GODFREY PEMBROKE

market update

APRIL 2020

- Large-scale fiscal and monetary stimulus is being deployed by countries around the world as governments confront the extent of the economic impact of the coronavirus.
- Oil markets were thrown into disarray after failed talks between Russia and Saudi Arabia resulted in a price war that threatens US shale oil producers.
- The Australian government has announced a raft of stimulus measures, including support for businesses to keep workers on the payroll.
- In the US, various therapeutic agents are working on active trials of a vaccine, but these will likely take many more months to be made available.
- As the UK announced its own support measures, Prime Minister Boris Johnson was moved to intensive care after contracting the virus.

March market performance

Equity Markets – Index Return*	Index	At Close 31/03/2020	% Return 1 Month	% Return 12 Months
Australia	S&P/ASX 200 Index	5076.83	-20.65%	-14.42%
United States	S&P 500 Index	2584.59	-12.35%	-6.98%
Japan	Nikkei 225 Index	18917.01	-9.69%	-8.78%
Hong Kong	Hang Seng Index	23603.48	-9.53%	-15.73%
China	CSI 300 Index	3686.16	-6.44%	-2.66%
United Kingdom	FTSE 100 Index	5671.96	-13.41%	-18.39%
Germany	DAX 30 Index	9935.84	-16.44%	-13.80%
Europe	FTSE Eurotop 100 Index	2448.74	-12.28%	-12.27%

Property – Index Returns*	Index	At Close 31/03/2020	% Return 1 Month	% Return 12 Months
Listed Property	S&P/ASX 200 A-REITS	1022.00	-35.14%	-31.73%

Interest Rates	At Close 31/03/2020	At Close 29/02/2020	At Close 31/03/2019
Australian 90 day Bank Bills	0.36%	0.80%	1.77%
Australian 10 year Bonds	0.76%	0.82%	1.78%
US 90 day T Bill	0.06%	1.27%	2.38%
US 10 year Bonds	0.67%	1.15%	2.41%

Currency**		At Close 31/03/2019	% Change 1 Month	% Change 12 Months
US dollar	AUD/USD	0.61	-6.34%	-14.01%
British pound	AUD/GBP	0.49	-3.11%	-9.61%
Euro	AUD/EUR	0.56	-5.83%	-12.09%
Japanese yen	AUD/JPY	65.76	-6.54%	-16.41%
Australian dollar Trade-weighted Index		54.7	-4.04%	-9.59%

* Closing index values are based on price indices. Index returns are expressed as total returns in local currency.
** All foreign exchange rates rounded to two decimal places.
Past performance is not a reliable indicator of future performance.

Global economies

Governments around the world have implemented extreme measures including social distancing, partial shutdowns, and full lockdowns in order to prevent the spread of the coronavirus. With consumer-facing sectors essentially shut down and global supply chains in disarray,

economic activity is rapidly falling and a recession has most likely already begun.

US

On 15 March the Federal Reserve cut the funds rate by a full percentage point from 1.25% to 0.25% and announced that it would embark on unlimited bond purchases in an unprecedented move that aims at keeping Treasury yields and mortgage rates low. The US 10-year Treasury yield spiked to 1.2% from 0.5%, while mortgage rates had crept up to 4.0%, undermining efforts to support housing and equity markets. The US appears set to pass a US $2 trillion fiscal stimulus package in response to the coronavirus. This amounts to around 10% of GDP, while the current fiscal deficit is around 5%. Given an expected contraction of GDP in the vicinity of 10% in the June quarter, this stimulus package seems appropriate. The key for any fiscal response is size, speed of implementation, and the ability to target the measures to those most exposed. There is, however, considerable uncertainty over the extent and duration of the damage to GDP. The extent of the economic damage to date has been most clearly evident in the unemployment data. Non-farm payrolls showed a reduction of 701,000 jobs in March, while initial jobless claims made an extraordinary leap to 6.6 million according to the April release, up from 281,000 in the March release.

Europe

EU leaders continue to disagree on a fiscal response to the coronavirus. While there were signs of some early support for so-called ‘corona-bonds’, which would take the form of jointly-issued debt by EU member states, the idea was ultimately rejected by Germany and the Netherlands. The most likely solution will involve providing credit via the European Stability Mechanism (ESM) bailout fund, which could be up to 2% of the requesting country’s GDP with a maturity of 5-10 years. Most Europe-wide economic data thus far pertains to February, before containment measures were introduced by national governments, making the full impact on jobs and economic activity difficult to determine. However, all agree that swift action is required from the EU in order to forestall the worst effects from the virus. At a national level, Germany announced a fiscal stimulus worth €756 billion, or 10% of annual GDP. This includes a €600 billion bailout fund to take stakes in stricken companies, while the government will also add €156 billion in additional debt and extend borrowing above the ‘debt brake’ limit of 0.35% of GDP. The UK announced a £350 billion package of loans and grants to help British businesses pay the bills, while those businesses in sectors such as retail and hospitality will receive a year-long holiday from paying business rates (taxes on non-residential properties).

China

The situation in China appears to be stabilising, with the rate of infection slowing in recent weeks while the rest of the world takes action to prevent the spread. China has begun easing restrictions in Hubei with some travel permitted and some industries restarting approximately two months since the region was locked down. This followed a visit from President Xi Jinping to the region as a show of confidence in his government’s efforts. The broader impact on the Chinese economy is most clearly seen from the PMI numbers, which gauge manufacturing activity. February’s result saw a drop from 50.0 to 35.7, indicating a very significant contraction. After recording GDP growth of 6.1% in 2019, the World Bank now estimates that growth will fall to 2.3% in 2020 (and that’s a best-case scenario). The market is expecting some form of stimulus to be forthcoming, but few expect the measures to be of the same magnitude as previous packages. This time around, China has less room to move given high levels of debt and the diminishing returns on large-scale infrastructure projects. That’s not to say there will be no response – Chinese authorities are considering spending up to RMB 2.8 trillion (US $394 billion) in local government special bonds to boost infrastructure, which, while smaller than previous programs, would be significant.

GODFREYPEMBROKE market update

Asia region

Japan is preparing to deploy a large-scale stimulus package worth JPY 108 trillion (US $990 billion) – the equivalent of 20% of GDP – to combat the economic impact of the coronavirus. Japanese GDP growth was already declining thanks to the US-China trade war and the consumption tax rate hike in October 2019. The postponement of the Tokyo Olympics also means Japan will forgo a much-needed economic boost. The Bank of Japan has doubled its annual equity-buying program target and has rolled out a new lending facility, pledging to provide ample funds and continuing to buy Japanese government bonds. So far it has not lowered interest rates further below zero, but further cuts remain an option. The priority is to provide smooth corporate financing and stability to financial markets. South Korea remains a source of positive news, with early signs that its aggressive strategy of broad testing, which enables them to identify those infected early, isolate them, and trace their contact with other people, has been working. India has announced a US $23 billion relief package for its poorest citizens. The measures involve a combination of direct cash transfer benefits and food security measures, with Finance Minister Nirmala Sitharaman saying, “No one will be allowed to go hungry.”

Australia

As the COVID-19 pandemic sweeps across the globe, shutting down countries and closing borders, the Australian Government had to quickly come to terms with the severity of the health crisis and the inevitability of an economic recession. A series of economic measures has been announced since early March to mitigate the impact on the local economy and people’s lives. The usual May federal budget was delayed to October 2020, while the uncertainty makes formulating reliable economic and fiscal estimates an impossible task. The government is providing up to $100,000 to eligible small- and medium-sized businesses and not-for-profits (including charities) that employ people, with a minimum payment of $20,000. Employers with turnover less than $1 billion who have experienced a 30% reduction in revenue will receive payments of $1,500 per fortnight per eligible employees for up to six months. The RBA cut rates to 0.25% in March and left rates on hold at its April meeting. The RBA also announced a policy of yield curve control, targeting 3-year bond yields at 0.25%. Many loans are priced off the three-year bond and this guidance indicates that the RBA will purchase government bonds and semi-government securities across the yield curve to help achieve this target as well as to address market dislocations.

GODFREYPEMBROKE market update

EQUITY MARKETS

- Australia's S&P/ASX 200 Index fell 20.7% in March, with consumer-facing sectors hit especially hard by social distancing and quarantine measures.
- The US S&P 500 Index fell 12.4% with the Energy, Financials and Industrials sectors under the most stress.
- In Europe, the UK FTSE 100 Index fell 13.4%, Germany's DAX 30 Index fell 16.4%, and France's CAC 40 Index fell 17.0%.
- In Asia, Japan's Nikkei 225 Index fell 9.7%, Hong Kong's Hang Seng Index fell 9.5%, and China's CSI 300 Index fell 6.4%.
- Global developed market shares fell 7.4% in Australian dollar terms, while emerging market shares fell 10.0%.

Australian equities

	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	S&P/ASX 200 Acc. Index	-20.65%	-14.42%	-0.56%	1.38%	4.78%
	S&P/ASX 50 Acc. Index	-20.30%	-12.82%	-0.26%	1.11%	4.72%
	S&P/ASX Small Ordinaries Acc. Index	-22.38%	-21.02%	-1.33%	2.52%	1.91%

Australian shares faced a very tough March as measures to combat the spread of the coronavirus, along with the economic dislocation globally, hit businesses hard. The only good news was sign of a relief rally late in the month as markets began pricing in stimulus measures announced by the government, but no sector has made it through this period unscathed. Measures such as travel bans and social distancing have taken a huge toll on airlines, travel, leisure, retail and hospitality businesses. Flight Centre Travel Group (-69.6%) entered a trading halt in March, with a consequent capital raising in April, while Qantas (-41.6%) has significantly reduced capacity and was forced to stand down two thirds of its workforce, or around 20,000 people. Social distancing measures have also hit entertainment businesses like Star Entertainment Group (-41.1%), which owns Sydney's Star casino, and care providers like G8 Education (-48.6%), which owns a portfolio of childcare and early learning centre brands. Winners amid the chaos include some consumer staples names including wholesale distributor Metcash (+27.5%) and Coles Group (+6.7%), which have seen a boost in sales due to consumers stocking up as they prepare for quarantine. Telstra (-10.5%), while it has also taken a hit, has stated it may meet the lower end of its guidance range and will maintain its dividend amid strong NBN demand.

Investment Index/Benchmark returns*

S&P/ ASX 200 Index

Sector	1 Month	3 Months	1 Year
Consumer Staples	-3.61%	-3.14%	11.43%
Health Care	-5.38%	2.07%	37.78%
Utilities	-6.22%	-9.08%	-5.31%
Materials	-13.04%	-21.91%	-15.67%
Communications	-14.66%	-15.67%	-8.21%
Information Technology	-17.86%	-24.50%	-16.52%
Industrials	-22.75%	-27.73%	-17.81%
Consumer Discretionary	-25.90%	-29.14%	-16.63%
Financials ex-Property	-27.64%	-27.95%	-22.81%
Property	-35.14%	-34.37%	-31.73%
Energy	-37.53%	-47.92%	-44.52%

*Total returns based on GICS sector classification

GODFREYPEMBROKE market update

BIG MOVERS THIS MONTH

Going up

N/A

Going down

↓ Energy -37.5%

↓ Property -35.1%

↓ Financials -27.6%

Global Equities

	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Global	MSCI World Ex Australia Index (AUD)	-7.43%	4.66%	10.13%	8.09%	14.43%
	MSCI World Ex Australia Index (LCL)	-12.67%	-9.57%	1.99%	3.50%	7.02%
	MSCI World Ex Australia Small Cap Index (AUD)	-15.54%	-9.36%	3.70%	4.69%	12.08%
Emerging	MSCI Emerging Markets Index (AUD)	-10.02%	-4.26%	6.06%	4.15%	7.49%
	MSCI AC Far East Index (AUD)	-3.34%	5.54%	9.40%	6.52%	11.77%

While the extent of the fall is not unprecedented, the speed at which the market is falling certainly is. The tightening of liquidity conditions across a range of markets was symptomatic of severe stresses in the financial system, raising the risk of a more disorderly and precipitous decline in economic activity. The behaviour of financial markets in the period ahead and the ultimate depth of the economic downturn is highly uncertain. Market moves are not only dependent on the rate at which the virus spreads, but the fiscal, monetary and liquidity support that is provided by governments and central banks. The US share market tripped circuit breakers three times in two weeks (these are triggered by a sudden 7% drop in the market, resulting in a 15-minute pause in trading), while volatility, measured by the CBOE Volatility Index, hit 82.7 points mid-March. Adding to the global coronavirus situation is the rapid fall in oil prices precipitated by a price war between Russia and Saudi Arabia. The WTI crude oil price finished March at US $20.1 per barrel – the lowest price since February 2002. The sudden collapse in prices threatens the US shale oil industry, which relies on prices sitting above US $40 per barrel. Emerging markets may get caught up in a flight to quality, although they have generally held up reasonably well in the current crisis, due in part to the relative speed and effectiveness of the coronavirus response in Asia.

Property

	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	S&P/ASX 300 A-REIT Acc	-35.14%	-31.73%	-5.10%	0.16%	5.20%
Global	FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)	-22.65%	-23.28%	-2.88%	-0.64%	3.70%

Listed property has been dealt a severe blow by social distancing measures and the need for people only to venture out of their homes for essential shopping. The effects have been particularly acute for Australia's retail REITs, which have experienced a fall in foot traffic and will need to negotiate with distressed tenants who will be asking for rent relief. Scentre Group (-54.8%), which operates under the Westfield brand in Australia, was the worst performing of the S&P/ASX A-REIT Index in March, followed closely by Vicinity Centres (-52.1%), whose Chadstone shopping centre has seen major tenants like Kmart and Coles close or drastically reduce their opening hours. Now that listed market values have plummeted, pressure has mounted on investment managers and super funds to update values on their unlisted assets more regularly than the usual quarterly cycle. In Australia, AMP Capital is leading the way with valuers now being asked to revalue property assets in their flagship AMP Capital Shopping Centre Fund and AMP Capital

GODFREYPEMBROKE market update

Wholesale Office Fund. Globally, investors are cognisant that for sectors like Hotels, Offices and Shopping Centres, the impact of the virus could last six months or more due to physical distancing and working from home.

Fixed Interest

	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	Bloomberg AusBond Composite 0+ Yr Index	-0.21%	6.80%	5.74%	4.24%	5.06%
	Bloomberg AusBond Bank Bill Index	0.10%	1.23%	1.66%	1.83%	2.09%
Global	Bloomberg Barclays Global Aggregate Index	2.98%	20.93%	11.43%	7.28%	9.63%
	Bloomberg Barclays Global Aggregate Index (AUD Hedged)	-1.72%	5.61%	4.35%	3.94%	4.78%

Credit markets came under stress in March with little interest from market participants except in the highest quality names. There were concerns that default rates could rise broadly across multiple sectors, with services industries such as airlines (without sovereign backing) and hotels at a high risk of bankruptcy. Government bond markets also appear to be under stress with bid/ask spreads for US Treasuries stretched to 5–10 basis points (these are normally around 0.25 basis points or less). Australian government bond markets saw a 10–20 basis point bid/ask spread, which has not been experienced in over 30 years. US Libor rates (the rate at which banks lend to each other) also rose, while corporate credit spreads spiked higher as a wave of selling exposed a lack of liquidity in that market. A combination of corporates drawing down credit lines to build cash reserves, banks becoming more cautious in lending, and investors seeking to redeem investments across all asset classes led to acute liquidity concerns. This in turn raised the risk of a more severe downturn in financial markets and an even more significant decline in economic activity.

Australian dollar

The Australian dollar fell from US $0.6515 to $0.6102 in March as coronavirus fears took hold in markets, but a weaker dollar may act as a shock absorber and reduce the very worst of the economic impact. However, exports, especially travel and education related, will still be highly constrained due to the global travel lockdown.