Market & Economic Update - Coronavirus

April 2020

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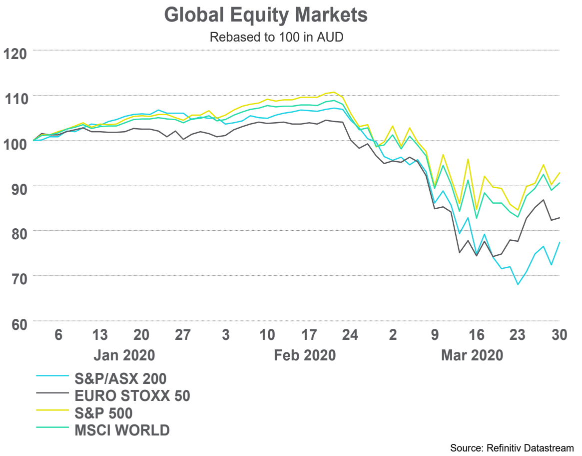
CENTREPOINT ALLIANCE

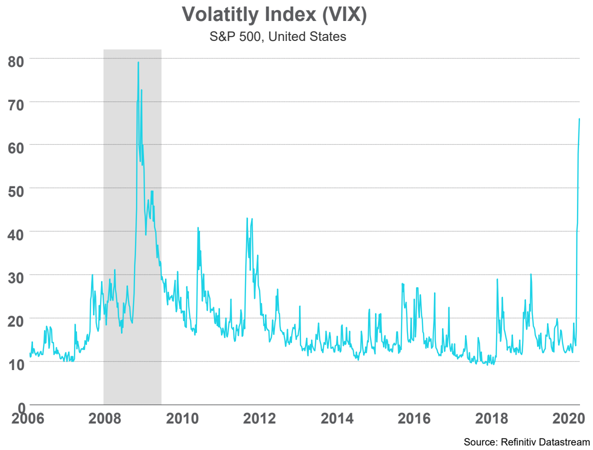
The Coronavirus Impact on Markets

The confirmed number of cases for the COVID-19 coronavirus are nearing 1 million worldwide[1]. This pandemic, originating in Wuhan City, China has spread rapidly with most countries reporting cases. Western developed countries have initially been the hardest hit and appear to be moving towards their peaks as varying levels of lockdown take place across societies. The world's developing countries are now beginning to have the numbers of cases accelerate. This unprecedented pandemic has caused governments to react drastically and force shutdowns of their economies to limit the spread.

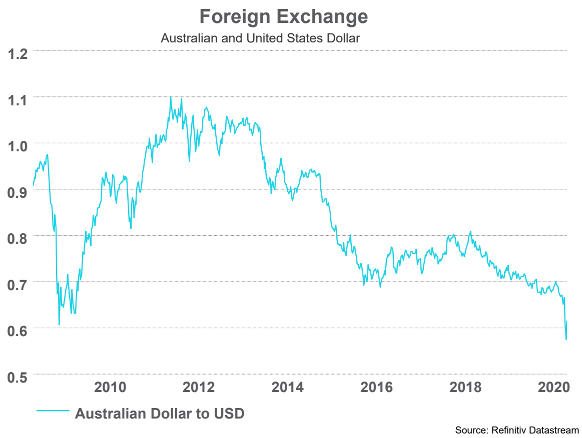
The unavoidable impacts on the markets are evident as markets peaked on the 20th of February and fell dramatically causing the fastest bear market (drop of at least 20%) in history. Australia (ASX 200), The United States (S&P 500) and Europe (EURO STOXX) fell 36%, 23.6% and 28.8%[2] respectively, priced in Australian Dollars. The lows were reached near the 23rd of March for these markets before they enjoyed a rebound of around 10%[3]



The extreme volatility over the past month in markets is evident with the CBOE Volatility Index (VIX) rising towards levels not seen since the Global Financial Crisis (GFC), as illustrated in the chart below.



The Australian Dollar (AUD) to United States Dollar (USD) exchange rate has fallen below 60 cents, below the lows of the GFC and the lowest level since 2002[4].

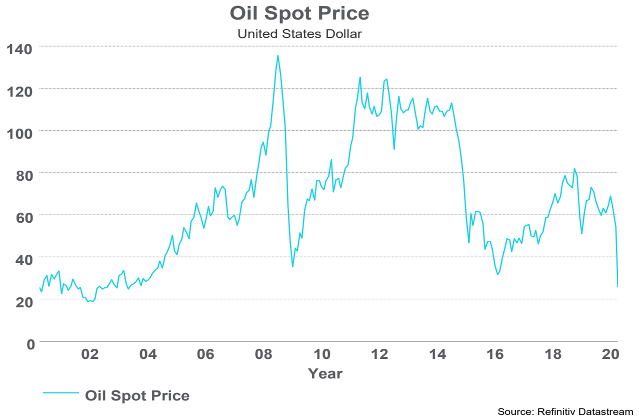


Oil and petrol prices fall

Expectations for a global recession has led to a collapse in oil prices. The chart below shows the current oil price of USD $20 has not been seen since 2003. Declines have been exacerbated by

[1] Worldometer.info
[2] Refinitiv
[3] Refinitiv
[4] Refinitiv

the government-imposed lockdowns all over the world which is having a noticeable reduction in demand. For example, the Global Airline and Aviation industries account for 15% of final oil consumption worldwide[5].

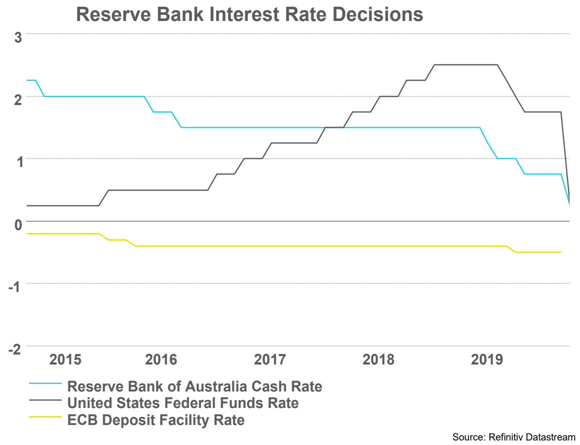


On the supple side, Russia's decision not to endorse the proposed OPEC production cuts resulted in a price war between Russia and Saudi Arabia. The ultimate winners from the price war will be households, through cheaper petrol prices and the losers will be higher cost producers of oil, such as the US Shale oil producers.

Monetary and Fiscal Response

Monetary policy response has been swift with Central Banks globally cutting interest rates. As shown in the below chart the Reserve Bank of Australia (RBA) cut cash rates to 0.25%, now close to the level of the US Fed Funds rate at a set range of 0-0.25%.

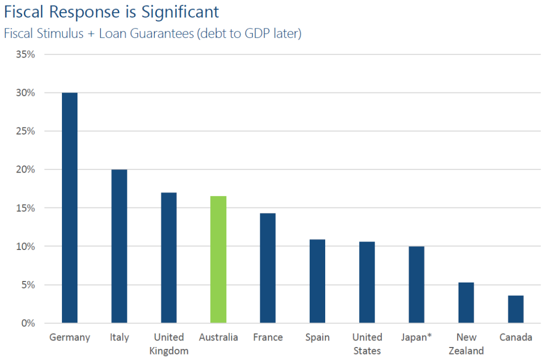
Australia's RBA also announced Quantitative Easing for the first time. Quantitative Easing has been used by many central banks around the world to purchase Government Bonds and mortgage assets. The objective of Quantitative Easing is to restore confidence in financial markets by lowering bond yields (interest rates) which act a reference rate for many other interest rate products and further restoring liquidity and confidence in markets.



In addition, the RBA announced a funding facility of $90B to Authorised Deposit Institutions in Australia.[6] The facility will promote lending to small and mid-sized business in Australia.

Pleasingly we've seen bipartisan support from governments around the world with massive fiscal responses. The below chart shows the magnitude of the response in the form of Fiscal Stimulus and Loan Guarantees for essential services such as Airlines. Germany tops the list with 30% of GDP with Australia in the teens as a percentage of GDP. The swift Fiscal and monetary response by governments will provide a backstop to the global economy and provide emergency funding to businesses unable to access finance.

[5]Planete Energies June 2019
[6]rba.gov.au March 2020



Source: Bentham Asset Management

Closer to home the Australian Government has announced three fiscal stimulus packages worth $214Billion or 16% of GDP[7]. Round one was worth $17B, round two was $66B with round three the biggest yet[8].

Further details on the fiscal stimulus packages can be found on Centrepoint Connect here. The government's jobKeeper payment of $1,500 per fortnight aimed at keeping staff on the payroll has proven popular with 280,000 business already expressing an interest.

Even during a pandemic, lots of talk has begun on who will foot the bill globally for the unprecedented fiscal stimulus measures. Many Australians, living in the lucky country, with no memory of recession for 25 years, will likely need to reset their expectations for prosperity in the years to come, and the National debt will likely linger for generations.

Outlook and Portfolios

The magnitude and length of the economic downturn in Australia and around the world is highly uncertain. The measures being taken by governments to shut down large sectors of the economy in order to manage the pandemic crisis have been deliberate and are unprecedented. We expect the extreme volatility in financial markets to continue until there are signs that the spread of the Coronavirus is being managed, which will provide greater clarity around the true economic impact of the shut down measures which have been imposed by governments around the world.

It is vital at this time of extreme market volatility and uncertainty that investors focus on the investment horizon which is relevant for their own personal circumstances and financial requirements. The worst thing that a client can do after a large equity market fall is to lock in losses by selling their equity exposure, if they don't require the assets to fund their living expenses.

The importance of diversification across different asset classes cannot be emphasized enough. Different types of assets, such as stocks and bonds, are expected to perform differently under different market conditions and economic scenarios. Combining these different types of assets into one portfolio is one of the most effective ways to reduce volatility and experiencing a smoother ride.

Timing the market is extremely difficult and we don't recommend trying to predict the future movement of the market and buying and selling accordingly. We instead recommend retaining the stock market exposure of a portfolio and instead using Managed Funds where the investment managers incorporate a focus on downside protection into their investment process.

[7] Bentham Asset Management
[8] The Australian

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