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Market Review – September 2020

Impact of COVID-19 in September

- After a summer lull (at least in Europe) Covid-19 returned with force across the continent and in the UK. While increased testing explained away some of the high numbers, governments and markets appeared uncertain how to deal with or contain the pandemic.
- Governments slowly re-introduced limitations on citizens movements and interactions and brought in new measures to support economies.
- In the US, the battle between the federal government and states in how to tackle the virus continued. Economy wise, the resurgence seemed to rule out the hoped-for V-shaped recovery as economists quietly moved onto the letter W.
- US stocks dropped in September as investors worried about stalled fiscal stimulus talks in Washington, the upcoming election, and new coronavirus cases in Europe.
- In Australia, fiscal and monetary policy should remain very supportive. The government is set to announce new measures at the October budget, and many economists expect that the Reserve Bank of Australia will keep rates steady for the rest of the calendar year 2020.
- The Australian Government is forecasting the economy to contract this financial year by -1.5%. But this conceals a "record" -7% contraction in June quarter GDP and a gradual recovery from the second half of this year. A big factor constraining growth is that net immigration is expected to be negative resulting in population growth of just 0.2%, the lowest since 1917.
- For the month, the Dow Jones Industrial Average, which lagged this year slipped -2.3%. The S&P 500 Index -3.9% and the Nasdaq Composite declined -5.2%.
- The S&P/ASX200 fell -3.7%, which was in line with S&P500 and the MSCI world -2.8% (hedged).
- There was some modest rotation towards value factors in foreign markets, but this was not seen in Australia due to underperformance of the financial and energy sectors.

Australian Economy

Even as the global environment clouds over, things are brighter in Australia. Further fiscal largesse from the government in the federal budget and a central bank that is poised to do more sets up a positive policy narrative for the local economy. Furthermore, while not yet eradicated, the spread of COVID-19 appears to be under control and domestic borders are set to reopen. Well let's hope so anyway, especially for the Victorians!!

Consumer and business confidence continue to recover as COVID-19 cases fall and domestic borders reopen along with some parts of the service sector. Consumer confidence rose to 93.8 in September and business confidence to -3.8. While still low by historical standards, they are trending in the right direction.

The labour market is key to the economic outlook but is currently sending mixed signals. The unemployment rate continues to decline and fell by more than expected in August to 6.8%. However, the weekly series of payrolls indicated that job losses had actually increased over the month. It should be acknowledged that the Government's employment schemes are distorting the data, and the pace of improvement in the labour market under any extension or revision of these schemes will be crucial for the economic outlook.

The yield on 10-year Australian government debt fell by 20 basis points (bps) over the month to 0.84% as there was some speculation that the Reserve Bank of Australia will cut rates again this year and may engage in outright quantitative easing.

The latest stimulus takes Australia's total level of coronavirus related fiscal stimulus this year up to 10% of GDP, which is at the high end of comparable countries. This along with ongoing stimulus into next year should aid the economic recovery. However, a test lies ahead as direct income support and the bank payment holiday taper, given the long tail of unemployment and underemployment.

It is expected that the cash rate is likely fall to 0.1%, and that cash and bank deposit returns will remain low for some time.

Global Economy

The month of September, driven by a combination of increasing COVID-19 cases in parts of Europe and the U.S., rising political uncertainty running into the U.S. presidential and congressional elections and questions about the durability of the global economic recovery without further fiscal support.

A second wave of COVID-19 infections is washing through Europe, with France, Spain and the UK being hit the hardest and experiencing an increase in mobility restrictions. There is no expectation of nationwide lockdowns this time around, but the rise in cases highlights the stop-start nature of dealing with a pandemic and what it means for a staggered recovery.

Also evident is the waning economic momentum into the end of the year across many developed markets. Due to the high number of COVID-19 cases, services-related industries continue to lag the improvement in the manufacturing cycle from the increased demand for goods. Given that services are a larger share in many developed economies, this has led to downward revisions to growth expectations in the coming quarters.

US: Central bank policy continues to have a significant influence on returns. At its September meeting, the US Federal Reserve (Fed) reiterated its message that US interest rates will remain low for the foreseeable future. The Fed, which is now targeting long-term rather than annual inflation, does not think that inflation will reach 2% until 2023. The "dot-plot", which is the forecasts of each member responsible for setting US interest rates shows no change until 2023.

US equity markets slipped lower in September to record their first monthly losses since March as virus second wave concerns rose. The failure of lawmakers to agree on another stimulus bill and rising tensions with China ahead of the forthcoming US presidential election also dampened sentiment.

While economic data was generally positive – pending home sales jumped to an all-time high – momentum in the recovering labour market appears to be stalling as worries about the reintroduction of new containment measures increased.

The US unemployment rate dropped to 8.4% in August, down from 10.2% in July and below consensus expectations of 9.8%. The labour force participation rate also improved, but it is still below its February pre-pandemic level. Industrial production rose for the fourth consecutive month in August, albeit at a much lower rate than earlier in the summer, signalling a slowing recovery in manufacturing. Similarly, retail sales increased in August, but again at a slower rate and below consensus expectations. Spending at food and beverage stores continued to be strong.

However, the monthly ADP report – a precursor to the US government's non-farm payrolls report (due for release in early October) – was better than-expected with private US companies adding 749,000 payrolls in September.

In other developments, the first of three scheduled presidential debates between Donald Trump and Joe Biden was held, although the event will probably be remembered for chaos and the exchange of insults.

The housing sector has been a bright spot in a challenging year and has seen strong consumer demand thanks to historically low interest rates.

Home building and home sales have set new records in recent months, while home builder confidence is at an all-time high. The National Association of Home Builders/Wells Fargo Housing Market Index posted a reading of 83 out of a possible 100 in September, well above its previous record high of 78.4,5. Housing accounts for 15% of US gross domestic product.

UK and Europe: In the UK, the minutes from the Bank of England's September meeting again raised the prospect of a negative UK policy rate. The minutes revealed that they have been briefed on plans to explore how a negative Bank Rate could be implemented. Subsequently, some members have cast on this policy. Nonetheless, the news provided a further catalyst for Gilt yields to fall. Brexit came back into focus, in particular the difficulties with Northern Ireland.

The UK government's internal markets bill, which seeks to maintain an internal market within UK in the case of no deal, raised concerns in the European Union. This was not only because of its implication for trade between the Republic and Northern Ireland, but also the UK government's admittance that the legislation would break international law. Sterling weakened in light of legislation.

The rate of improvement in economic data slowed over the quarter and worries took hold over sharply rising Covid-19 infections in many European countries. The energy and financials sectors saw the sharpest falls while materials and consumer discretionary advanced, with automotive and luxury goods stocks generally faring well.

Emerging Markets & Asia: Emerging market equities registered a robust return in Q3, aided by optimism towards progress on a Covid-19 vaccine and ongoing economic recovery. US dollar weakness proved supportive.

Taiwan, where strong performance from IT stocks supported gains, and India and South Korea were among the best-performing index markets. India outperformed the MSCI Emerging Markets Index as monsoon rains remained reasonable and the government made progress with agriculture and labour reforms. This was in-spite of continued increases in the number of new Covid-19 cases as well as tensions with its border with China.

China's economy continued to recover. Q2 GDP growth rebounded to 3.2% year-on-year, after a fall of -6.8% in Q1, and was stronger than expected. Q2 earnings results were also ahead of expectations, notably in the e-commerce sector. However, US-China tensions continued to escalate. These included additional measures against Chinese technology companies, and President Trump's executive order to end Hong Kong SAR's special status with the US.

Conversely, Turkey recorded a negative return and was the weakest market in the index, primarily due to lira weakness. This was despite a 200bps interest rate rise from the central bank in September.

Thailand and Indonesia underperformed, as did the CE3 markets of Poland, Czechia and Hungary, as new cases of Covid-19 increased. Russia and Brazil also finished poorly. In Russia, uncertainty over US foreign policy due to the US presidential election and, later in the period, crude oil price weakness, weighed on sentiment. In Brazil, concern over the fiscal outlook was the main headwind.

In conclusion: In the coming weeks' the global economy has to deal with the effects emanating from the US election which has the potential to create further volatility in investment markets. A Trump victory will mean more of the same and at least initially would probably be more positive for US shares than global and Australian shares (all other things being equal). By contrast a Biden victory may add to short-term volatility but this is likely to be short lived as there is no reason to expect a weaker economy and hence share market under a Biden presidency and he is likely to take a less disruptive approach to trade and foreign policy issues.

Currencies

The USD rose by 1.9% in September, largely driven by risk off sentiment and less dovish than expected US Fed comments. The Japanese Yen (+0.2%), Euro (+1.8%) and Danish Krone (+1.8%) were the best performing currencies, while the Norwegian Krone (-7.4%), Swedish Krona (-4.1%) and Sterling (-3.6%) were the worst performers.

Commodities

Commodities, as measured by the S&P GSCI Index, delivered a positive return in the third quarter, aided in part by US dollar weakness. Livestock and agriculture were the best-performing components. Industrial metals posted a strong gain, led by steel, iron ore and zinc. The positive return from precious metals was driven mainly by a rally in the silver price. Energy was the only component to finish in negative territory, posting a slight fall. Crude oil prices fell back in September amid concern over the sustainability of the recovery in global growth. An extension of supply cuts from OPEC (the Organisation of Petroleum Exporting Countries) and partner nations also remained unclear.

Table 1: Market Performance – Periods to 30 September 2020

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	-3.7	-0.4	-10.2	4.8	7.3
Australian Shares Small Cap	-2.8	5.7	-3.3	6.5	10.0
International Shares Ex-Aus (Unhedged)	-0.3	3.9	4.9	11.8	10.7
International Shares Ex-Aus (Hedged)	-2.8	7.0	9.6	8.5	11.0
Emerging Markets (Hedged)	-1.6	8.8	5.2	10.0	6.0
Emerging Markets (Unhedged)	1.6	5.4	5.9	8.9	6.0
Australian Listed Property	-1.5	7.0	3.7	5.6	9.6
International Listed Property (Unhedged)	-2.4	-4.7	2.5	2.4	8.8
Australian Direct Property*	0.2	0.8	-0.3	6.3	9.2
Australian Fixed Interest	1.1	1.0	6.0	4.5	5.6
International Fixed Interest (Hedged)	0.4	0.7	4.7	4.5	5.7
Cash (BAUBIL)	0.0	0.0	0.6	1.4	1.6
		Change over the month			
Australian Govt. 10 yr Bond Yield	0.90%	+1 bps			
AUD/USD	$0.72	-$0.02			

*As at 31 September 2020

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

The S&P/ASX200 fell -3.7%, which was in line with S&P500 -3.9% and the MSCI world -2.8% (hedged). There was some modest rotation towards value factors in foreign markets, but this was not seen in Australia due to underperformance of the financial and energy sectors.

In Australia, Health Care (+0.9%), Industrials (-0.3%) and REITs (-1.5%) outperformed the most, while Energy (-11.1%), IT (-6.8%) and Consumer Staples (-6.6%) underperformed.

Stocks that had a positive return in the month were; Carbon Revolution (+64%), Opticomm (+17%), Corporate Travel (+13%) and James Hardie (+6%).

The index finished trading at a P/BV of 1.9x and a P/E Ratio of 18.5x and equity yield (dividend) of 3.6%.

The A-VIX was at 26.0 (the average since 01.10.2010 is 16.4 indicating a high level of market volatility.

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

The Small Ords Accumulation index fell -2.8% after a very strong August. Industrials outperformed resources despite iron ore and base metals being particularly strong and gold rising. Consumer discretionary stocks (especially retailers) led the small-cap market with building material companies also strong late in the month.

Many of the retailers have been seeing extraordinary sales growth figures –not just with their online offerings. Standout performers were; Codan, Baby Bunting, Pinnacle Investment Management and Redbubble.

The performance of the S&P/ASX Small Ords Index continues to outpace the broader market – as it has done both this year and in the past five. Why? Better growth characteristics and valuation.

Trailing P/E Ratio was at 18.9x at the end of the month, P/BV is at 1.6x and equity yield (dividend) of 3.1%.

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) -0.3% for September whilst the MSCI World ex Australia Index (Hedged) returned -2.8%.

International markets struggled amid more coronavirus cases in Europe and concerns over the tensions between the U.S. and China. European markets were broadly weaker. France dropped -2.9%, Germany lost -1.4%, and the U.K. slipped -1.7%. Pacific Rim stocks were mixed as Hong Kong declined -6.8%. Japan notched a solid gain +9.7%.

The index finished trading at a P/BV of 2.5x and a P/E Ratio of 24.0x and equity yield (dividend) of 2.1%.

US market: The Dow Jones Industrial Average, which lagged this year slipped -2.3%. The Standard & Poor's 500 Index lost -3.9% and the Nasdaq Composite declined -5.2%.

After a strong summer rally, equity prices in the communication services sector retreated with Facebook and Alphabet (owner of Google) losing the most ground. However, it wasn't all one-way traffic with Twitter aficionados more upbeat as the social messaging company's share price hit a two-year high. Technology stocks also gave up some ground following their stellar performances since mid-March with Apple's shares feeling a little bruised as the company's market capitalisation fell below US$2 trillion.

After a strong rally in August, US investor sentiment quickly turned negative as technology stocks dragged down the overall market.

The retreat in the technology sector gathered steam as the month wore on, sending the tech-heavy Nasdaq Composite into correction territory over a three-day span following a recent record high. A correction is defined as a decline of at least 10% but not more than 20% from a recent high.

All 11 industry sectors were lower in September, with losses in Communication Services (−6.6%), Consumer Discretionary (−3.1%), Consumer Staples (−3.7%), Energy (−17.6%), Financials (−6.4%), Health Care (−3.9%), Industrials (−2.0%), Materials (−1.5%), Real Estate (−4.0%), Technology (−6.0%), and Utilities (−0.4%).

UK market: The UK Equity market ended the month in negative territory reflecting news flow around the pandemic. A steep rise in confirmed cases of the virus raised the prospect of a second lockdown. Concerns about a stalling economic recovery ahead of the next round of Brexit negotiations also impacted sentiment.

Volatility remained at elevated levels, though it has reduced from the extremes of March and April. It is likely to remain high until the outcome of the Brexit negotiations become clearer, the impact of a second (or third) wave of the virus is better understood, and pending further action by Governments and Central Banks – both in the UK and around the world. Oil & Gas and Financials were the worst performing sectors over the month. Pessimism remains entrenched in Oil & Gas. Refineries are struggling to deliver a profit as overcapacity in the sector meets tepid demand for its end-products.

For the month of September, the UK equity market fell, with the UK FTSE Index returning -1.7%.

European markets: European equity markets fell in September as investors were spooked by the rise in coronavirus cases and subsequent increase in restrictions. Against this backdrop, consumer discretionary, health care and materials rose most. Meanwhile, energy, financials and real estate were by some degree the worst performing areas in the market.

Eurozone PMIs (the purchasing managers' index) recorded another miss in September, barely staying above the important above 50-point level (above 50 suggests economic expansion, while below 50 suggests economic contraction). However, digging beneath the surface shows that the trajectory is not the same for all parts of the economy. The Services component is now firmly back into contraction territory after falling to 47.6 (50.5 in August).

Meanwhile, Manufacturing registered strong growth after rising to 53.7 (51.7 in August), largely driven by a rebound in manufacturing activity in Germany. The data points to a two-speed economy with manufacturing continuing its strong recovery, while services, most under pressure from lockdown measures and restrictions, has stalled as coronavirus cases continue to rise.

Chinese market: In China, the market lagged the performance of the region, partly down to elevated US-China tensions on the technology front. The US announced the imposition of export controls over Semiconductor Manufacturing International Corporation (SMIC), which triggered waves of sell-offs particularly among semiconductor stocks.

Furthermore, Trump's attempt to ban WeChat increased concerns over a potential broadening of sanctions as the US election approaches.

Emerging markets: Emerging equity markets failed to hold onto early gains as a resurgence in global Covid-19 cases increased concerns over a second wave. Among the regions Latin America was the weakest performer, followed by EMEA (European Middle East and Africa).

Performance in Asia displayed more resilience, drawing support from positive economic data and a sense that Asian economies have generally handled coronavirus outbreaks relatively well. At a country level, performance varied with India, Korea, Taiwan and Mexico generating positive returns. At the other end of the table, Indonesia was the laggard on fears that its critically important tourism industry could suffer serious blows from the pandemic.

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

Emerging market (EM) equities (unhedged) was up +1.6% in September but down -1.6% on a hedged basis.

India was the star performer from emerging markets, whilst China, Brazil and Russia were the main contributors to the index's negative performance for the month.

The index ended trading at a forward P/E Ratio of 16.4x and P/BV of 1.9x and equity yield (dividend) 2.5%.

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

The S&P/ASX 200 Property Accumulation index returned -1.5% in September, outperforming the S&P/ASX 200, which returned -3.7%. For the 12 months, AREITs returned -16.6%, underperforming the market, which returned -10.2%. S&P/ASX Diversified AREITs returned +0.4% in September, S&P/ASX Office AREITs returned +0.1%, S&P/ASX Industrial AREITs returned -1.8% and S&P/ASX Retail AREITs returned -3.4%.

The best AREIT performers over the month were Abacus Property Group (ABP) at +4.7% and Mirvac Group (MGR) at +3.3%.

At the end of the month the index was trading on a dividend yield of 5.0% with a P/BV 1.1x and a P/E Ratio 17.4x.

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

Globally, REITs returned -2.4% over the month of September. In USD terms the top-performing region was New Zealand (-0.3%) followed by Singapore (-1.0%). The worst-performing region over the month was the United Kingdom (-8.8%).

At the end of the month the index was trading on a dividend yield of 4.6% with a P/BV 1.4x and a P/E Ratio 19.6x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted +0.8% return over 3-month period to September2020. 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 5.1%, 5.3% and 5.3% respectively.

Australian Fixed Interest (Bloomberg AusBond Composite Bond Index)

Australian fixed interest returned +1.08% over the month. Australian government 10-year bond yields decreased by 20bps to 0.84% (December futures contract). At this point, the Australian 10-year Treasury bond yield was 16bps above the US 10-year Treasury yield.

3-year “single A” corporate credit spreads widened from 0.66% to 0.68%.

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

Global bond yields fell in September but by less in the US, with the US 10-year Treasury bond yield down 3 basis points to 0.68%. The Aussie dollar moved from 73.77 US cents to 71.66 US cents.

International fixed interest returned +0.42% over the month (in AUD, as per Bloomberg Barclays' benchmark). The US corporate investment-grade (BBB) credit spread widened from 1.76% to 1.84%.

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