Count

Market Wrap

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Economics overview

- Earlier optimism on the virus front started to fade, as a gradual easing of restrictions saw a spike in the number of new cases. This saw new constraints imposed in some areas and prompted the World Health Organisation to suggest the worst of the pandemic may be ahead.
- Locally, further outbreaks of the virus prompted the implementation of new four-week lockdowns in parts of Melbourne. Meanwhile in the US, soaring numbers of new cases saw reopenings scaled back in large States including Florida, Texas, California and Arizona.
- Whilst concerning, markets appears to shrug off these developments. With implicit support from major central banks – which continue to flood markets with liquidity – risk assets remained well supported globally. Australian shares made further progress following solid gains in April and May and credit spreads narrowed further.

- **US:** There is something of an arm wrestle going on in the US. With an eye on November's election, President Trump is encouraging States to reopen to help boost economic activity and employment. At the same time, the number of new COVID-19 cases is spiking up in several key States, suggesting caution may be warranted.
- To put things into context, Florida has a population similar to the whole of Australia, but has now recorded more than 150,000 virus cases compared to less than 8,000 in Australia.
- The number of Americans losing their jobs has fallen from the peak in April, but remains elevated. Initial jobless claims are running around 6x the 'normal' level seen in early 2020 and for several years prior to that. Consumer sentiment remains well below pre-pandemic levels.
- These indicators do not augur well for a rebound in spending, reducing the likelihood of a 'V-shaped' recovery. A 'swoosh' – yes, like the famous sports brand – is increasingly being discussed, whereby the economy will recover much more slowly than initially hoped.
- With the economy on its knees and with social unrest continuing to bubble away beneath the surface, Trump's Presidency appears under threat. He is trailing Democrat rival Joe Biden by around 12 percentage points in national polls. Investors can expect this topic to dominate attention and news headlines in the next few months.

- **Australia:** New clusters of COVID-19 cases in Victoria were concerning, but other States prepared to ease restrictions further in July as the number of new virus cases continued to fall. 'Stage 3' reopening will permit larger public gatherings – up to 100 indoors and up to 10,000 at ticketed outdoor events – enabling pubs, restaurants and other leisure and entertainment venues to reopen.
- Australia's borders remain closed to overseas citizens, though international students will be allowed back into the country with reduced quarantine requirements. Interstate travel will also be permitted in July; a move welcomed by tourism-related businesses.
- Policy settings were unchanged. The official cash rate was left on hold at 0.25% and the Reserve Bank of Australia continued to target the same rate on 3-year government bonds. Interestingly, the central bank was able to achieve this in June with minimal effort. After intervening in the fixed income market and making substantial purchases in April and May, the Reserve Bank did not buy any Australian government bonds in June.
- Consumer confidence remains fragile, especially with house prices falling for a second consecutive month. Prices in major cities declined -0.8% in June, following a -0.5% move in May.

- **New Zealand:** Consumer confidence slumped to its lowest level in more than a decade in the June quarter – hardly surprising given the extent of virus-related disruptions and rising unemployment.
- Despite an improvement since April, credit card spending remains more than -20% below 2019 levels. The hope is that spending will pick up as activity levels start to normalise.
- Encouragingly, New Zealand appears to have the virus under control, enabling authorities to fully reopen the economy. This appeared to support business sentiment, which rose for a second consecutive month. In fact, according to the latest survey, businesses in New Zealand are currently more confident now than they were a year ago.

- **Europe:** The weakness in global economic conditions is being reflected in European industrial production data. Output is currently running -28% below 2019 levels; clearly a major headwind to economic growth rates and confidence levels.
- There is also concern that tariffs may be applied on some European goods imported into the US. This could further erode demand for produce and, in turn, delay any economic recovery in the Eurozone.
- In the UK, Prime Minister Johnson pledged around £5 billion (~A$9 billion) of new infrastructure spending to help support the economy. Investment will be directed towards roads, schools and hospitals and planning rules will be amended to help speed up approval processes.
- The UK economy appears to be performing slightly less badly than anticipated, though the government continues to support incomes through a large and costly job preservation program. It will be interesting to see whether the economy can stand on its own two feet once this support is removed later in the year.

- **Asia/EM:** There was some encouraging news in China, where both manufacturing and non-manufacturing areas of the economy continued to rebound. PMI surveys were ahead of expectations in both areas, suggesting there could be some emerging momentum in the world's second largest economy.
- Economic data for the June quarter will be released in mid-July and will be closely monitored. China is ahead of other countries, having implemented and subsequently removed lockdowns earlier than elsewhere. Accordingly, global investors are looking towards China as a roadmap to see how other economies might respond as restrictions are gradually lifted elsewhere.
- Elsewhere in the region, confidence among Japanese manufacturers slipped to the lowest level since the Global Financial Crisis (GFC).
- The economic slowdown – both domestically and offshore – has eroded demand for almost all types of Japanese goods. This is a concern for car makers and other large manufacturers, who still have the scars from the GFC when Japanese exports halved.

Australian dollar

- Generally buoyant risk sentiment globally continued to support the Australian dollar.
- The currency appreciated by 3.7% and 3.6% against the US dollar and Japanese yen, respectively.
- The 'Aussie' also fared well against a trade-weighted basket of international currencies, closing the month 2.0% stronger.
- These moves had the effect of reducing returns from overseas assets. Global shares added 2.4% in local currency terms, for example, but declined in value (-1.0%) for AUD investors.

Australian equities

- Australian shares were somewhat volatile through June. The strength experienced in late May continued into early June as an improved economic outlook provided support to the poorly performing major banks and saw the S&P/ASX 100 Accumulation Index rise more than 7%.
- However, cautious comments from the US Federal Reserve and growing concerns of a second wave of coronavirus saw the index rewind and end the month +3.0% higher.
- It was a poor financial year for Australian equities as the S&P/ASX 100 Accumulation Index declined -7.8%; the worst performance since the 2008/09 financial year. The social and economic implications of the coronavirus quickly evaporated the 10%+ gains experienced in the first half of the year.
- At the sector level, Information Technology (+8.1%) delivered the best return for the third month in a row. Buy-now-pay-later company Afterpay (+28.6%) continues to integrate itself into the e-commerce market, as it offers value to both merchants and consumers. The company has also continued to grow its customer base globally.
- Gold rallied in US dollar terms, but the appreciation of the Australian dollar saw the price of the yellow metal marginally decline locally. Its weakness contributed to the poor performance of Australian miners Northern Star Resources (-9.7%) and Evolution Mining (-7.0%).
- Both Rio Tinto (+4.9%) and BHP Group (+3.4%) benefited from iron ore supply constraints. Brazilian mining giant Vale was forced to close several mines as workers tested positive for coronavirus.
- The Real Estate (-2.2%) and Energy (-2.1%) sectors were the worst performers. Returns within the Energy sector were widely distributed despite Brent Oil prices rising 4.0% over the month in AUD terms. The sector was dragged lower given the poor performance of sector heavyweight Woodside Petroleum (-4.5%).
- The S&P/ASX Small Ordinaries fell -2.0% over the month, with nearly 60% of constituents delivering negative performances.

Global equities

- Optimism over economies reopening and better than expected employment numbers in the US saw global shares enjoy a strong start to the month, before fresh concerns over a second wave of virus infections and downgraded US growth forecasts spooked investors.
- Despite the volatility, global markets still finished June in positive territory, buoyed by ongoing signs of an economic turnaround in Asia.
- The MSCI World Index finished the month up 2.4% in local currency terms, closing off its best quarterly return, 18.6%, since 1998. The Australian dollar's appreciation limited returns from overseas shares for Australian-based investors to 6.3% over the quarter.
- European markets outperformed, driven by relative success in containing the virus, the potential for the European Commission to establish a €750 billion crisis fund and as investors banked strong recent gains in US shares and reinvested into weaker performing European markets. The German DAX was up 6.2% in Euro terms.
- Emerging Markets bounced back with the MSCI Emerging Markets up 3.5% in Australian dollar terms and comfortably outperforming their developed market counterparts. Recovering commodity prices, particularly gold, drove South African (+16.4%) and Russian (+6.2%) shares higher.

Listed property

- Property markets were mostly flat in June. The FTSE EPRA/NAREIT Developed Index fell -1.0% in Australian dollar terms, broadly in line with returns from broader global share markets.
- News flow regarding the reopening of economies remained the dominant driver of sentiment. Ongoing debate around longer-term implications of the pandemic – such as the impacts of remote working for office buildings – also continued to influence sub-sector performance.
- The best performing region by far was Hong Kong (+12.3%), which bounced back after falling -13.9% in May after Beijing had imposed controversial national security laws in the region. This new legislation was passed in late June.
- Encouragingly, there has been virtually no community transmission of COVID-19 in Hong Kong and the virus appears contained, with below 100 active cases at month end.
- Locally, A-REITs fell -1.4%. The weakness was largely driven by the discretionary retail sub-sector, which continues to be plagued by reduced retail footfall and weak consumer sentiment. The longer term implications of rising e-commerce adoption are also affecting sentiment towards this area of the market. Indeed, a number of retail assets were materially devalued during the month; Mirvac Group, for example, recently reported that the preliminary valuation of its retail portfolio fell -9.9% in the first half of 2020.

Global and Australian Fixed Income

- It was a quiet month in both overseas and domestic bond markets. Policy settings by major central banks have had their desired effect, dampening previous volatility and enabling government bond yields to stabilise.
- Benchmark 10-year government bond yields traded in narrow ranges in June and were little changed in the month as a whole. In the US, for example, 10-year Treasury yields closed the month just a single basis point higher, at 0.66%.
- Yields were unchanged during the month in Germany and Japan and closed 1 and 2 basis points lower in the UK and Australia, respectively.
- All of this resulted in a month of relatively flat returns from global bond markets.
- In Australia, State Government bonds held in relatively well after a strong outperformance back to pre-virus levels over April and May. These securities typically offer higher yields than comparable government bonds and have the same – or very similar – credit ratings as the sovereign. Accordingly, they remained well supported by domestic and offshore investors seeking additional income from the most defensive part of their portfolios.
- Similarly, a new bond was issued by the National Housing Finance and Investment Corporation – a government entity dedicated to the provision of affordable housing for Australians. This security was issued at a yield of 38 basis points above comparable government bonds, with an explicit guarantee by the Commonwealth Government. The issue was therefore attractive, particularly for investors with an orientation towards Responsible Investment. Several of our Fixed Income funds participated in the offer, though allocations were scaled back reflecting strong demand from local investors.

Global credit

- Like equities, buoyant risk appetite enabled corporate bonds to make further progress. Investment grade credit spreads narrowed by a further 25 basis points, to 1.56%, clawing back more of the lost ground from March's sell-off. High Yield spreads were little changed, consolidating following very sharp movements in April and May as valuations snapped back from March's lows.
- Importantly, corporate bonds are included as part of large-scale asset purchase programs that are continuing at the US Federal Reserve, European Central Bank and Bank of Japan. Accordingly, other investors appear to be confident buying corporate bonds in the knowledge that valuations will likely be propped up by central banks on any sign of weakness.
- In Australia and overseas, firms continued to tap into the strong demand for credit by issuing large volumes of new bonds. More than US$100 billion of new bonds were issued in June; the sixth biggest month of new supply ever. All of these issues were digested without any sign of indigestion, underlining the favourable conditions that currently exist in corporate bond markets globally.

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