed Property	7.0	-21.1	-16.8	0.8	3.8
International Listed Property ($A)	-1.0	-12.9	-5.5	3.9	4.5
Australian Direct Property*	0.4	-2.6	-1.1	7.5	9.9
Australian Fixed Interest	0.3	0.0	4.9	5.1	4.5
International Fixed Interest (Hedged)	0.3	0.2	6.1	4.5	4.5
Cash (BAUBIL)	0.0	0.2	1.0	1.6	1.8
		Change over the month			
Australian Govt. 10 yr Bond Yield	0.91%	5 bps			
AUD/USD	$0.67	$0.02			

*As at 30 April 2020

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

The S&P/ASX 200 Accumulation Index had another strong month, up +4.4% in May but down -6.7% for the 12 months.

As health-based restrictions begin to ease, consumer exposed sectors have been leading the rally.

In Australia, Information Technology (+14.5%) and Small Resources (+14.3%) outperformed the most, while Healthcare (-5.3%) and Consumer Staples (-0.4%) under-performed. Best performing shares in May were: Kogan (+40%), Carbon Revolution (+25%), Ansell (+24%), and Vista Group (+22%).

The index finished trading at a P/BV of 1.8x and a P/E Ratio of 16.5x and equity yield (dividend) of 4.2%.

The VIX was at 28.0 (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 strong month rising +10.6% in May and only -2.9% for the 12months. Resources outperformed Industrials helped by the 85% bounce in oil prices.

Key contributors to the index return for May were online design and fulfilment provider Redbubble (+57.0%), aerospace component fabricator Quickstep Holdings (+42.9%) and digital payments company EML Payments (+29.5%).

Trailing P/E Ratio was at 15.9x 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) +3.5% for May whilst the MSCI World ex Australia Index (Hedged) returned +4.8%.

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 2.3x and a P/E Ratio of 20.0x and equity yield (dividend) of 2.4%.

US market: US equity markets advanced higher during May, encouraged by signs of states and businesses around the country reopening. Positive sentiment was also enhanced by the potential development of a coronavirus vaccine although the number of Covid-19 cases continued to rise.

The Dow Jones Industrial Average rose +4.3% in May. The S&P 500 Index rose +4.5% and the NASDAQ Composite surged +6.8%.

The majority of industry sectors moved higher in May, with increases in Communication Services (+11.5%, Consumer Discretionary (+7.8%), Energy (+7.6%), Financials (+4.2%), Health Care (+2.3%), Industrials (+5.9%), Materials (+6.3%), Real Estate (+2.3%), Technology (+10.0), and Utilities (+0.1%). A small loss was experienced by Consumer Staples (-0.1%).

UK market: In anticipation of a resumption of economic growth, and a corresponding recovery in corporate earnings, the UK equity market ended the month higher amid the continued loosening of pandemic-related restrictions. News of a possible Covid-19 vaccine also boosted returns, though volatility remained high.

The recovery in equity prices experienced in recent weeks can in large part be attributed to the expected impact of a dramatic easing of fiscal and monetary policies in all the major economies.

For the month of May, the UK equity market rebounded strongly, with the UK FTSE Index returning +8.0%.

European markets: European equity markets took comfort from the reopening of virus hit economies around the world despite the rate of infections in Brazil, Russia and India continuing to rise. Overall gains, however, were held up by mild weakness in Asia (mainly Hong Kong). Healthcare was the best performing sector with real estate and financials being the laggards.

Chinese market: Chinese stocks fared worst (-0.6%) amid the deepening trade conflict and weaker-than-expected economic data for April**.** Hong Kong equities also retreated due to the re-emergence of demonstrations.

Emerging markets: Emerging market equities fell in May as US-China trade talks unexpectedly broke down, and global growth concerns increased. Separately, the US announced plans for a 5% levy on Mexican imports. The MSCI Emerging Markets Index declined marginally and underperformed the MSCI World.

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

Emerging market (EM) equities, in local currency terms, rose marginally in May +0.7%, and -0.6% in AUD.

The index ended trading at a forward P/E Ratio of 12.8x and P/BV of 1.7x and equity yield (dividend) 3.1%.

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

The S&P/ASX 200 Property Accumulation index returned +7.0% in May again outperforming the S&P/ASX 200 by a staggering +4.6%.

S&P/ASX Industrial AREITs returned +16.7% in May, S&P/ASX Diversified AREITs returned +8.4% and S&P/ASX Retail A-REITs returned +0.7%. S&P/ASX Office AREITs returned -0.9%.

The best AREIT performers over the month were Charter Hall Group (+26.7%) and Stockland Group (+24.0%). Key underperformers were Unibail-Rodamco-Westfield (-14.3%) and GPT Group (-5.7%).

At the end of May, the index was trading on a dividend yield of 5.9% with a P/BV 0.9x and a P/E Ratio 11.1x.

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

Globally, REITs returned -1.0% (Unhedged) over the month of May. Japan was the top-performing region (+5.0%). The worst-performing region over the month was Hong Kong (-13.9%).

At the end of May, the index was trading on a dividend yield of 4.8% with a P/B 1.3x and a P/E Ratio 17.4x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted -2.6% return over 3-month period to April 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 +0.29% over the month. Australian government 10-year bond yields decreased by 1bp to 0.88% (June futures contract). At this point, the 10-year Australian bond yield was 23bps above the US 10-year Treasury yield. 3-year “single A” corporate credit spreads tightened from 1.48% to 1.29%.

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

Global bond yields hardly moved in May, with the US 10-year Treasury bond yield up 1 basis point to 0.65%. The Aussie dollar moved from 65.11 to 66.69.

International fixed interest returned +0.40% over the month (in AUD, as per Bloomberg Barclays' benchmark). The US corporate investment-grade (BBB) credit spread tightened from 2.82% to 2.44%.

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