Count

Market Wrap

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July 2020

Economics Overview

- Covid-19 developments continued to dominate attention. There were spikes in the number of new infections in both Australia and overseas, suggesting an economic recovery may be delayed.
- Share markets powered ahead, however, as investors remained convinced that governments and central banks will provide sufficient financial assistance through the crisis.
- Fixed income markets also registered gains; government bond yields moved lower and credit spreads continued to tighten.

- US: Federal Reserve officials reiterated that the central bank will do 'whatever it takes'' to support the world's largest economy through the coronavirus pandemic. Fed Chair Powell described the economic downturn as the most severe "in our lifetime".
- Politically, there was growing pressure on Congress to approve another stimulus plan, which would likely see unemployment assistance payments extended.
- This was particularly topical, as the number of Americans filing for unemployment benefits started to rise again. This suggested the rebound in the world's largest economy is not progressing as rapidly as had been anticipated.
- The latest data showed US GDP plunged –32.9% in the June quarter; comfortably the biggest decline on record. Consumer spending was very subdued as expected, which acted as a drag.
- With factories closed, companies met demand by running down inventory levels. Economists suggested this could result in a sharp rebound in activity levels in the September quarter and beyond as firms look to restock inventories.
- Business investment was also understandably low – many firms remain focused on staying in business, rather than committing to capital expenditure on new machinery and equipment.

- Australia: Spiking virus numbers in Victoria, in particular, are a concern for the shape of the anticipated economic rebound.
- Border restrictions are expected to remain in place for an extended period, halting tourism and affecting the normal movement of goods and services.
- Unemployment rose to 7.4% in June, a jump of more than 2% from pre-crisis levels. This has significant implications for the Treasury; the Jobkeeper program is costing more than $10 billion per month. Proposed changes to the scheme mean additional unemployment benefits could be paid until March 2021, although plans remain under review and subject to change. The Treasury has suggested an extension to the current program – due to expire in September – will help support the Australian economy through a potential 'second wave' of virus-related disruptions.
- At -0.3%, inflation turned negative in the June quarter; the first negative print since the late 1990s. Even if there is a rebound in the next few months, disinflationary forces are expected to persist. It is extremely unlikely that inflation will return to the 2% to 3% target band any time soon, suggesting there is almost no chance of any interest rate increases for the foreseeable future.

- New Zealand: The recovery in the economy continued to gather pace. Card spending in June was 19% above May's level, which itself was an 80% improvement from April.
- Higher spending means inflationary pressures are persisting. Inflation has come down sharply from earlier in the year, but remains positive. CPI printed at 1.5% for the June quarter.
- Despite these encouraging indicators, both consumer and business confidence dipped in July.

- Europe: June quarter GDP data were dismal in Europe – the German and French economies contracted at an annual pace of -11% and -19% respectively, while Spanish data were worse still.
- Unemployment numbers have increased across Europe, though not quite as substantially as in other regions. In fact, the most recent indicators were more encouraging, with German employment data not deteriorating in July from June.
- In the UK, there was increasing speculation that the Bank of England was considering moving interest rates into negative territory. The Bank's Governor suggested the policy is under "active review", prompting economists to call for more clarity on policymakers' current thinking.

- Asia/EM: The Chinese economy grew at an annual pace of 3.2% in the June quarter, rebounding from a -6.8% year-on-year contraction in the March quarter. While consumer spending remains subdued, exports are currently running above 2019 levels. This is expected to contribute to an acceleration in growth in the second half of 2020.
- The Hong Kong economy shrank by -9.0% in the year ending 30 June 2020. This reflected the impact of civil protests as well as disruptions associated with Covid-19.
- The longer-term outlook for Hong Kong remains concerning too; western companies are increasingly withdrawing from the region and there is a concern that a 'brain drain' could be seen as skilled locals and expatriates consider relocating.
- US/China tensions continued to bubble away just beneath the surface. During July, President Trump suggested he intends banning TikTok and other Chinese-owned apps in the US, following a similar ban on the use of products manufactured by Huawei Technologies. The news suggested the US is starting to take a harder line on all Chinese companies, irrespective of whether they pose any national security risk. These tensions seem likely to flare up periodically, potentially eroding investor sentiment towards risk assets as and when they do.

Australian dollar

- The ongoing rally in risk assets continued to support the Australian dollar. The currency added more than 4% against the US dollar in July, closing the month at 71.7 US cents.
- The 'Aussie' was similarly strong in other major foreign exchange markets, appreciating by more than 3% against a trade weighted basket of international currencies.

Australian equities

- Encouraging results for possible coronavirus vaccines, combined with commitments from Australian government and central bank officials to extend respective support packages, helped push the S&P/ASX 100 Accumulation Index more than 4% higher into the middle of July. However, the rebound in coronavirus cases across New South Wales and Victoria, which is now in lockdown, saw equities rewind in the final week. As a result, the S&P/ASX 100 Accumulation Index closed July just 0.5% higher; the fourth consecutive month of gains.
- Similarly, the IT sector delivered the best sector-level returns for a fourth consecutive month. Data centre operator NextDC (+15.3%) benefited from additional contract wins and has committed to completing its S2 data centre fit-out.
- Ongoing volatility saw gold prices hit all-time highs in both USD and AUD terms. The surge in the yellow metal supported gold miners, such as Northern Star Resources (+15.7%) and Newcrest Mining (+11.6%). Major iron ore miners were also among the top performers in the Materials sector (+5.9%) as the price of iron ore rose 12% through July.
- The Energy sector (-6.6%) was the worst performer, despite the small rise in Brent crude oil prices, as investors cautiously await the coming reporting season. Origin Energy (-8.0%) fell as its fourth quarter update revealed a -7% decline in electricity sales and a -5% decline in Integrated Gas revenue in FY20.
- The S&P/ASX Small Ordinaries Index outperformed the large cap index, rallying 1.4% through the month.
- Investment platform HUB24 was the best performer in the small cap index. The company surged +43.4% as its fourth quarter result highlighted strong net inflows, which helped lift its Funds under Administration to more than $17 billion.

Listed property

- Listed property markets were relatively subdued in July. The FTSE EPRA/NAREIT Developed Index fell -1.3% in Australian dollar terms, trailing the returns of broader global share markets.
- The best performing markets were Singapore (+3.9%), the US (+3.5%) and Germany (+3.2%).
- Laggards included Hong Kong (-6.3%), France (-4.8%) and Japan (-2.8%).
- News flow regarding the ‘re-opening’ of domestic economies and mounting concerns regarding ‘second wave’ lockdowns continued to influence property markets, given the inherent degree of communal interaction associated with the operation of major property types, such as shopping malls and office buildings.
- Locally, A-REITs gained +0.6%, marginally outperforming the broader local equity market.
- The relatively insulated Industrial sub-sector (+13.6%) led the charge, while Office (-6.7%) and Retail (-5.5%) landlords weighed on the group.
- Victoria’s recently announced ‘stage 4’ Covid-19 restrictions do not augur well for retail and office landlords in the near-term. These sub-sectors also continue to be affected by evolving and longer-term secular trends, including the ‘work from home’ thematic and the rising adoption of e-commerce.

Global equities

- Despite the gloom and uncertainty from the continued pandemic, global equities continued to generate favourable returns for investors. The vast amount of liquidity being pumped into financial markets by central banks worldwide continues to support sentiment towards risk assets.
- Towards the end of the month, there was also some optimism among companies in the technology sector. This helped support sentiment towards share markets more broadly.
- US equities fared particularly well, with the S&P 500 Index adding 5.6%. By month end, more than half of US listed companies had reported their results for the June quarter.
- In aggregate, earnings fell by almost a third compared to the corresponding period in 2019 and a number of high profile firms including General Motors, General Electric, Starbucks and Nike reported losses.
- Returns from European markets were more modest, as potential second waves of the virus began to emerge. The Spanish IBEX, French CAC and Italian MIB indices all closed the month lower, while the German DAX Index was little changed.
- In the UK, the FTSE 100 Index fell by 4.4% in local currency terms as the government reintroduced lockdown measures in some parts of the country.
- Asian markets were mixed. China’s CSI 300 added 12.8%, while the Japanese Nikkei closed -2.6% lower, both in local currency.
- Buoyant risk sentiment continued to support emerging markets. The MSCI Emerging Markets Index rose 8.4%. Developed markets were well behind, with the MSCI World Index rising ‘only’ 3.4% in local currency terms.

Global and Australian Fixed Income

- Downbeat economic indicators and central bank policy measures continued to exert downward pressure on government bond yields. Moves were most extreme in the US, where 10-year Treasury yields dropped 13 bps to a new all-time low of 0.53%.
- German yields plunged further into negative territory, closing the month 7 bps lower, at -0.52%. In the UK, 10-year gilt yields also closed 7 bps lower, at 0.10%, as investors continued to speculate about the possibility of the Bank of England formally targeting negative official interest rates.
- Australian 10-year Commonwealth Government Bond yields closed July 6 bps lower, at 0.82%. Returns from the domestic fixed income market were also buoyed by further appreciation in credit markets and in the State Government sector.

Global credit

- Corporate bonds continued to recover from March’s sell-off, with credit spreads narrowing for a fourth consecutive month.
- Investment grade spreads closed the month 19 bps lower, at 1.37%. High yield credit performed even better, with spreads 118 bps lower by month end. As an asset class, high yield credit has now returned more than 25% since the lows during March.
- These moves reflected ongoing strong demand and a moderation in the pace of new issuance. Despite lower overall yields from corporate bonds due to narrowing spreads and lower Treasury yields, investors continue to look towards the asset class for income. Indeed, there were further strong inflows across both investment grade and high yield during July.

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