Market Wrap

August 2020

Economics overview

- The release of Australian-listed company earnings gave local investors something other than virus-related news to focus on.
- Earnings rose ~15% in the June quarter compared to the first three months of the year. This was ahead of consensus expectations, but overall the results were underwhelming as anticipated.
- Bond yields drifted higher in most major regions, including Australia, amid signs of increasing supply.

- **US**: As well as the latest Covid statistics, investors watched fluctuating odds for November's Presidential election. A few weeks ago, Republican Donald Trump was trailing Democrat rival Joe Biden, but appears to have regained some earlier lost ground. The latest polls suggest the contest is too close to call.
- On the economic front, manufacturing PMI data edged back above 50, indicating expansion. This was encouraging, as the reading had been below 50 – indicating contraction – for the previous four months. Durable goods orders also rebounded more quickly than expected, suggesting conditions are improving for manufacturers following months of disruptions.
- Conditions have also improved markedly in the services sector as lockdown restrictions have been eased. The ISM Services Index for July rose to its highest level for nearly a year and a half.
- More than 1.7 million jobs were created in the US in July. This saw the unemployment rate drop to 10.2%, from 11.1% in June.
- Average hourly earnings are also rising at an annual pace of nearly 5%, which augurs well for discretionary spending.

- **Australia**: The post-lockdown rebound in employment appears to have stalled, partly due to renewed lockdown measures in Victoria. The official unemployment rate only increased by 0.1% in July, to 7.5%, but other indicators indicate actual employment conditions may be somewhat worse.
- The number of workers receiving wages is currently down around -5% from pre-virus levels, for example, while the overall value of wages paid is more than -6% down according to some measures.
- In its latest projections, the Reserve Bank of Australia has suggested the official unemployment rate could increase to around 10% towards the end of 2020.
- The JobKeeper program is helping support overall income levels, but economists have suggested much of this may be saved rather than spent, in turn delaying the intended economic rebound.
- The latest forecasts from Commonwealth Bank, for example, suggest the Australian economy will not return to pre-Covid levels until the second half of 2022 at the earliest.

- **New Zealand:** A new lockdown was implemented in Auckland following a fresh outbreak of Covid-19. This threatened to derail the recent economic rebound.

- The latest data showed unemployment fell during the June quarter, even while earlier lockdown restrictions were in place. The data was likely skewed by government wage subsidies, suggesting employment indicators could worsen later this year.

- **Europe**: Conditions remain challenging for Europe's large manufacturers. The pace of decline in German factory orders has slowed, but industrial output is still running nearly -12% below 2019 levels.
- Unemployment in Germany was unchanged in August, but consumer confidence dipped following three consecutive months of improvement.
- In the UK, schools prepared to open in early September having been closed since March. The Government is encouraging parents to send their children to school and focus on returning to work, in turn hastening the economic recovery.
- There could be less encouraging news on the Brexit front as policymakers continue to squabble over the terms of a future trade agreement between the UK and Continental Europe. If no deal can be agreed before the end of 2020, tariffs could be imposed on goods being imported/exported. With economies already struggling to recover from virus-related disruptions, this would undoubtedly be an undesirable outcome for both sides.

- **Asia/EM:** Chinese exports are running more than 7% above 2019 levels. This seems inconsistent with economic readings elsewhere, but underlines China's commitment to revive the manufacturing sector following shutdowns earlier in the year.
- Inflation in China also appears to be ramping up again, after coming off the boil in the June quarter.
- These indicators are encouraging for global GDP, which will require a buoyant Chinese economy to make a meaningful recovery in the second half of 2020 and beyond.
- Elsewhere, data showed Japanese GDP slumping -27.8% in the June quarter; the biggest contraction on record and worse than expected. This was a concern given the Japanese economy remains the world's third largest.
- The recent economic slump has effectively wiped out growth from the past nine years. The overall size of the Japanese economy is now close to 2011 levels, after the tsunami.
- Conditions in emerging markets remained mixed. Most continue to struggle with lower export demand, though Indian officials are concerned about inflation due to rising demand in the economy.

Australian dollar

- The Australian dollar continued to appreciate against other major currencies. The 'Aussie' added 3.3% against the US dollar, closing the month at 73.8 US cents; its highest level in more than two years. Since bottoming in mid-March, the 'Aussie' has since gained more than 28% against the US dollar.
- The 'Aussie' added a more modest 1.1% against a trade-weighted basket of international currencies.

Australian equities

- The S&P/ASX 100 Accumulation Index ended the month 2.5% higher, the best August performance since 2009.
- The favourable return was driven primarily by the strength of overseas markets, rather than being indicative of a particularly strong earnings season.
- Forward-looking earnings forecasts had come under scrutiny during July as concerns increased about a potential second wave of virus infections. There was particular consternation about Victoria re-introducing lockdown measures, but the path to economic normality remained highly uncertain nationally.
- Investors had become extremely pessimistic, particularly towards hospitality and tourism stocks. They appeared to 'look through' the weak earnings results, however, instead focusing on when earnings might start to recover. Even though stocks like Qantas, Corporate Travel Management, Flight Centre and Webjet contributed to the market's positive returns, Australian shares lagged their overseas peers, suggesting the earnings season was not received as positively as profit updates in the US.
- Australia's technology sector continued to impress, delivering the best sector-level return for a fifth consecutive month (+18.2%).
- Commodity prices were mixed through August. The gold price declined. Combined with increased capital expenditure and cost guidance, this drove the majority of Australian-listed gold producers lower.
- Iron ore rallied in both USD and AUD terms, however, enabling bulk commodity producers like BHP Group, Rio Tinto and Fortescue Metals Group to appreciate.
- Communication Services (-5.6%) was the worst performing sector. Australia's largest telecommunications company, Telstra (-11.4%) continues to suffer from increased competition, particularly in its mobile business. As a result, the company announced it had lowered long-term targets for returns on invested capital.
- The S&P/ASX Small Ordinaries Index fared very well, adding 7.2% over the month.

Listed property

- Most listed property markets edged higher in August. The FTSE EPRA/NAREIT Developed Index fell -0.5% in Australian dollar terms, however, reflecting the strength in the AUD. Returns trailed those from broader global share markets.
- The best performing markets were Australia (+7.9%), Japan (+7.1%) and Germany (+6.5%). Laggards included Sweden (-2.4%), Singapore (-1.4%) and Canada (+0.2%).
- Property names were generally supported by growing optimism that the Covid-19 situation was coming under control in key regions. Political appetite for further restrictions appears to remain low, potentially reducing the risk of further widespread, economically damaging lockdowns.
- Locally, A-REITs rallied amid the August reporting season, led by Diversified A-REITs (+9.8%). Retail (+8.4%), Industrial (+7.6%) and Office landlords (+3.4%) also made solid gains.
- It appears likely that Victoria will begin progressively easing its strict 'Stage 4' restrictions in the coming weeks as the number of new daily cases reported in the state had fallen below 100 by month end. This provided some support to A-REITs with material exposure to discretionary retail in the State.

Global equities

- Most major equity markets enjoyed further gains over the month, as progress on a Covid-19 vaccine boosted optimism.
- While economic indicators remained deflated, government and central bank support kept risk sentiment buoyed.
- The corporate earnings season has showed signs of stabilisation in various industries, particularly in the US. The best performing sectors included Consumer Discretionary and Materials.
- The MSCI World Index increased 3.5% in Australian dollar terms. Emerging Markets underperformed, declining by -0.9% in AUD.
- US equities continued to generate favourable returns, with the S&P 500 Index adding 7.2% in US dollars. This was one of the best August performances from US equities since the 1980s.
- In Europe, the UK's FTSE 100 added 1.1%, while the MSCI Europe ex-UK Index rose 3.1% in local currency terms. German stocks fared particularly well, with the DAX Index adding 5.1%.
- In Asia, the Japanese Nikkei rose 6.6%, while the MSCI Asia ex-Japan Index climbed 3.2%, again in local currency terms.

Global and Australian Fixed Income

- Government bond yields rose in all major regions, hampering returns from fixed income. Whilst poor, economic data has not been quite as bad as anticipated recently, suggesting conditions may be steadily improving in most regions.
- Investors are also expecting greater bond issuance as countries fund their Covid-related spending. This appears to be pushing yields higher and exerting downward pressure on bond prices.
- Australian bond yields also drifted higher in August, again partly reflecting increased supply. The yield on 10-year government securities closed the month 17 bps higher, at 0.98%.
- The Government continued with its new bond issuance program to help fund Covid-related spending packages. Nearly $35 billion was raised from government bond sales during August, including a single issue of $21 billion; the largest ever in Australia.

Global credit

- Corporate bond yields continued to tighten in August, resulting in another month of positive returns from global credit.
- The overall backdrop was little changed. The outlook for corporate earnings remained mixed, at best, and news releases suggested companies in various sectors and in different countries continued to face serious financial pressures.
- In spite of that and the historically low yields on offer, demand for investment grade credit remained very strong. Ultimately, investors seemed assured that the Federal Reserve and other central banks would step in and support valuations with large-scale purchases on any sign of weakness.
- New issuance markets remained active, as companies sought to take advantage of strong demand and 'cheap' financing.
- Some companies with already strong balance sheets are using the current low cost of debt as an opportunity to increase their borrowing, either to fortify their balance sheets even further, or in preparation for potential M&A activity in the future.
- In fact, the value of new issuance set a new record for the month of August and extended the value of new issuance in 2020 as a whole. With four months of the year left, total issuance is already comfortably above any other calendar year on record. This underlines the appeal of corporate bonds among income-seeking investors given the fall in risk-free rates.

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