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Market Review – October 2020

Impact of COVID-19 in October

- Along with high rates of infection in the US and elsewhere, the surge in infections had economists scrambling to re-assess recovery trajectories which also dented market confidence. Asia was a bright spot as the largest economies there appeared to be avoiding the worst.
- New deaths in developed countries remain below April highs despite new cases being far higher. However, deaths are rising rapidly in Europe as are hospitalisations which is threatening to overwhelm the health system in some countries.
- Global equities declined in October. The US presidential election and rising Covid-19 cases in many countries, notably across Europe, were the main focus for investors.
- The 2020 US election comes at a historic time, with the global economy in the grips of a pandemic, central banks unleashing massive stimulus and trade relationships fraying.
- The IMF has predicted that China's economy would expand by 1.9% in 2020 following its rapid recovery from the coronavirus pandemic.
- Compared with other global equity markets, Australia performed well in October. The US S&P500 Index was down -2.8%, the Nasdaq down -2.3% and the Dow Jones lost -4.6%. European markets were very soft on new lockdowns with the UK FTSE100 down -4.9% and the German DAX tumbling -9.4%.
- The ASX edged higher +1.9% in October as deal making helped to offset rising COVID-19 infections in the northern hemisphere and amid increasing nervousness around the looming US election.
- In Australia, consumer confidence continued to rise, NAB business conditions rebounded further to +0.4 in September (previous: -6.2), and business confidence rose to a still weak -3.8 (previous: -8.2). The October Westpac Melbourne Institute consumer sentiment rose 11.9% (previous: +18.0%).
- Domestically, Governor of the RBA, Philip Lowe, confirmed that based on the local economy's current outlook, the cash rate is not expected to increase for at least three years.

Australian Economy

September quarter inflation data provided no surprises with a sharp rebound at the headline level on the back of the ending of free childcare and a rebound in petrol prices. Underlying inflation remains a much better guide to inflation pressures in the economy and it remained weak at 1.2% year on year and consistent with the RBA providing more monetary easing in November. Producer price inflation also remained weak at -0.4%yoy in the September quarter.

Meanwhile, growth in the stock of total credit remained soft in September with a slight uptick in housing credit suggesting growth in new loans is just starting to offset the more rapid repayment of existing loans. The terms of trade look to have fallen again in the September quarter with export prices declining faster than import prices (with sharp falls in gas and coal prices) and therefore expected cut into national income.

In annual terms, retail sales rose 6.6% in September, following August's 5.4% expansion. Meanwhile, annual average growth in retail sales rose from 4.2% in August to 4.6% in September. Cafes, restaurants and takeaway food services and department stores retailing expanded.

Level 3, 155 Queen Street, Melbourne VIC 3000 ABN: 58 097 703 047 AFSL Number: 230846
enquiries@atchison.com.au www.atchison.com.au P: +61 3 9642 3835 F: +61 3 9642 8886

On 6 October, the government presented the 2020–2021 draft budget to Parliament, which includes both tax cuts and additional spending in an effort to boost the economy and spur job creation following the impact of the coronavirus outbreak. As such, the budget envisages a record-breaking fiscal deficit of roughly AUD 214 billion (10.7% of GDP). The plans come on the heels of the Central Bank's ultra-expansionary monetary policy stance and should help the economy to leave behind its first recession after almost 30 years of uninterrupted GDP growth.

The package includes bringing forward income tax cuts previously set for 2022, making them effective from 1 July of this year, in order to sustain household spending. It also contains a notable spike in expenditure, aiming to provide around AUD 14 billion in additional infrastructure spending to the states. In an effort to support job creation, the proposal assigns AUD 4 billion to incentivise firms to hire younger people and AUD 1.2 billion for wage subsidies for new apprentices. On top of that, the budget also includes measures to encourage business investment by granting instant asset write-offs worth around AUD 26.7 billion.

Looking ahead, the mix between extra spending and lower taxes, coupled with the Reserve Bank of Australia's extremely loose monetary policy stance, will likely support a faster pace of recovery ahead.

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

US: US GDP showed a sharp 7.4% rebound in the September quarter after the 9% slump seen in the June quarter. This was broad based and pretty much as expected reflecting the reopening of the economy. More timely data was mostly good with solid gains in durable goods orders, regional manufacturing conditions surveys and house prices, stronger than expected growth in personal spending, new and pending home sales remaining strong despite slight pull backs and initial and continuing jobless claims falling. Consumer confidence was weaker than expected though. After the September quarter rebound the level of US GDP is still 3.5% down from its December high and the recovery is likely to be a lot slower going forward as rising coronavirus cases constrain activity and some parts of the economy take longer to recover.

US non-farm payrolls grew by 661,000 in September. Hiring was slightly below expectations, but it was enough to drop the unemployment rate to 7.9%, down from the previous month's 8.4%.

Consumer spending rose 1.9%, led by a 3.6% jump in motor vehicle sales. It was the fifth consecutive month of higher retail sales.

Industrial output fell 0.6% in September after four straight months of gains. Industrial production was 7.1% below its pre-pandemic February level.

By month end around 64% of US S&P 500 companies have reported September quarter earnings with 85% surprising on the upside regarding earnings (compared to a norm of 75%) and 77% surprising on the upside regarding revenue.

UK and Europe: The perennial issue of Brexit also re-emerged last month, with the European Council meeting on 15-16 October (which was previously seen as a key deadline) passing without a deal being struck. After negotiations were briefly paused, talks are now intensifying as both sides seek to agree a trade deal before the year end.

UK business confidence has fallen for the first time in five months, hit by the resurgence of COVID-19 cases and restrictions to contain their spread, a survey showed in October. Lloyds Bank's business barometer slumped by seven points to -18, dragged down by the services sector. Confidence among manufacturers and retailers edged up. UK companies were also worried about the prospect of a no-deal end to Britain's post-Brexit trade transition with the European Union on December 31.

UK factories lost more momentum in October, especially among consumer goods makers, according to a survey which added to signs of a slowdown in the economy as the number of coronavirus cases mounts again.

The IHS Markit/CIPS manufacturing Purchasing Managers' Index (PMI) fell to 53.7 from September's 54.1 but was up a touch from a preliminary reading and remained above the 50.0 threshold denoting growth.

Stock-building by clients in Europe ahead of a possible no-deal end to Britain's post-Brexit transition period on December 31 and increased demand from the recovering economies of China and the United States boosted exports.

After a catastrophic decline in the second quarter 2020, Europe's real GDP increased sharply in the third quarter. However, it remained significantly below the level from a year earlier, especially in Spain. Moreover, it is likely that economic growth is stalling due to the resurgence of the virus. Indeed, the relatively weak performance of Spain is likely related to the fact that Spain was early to experience the resurgence.

In the third quarter, real GDP in the Eurozone was up 12.7% from the previous quarter but down 4.3% from a year earlier. In the larger European Union (EU), real GDP was up 12.1% from the previous quarter and down 3.9% from a year earlier. It appears to be the case that the sharper the decline in the second quarter, the faster the rebound in the third quarter. Hence, German GDP fell 9.8% in the second quarter and increased 8.2% in the third. Meanwhile, Spain's GDP fell 17.8% in the second quarter and increased 16.7% in the third. Still, Spain's GDP remains 8.7% below a year earlier while Germany's is only 4.2% below a year earlier.

Eurozone unemployment rose to 8.3% in September, the recovery in economic confidence stalled in October and core inflation remained weak at 0.2% year on year. While the ECB left monetary policy on hold, it indicated that it will "take action" and "recalibrate all our instruments" at its December meeting on the back of the threat from rising new coronavirus cases and a loss of momentum in the recovery. We expect this additional easing to take the form of more bond buying and extended cheap bank financing.

Emerging Markets & Asia: Emerging equity markets rose in October, unlike their peers in the developed world. However, there was a significant divergence in performance across emerging countries. Asian markets stood out as this was the only region in the world to register a positive return. The advance was led by previous laggards Indonesia and the Philippines.

Equity markets in China also gained ground, drawing support from favourable economic data and rising investor optimism following the unveiling of the country's 14th Five Year Plan. China was the first country to suffer from the virus and has retained stringent controls since. October finally saw the relaxing of the internal controls restricting movement between provinces that China has kept in place since the outbreak. This has not, so far, led to a resurgence in infections.

China's success in controlling the virus has allowed its economic recovery to gather pace, with third-quarter GDP growth printing at 4.9% year on year. After a strong bounce over the summer, China now looks set to be one of the only major nations that will see positive economic growth in aggregate over 2020 relative to 2019. Chinese imports have also recovered with the latest data for September showing imports 13.2% higher year on year.

By comparison, equity markets in Latin America and EMEA (Europe, Middle East and Africa) continued to struggle as an increase in fresh Covid-19 cases and the re-imposition of partial to complete shutdowns in selected regions prompted fears of double-dip recessions. All Latin American countries except Mexico posted a weak performance, with Colombia and Brazil leading the declines. A strengthening currency – the peso appreciated by 4.4% – supported equity prices in Mexico along with data showing the economy had bounced back strongly in the third quarter.

Japan's equity market declined over the month in local currency terms. Investor sentiment was dampened by growing concerns about the reopening of economies, a resurgence of Covid-19 infections internationally and the outcome of the US presidential election. However, the number of Covid-19 cases is remaining low in Japan and, so far, the country has not seen a winter rise. After making a good start in September, Prime Minister Suga and his cabinet continued to hold a favourable approval rating while the Bank of Japan maintained its large-scale accommodative stance at its Monetary Policy Meeting at the end of October, as was widely expected.

In conclusion: Investment markets remain vulnerable to further short-term volatility given uncertainties around coronavirus, economic recovery and the US election. But on a 6 to 12-month view shares are expected to see good total returns helped by a pick-up in economic activity and stimulus.

Low starting point yields are likely to result in low returns from bonds once the dust settles from coronavirus. Cash and bank deposits are likely to provide very poor returns, given the ultra-low cash rate of just 0.25% and falling!

Currencies

The USD rose a slight 0.2% in October, largely driven by an increase in risk off sentiment. The Swedish Krona (+1.3%), Japanese Yen (+1.2%) and British Pound (+1.1%) were the best performing currencies, while the Australian Dollar (-1.1%), Norwegian Krone (-0.7%) and Danish Krone (-0.3%) were the worst performers.

Commodities

Global commodity prices fell slightly in October. Brent Oil prices fell $3.49/bbl to $37.46/bbl, partly driven by an appreciating USD. Iron ore prices fell by a slight $2.00/t to $118.00/t. Gold prices decreased slightly from $1886.90/oz to $1,881.85/oz but are still close to record highs.

Table 1: Market Performance – Periods to 31 October 2020

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	1.9	1.0	-8.2	4.1	6.8
Australian Shares Small Cap	0.5	4.7	-2.4	4.6	8.6
International Shares Ex-Aus (Unhedged)	-1.1	2.1	3.3	9.9	9.1
International Shares Ex-Aus (Hedged)	-3.1	0.1	4.2	6.5	8.6
Emerging Markets (Hedged)	1.5	2.1	11.2	4.4	9.2
Emerging Markets (Unhedged)	4.2	4.9	6.6	5.4	8.7
Australian Listed Property	-0.4	5.9	-18.0	2.8	4.5
International Listed Property (Unhedged)	-2.6	-4.9	-21.7	1.0	1.1
Australian Direct Property*	0.2	0.8	-0.3	6.3	9.2
Australian Fixed Interest	0.3	0.9	4.0	5.7	4.5
International Fixed Interest (Hedged)	0.0	-0.4	3.8	4.5	4.4
Cash (BAUBIL)	0.0	0.0	0.5	1.3	1.6
		Change over the month			
Australian Govt. 10 yr Bond Yield	0.82	-8 bps			
AUD/USD	$0.70	-$0.02			

*As at 30 September 2020

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

The ASX 200 rose by a slight 1.9% in local currency terms, outperforming the DM World's return of -3.0%, likely driven by Budget-related optimism. In Australia, IT (+9.0%), Financials (+6.3%) and Consumer Staples (+4.8%) outperformed the most, while Industrials (-3.9%), Utilities (-1.5%) and Materials (-1.2%) underperformed the most.

Stocks that had a positive return in the month were; Coca Cola (+31%), AMP (+17%), CBA, Lendlease and CreditCorp Corporate Travel all up (+8%).

The index finished trading at a P/BV of 1.9x and a P/E Ratio of 19.7x and equity yield (dividend) of 3.6%.

The A-VIX was at 24.0, the average since 1 October 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 edged 0.5% higher in October having been up close to 7% mid-month.

Top performing stocks over the month were: 4DMedical, HUB24, Think Childcare and Johns Lying Group. Stocks that underperformed included Mesoblast, McPherson's, Austal and Uniti Group.

Trailing P/E Ratio was at 19.5x at the end of the month, P/BV is at 1.7x 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) -1.1% for October whilst the MSCI World ex Australia Index (Hedged) returned -3.1%.

Amidst a significant uptick in volatility in the final week of the month, global equity markets finished the month lower. All major bourses finished October in the red, unsettled by rising COVID cases through the US and Europe, the reintroduction of new lockdown measures throughout Europe and uncertainty arising from a contested US election.

The index finished trading at a P/BV of 2.4x and a P/E Ratio of 23.0x and equity yield (dividend) of 2.2%.

US market: The US S&P500 Index was down -2.8%, the Nasdaq down -2.3% and the Dow Jones lost -4.6%. European markets were very soft on new lockdowns with the UK FTSE100 down 4.9% and the German DAX tumbling 9.4%.

US equities declined in October, primarily due to the continued rise in Covid-19 cases in many states. Market optimism over additional fiscal stimulus also waxed and waned, contributing to stock market movements. As the deadline for stimulus negotiations drew near, the unpredictability of the 3 November presidential election added to the wider sense of uncertainty. President Trump hinted more than once that stimulus would be announced post the election, should he win a second term.

The utilities sector - a relatively small component of the S&P 500 - was among the strongest performers in October, while the more significant communications sector made modest gains. All other sectors fell to one extent or another, with the technology, energy and healthcare sectors among the weakest areas of the market.

Utilities (+5.1%) was the only sector to post a gain in October. Communication Services (-0.3%), Consumer Discretionary (-2.7%), Consumer Staples (-2.9%), Energy (-4.1%), Financials (-0.9%), Health Care (-3.6%), Industrials (-1.4%), Materials (-0.7%), Real Estate (-3.2%), and Technology (-5.0%) closed lower.

From a company perspective much of the market's focus was on the mega-cap technology stocks that have driven Wall Street's huge rally since March. Although four of the biggest five stocks in the S&P500 index (Apple, Amazon, Facebook and Google-parent Alphabet) reported quarterly profits that topped analyst forecast, weaker than expected revenue from iPhones and sales in China pushed Apple's share price into the red.

UK market: UK equities fell over the period amid renewed fears of a pick-up in Covid-19 cases. New lockdowns pushed the UK FTSE100 down -4.9%. Policymakers in Wales and Northern Ireland used devolved powers to implement new countrywide lockdowns, while Scotland introduced a tiered system. At the very end of the month, the UK government abandoned its own tiered system in favour of uniform restrictions across England, to run initially for four weeks from 5 November until 2 December.

In response to these events, the UK government announced it would extend the Coronavirus Job Retention Scheme, or furlough scheme, until December. Employees will receive 80% of their current salary for hours not worked, up to £2,500 a month. This scheme was due to be superseded by the Job Support Scheme (JSS) in November, as part of Chancellor Rishi Sunak's "Winter Economy Plan".

Expectations built that the Bank of England (BoE) would use its November policy meeting to extend quantitative easing. It also emerged that the bank's deputy governor, and CEO of the Prudential Regulation Authority, Sam Woods wrote to UK banks to ask them how ready they might be for negative interest rates

European markets: October saw shares fall in the eurozone as several countries reintroduced lockdowns to try and contain rising Covid-19 infection rates. France introduced a strict new national lockdown while partial lockdowns were announced in several other countries including Germany and Belgium. The European Central Bank kept monetary policy unchanged but indicated that more stimulus measures are likely to be announced at the next policy meeting in December.

Data showed that the eurozone economy expanded by 12.7% in the third quarter of 2020 as activity rebounded over the summer. However, this still leaves the economy 4.3% smaller than it was at the same time last year and expectations are that the new lockdowns will weigh on economic activity in the coming months. Indeed, business activity contracted in October according to the Markit composite purchasing managers' index (PMI) which fell to 49.4. from 50.4 in September. 50 is the level that separates expansion in business activity from contraction. The PMI surveys are based on responses from companies in the manufacturing and services sectors. Annual inflation remained stable at -0.3% in October.

October saw the bulk of Q3 corporate earnings' releases. These were largely positive, with many companies beating expectations. Never-the-less, all sectors ended the month in the red. Information technology was among those seeing the steepest falls. German software company SAP cut its revenue and profit forecasts for the year. The energy sector also fell sharply with lockdowns likely to mean reduced demand for oil. The telecommunication services sector was among the more resilient over the month.

Asian markets: The MSCI Asia ex Japan Index delivered a positive return in October, comfortably outperforming the MSCI World Index. Nearer-month-end worries about Covid-19 resurfaced as did US election uncertainty. Indonesia was the best-performing index market, as parliament passed the Omnibus Law which incorporates a number of labour market and tax reforms. The Philippines, where Covid-19 related restrictions were eased, and China also delivered strong gains and outperformed the index. Hopes of a Biden win in the US election – and potentially a smoother road forward for US-China relations – were supportive of Chinese equities, as was the performance of its internet companies and a number of positive Q3 earnings surprises.

Taiwan, India and Korea all finished in positive territory but underperformed the index. Earnings forecasts for Taiwan's companies increased as the outlook for growth improved. In India, the number of daily new cases of Covid-19 continued to fall after the peak in the middle of September. The weakest index market was Singapore followed by Thailand, and Malaysia and Hong Kong SAR also lagged behind.

Emerging markets: Emerging market (EM) equities posted a solid gain as expectations for additional fiscal stimulus in the US increased. It followed a widening of Democratic Party candidate Joe Biden's lead in opinion polls, ahead of the 3 November election. The MSCI Emerging Markets Index increased in value and outperformed the MSCI World.

Indonesia was the best performing EM market, as the approval of the Omnibus Law boosted sentiment. The Philippines, where Covid-19 restrictions were further eased, Mexico and China were the only other markets to outperform the EM index. In China, strong performance from internet stocks was beneficial. The prospect of more stable trade relations with the US under a prospective Biden presidency also proved supportive for stocks.

By contrast, Poland recorded a negative return and was the weakest market in the index. Daily new cases of Covid-19 accelerated and, later in the month protests against the government broke out across the country. Greece and Turkey also finished firmly in negative territory and underperformed the index.

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

Emerging market (EM) equities (unhedged) was up +4.2% in October but down +1.5% on a hedged basis.

Macroeconomic data remains encouraging. Emerging markets performed well during the month: China +5.4%, South Korea +0.6%, India +1.2% and South Africa +1.5%.

The index ended trading at a forward P/E Ratio of 17.0x 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 200 Property Accumulation index returned -0.4% in October, underperforming the S&P/ASX 200, which returned +1.9%. For the 12 months, AREITs returned -18.0%, underperforming the market, which returned -8.1%. S&P/ASX Industrial AREITs returned +2.4% in October, S&P/ASX Diversified AREITs returned -0.1%, S&P/ASX Office AREITs returned -1.9% and S&P/ASX Retail AREITs returned -3.1%.

Key outperformers were Unbail Rodamco Westfield (+19.8%), SCA Property Group (+8.4%) and GPT Group (+3.3%). Key underperformers were Vicinity Centres (-12.0%), Charter Hall WALE (-5.0%) and Abacus Property Group (-4.8%).

At the end of the month the index was trading on a dividend yield of 5.1% with a P/BV 1.0x and a P/E Ratio 17.5x.

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

Globally, REITs returned -2.6% over the month of October, unhedged. The top performing region was New Zealand (+8.2%). The worst-performing region over the month was the Singapore (-7.7%).

At the end of the month the index was trading on a dividend yield of 4.7% with a P/BV 1.3x and a P/E Ratio 18.9x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

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

Australian Fixed Interest (Bloomberg AusBond Composite Bond Index)

Australian fixed interest returned +0.288% over the month. Australian government 10-year bond yields decreased by 1bp to 0.82% (December futures contract). At this point, the Australian 10-year Treasury bond yield was 5bps below the US 10-year Treasury yield.

3-year “single A” corporate credit spreads tightened from 0.68% to 0.58%.

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

Euro-zone bond yields fell in October, but they rose noticeably in the US, with the US 10-year Treasury bond yield up 20 basis points to 0.88%. The Aussie dollar moved from 71.66 US cents to 70.29 US cents.

International fixed interest returned +0.01% over the month (in AUD, as per Bloomberg Barclays' benchmark). The US corporate investment-grade (BBB) credit spread narrowed from 1.84% to 1.71%.

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