COVID-19 HAS PUT ECONOMIES IN HIBERNATION: WHAT DOES THIS MEAN FOR INVESTORS?

PERPETUAL PRIVATE INSIGHTS
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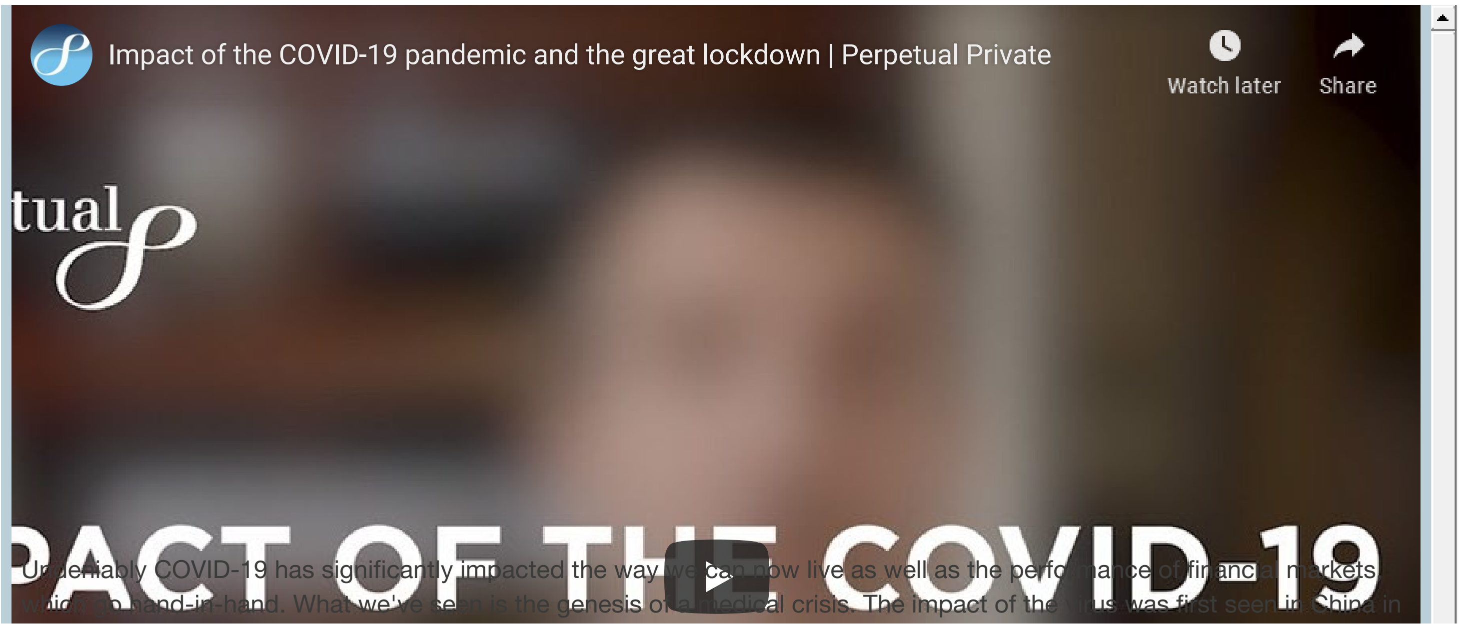
The first quarter of 2020 saw markets reckon with the emergence of a significant pandemic for the first time since the Spanish Flu a century ago.

All but the safest assets were affected, with Australian equities down 23.41% and international equities down 19.97% as at 31 March 2020. The Reserve Bank of Australia sought to minimise the impact by reducing the cash rate twice in March; taking it to a record low of 0.25%. This saw the Australian 10-year government bond gain 3.81%[1] as yields fell. See more detailed analysis of the performance in the Quarterly Market Update.

In the video below, Andrew Garrett, National Investment Specialist, Perpetual Private provides an overview of the current market situation, both in Australia and globally. He discusses some key areas of weakness and the opportunities in private markets for managers of alternative assets. He asserts that while it's hard to foresee the full effects of the pandemic, having a good solid plan in place will help ensure that investors (particularly those in retirement or approaching retirement) avoid overtrading, locking-in losses and ultimately destroying the value of their investment portfolio.

THE COVID-19 PANDEMIC AND THE 'GREAT LOCKDOWN' HAS EFFECTIVELY PUT ECONOMIES INTO HIBERNATION

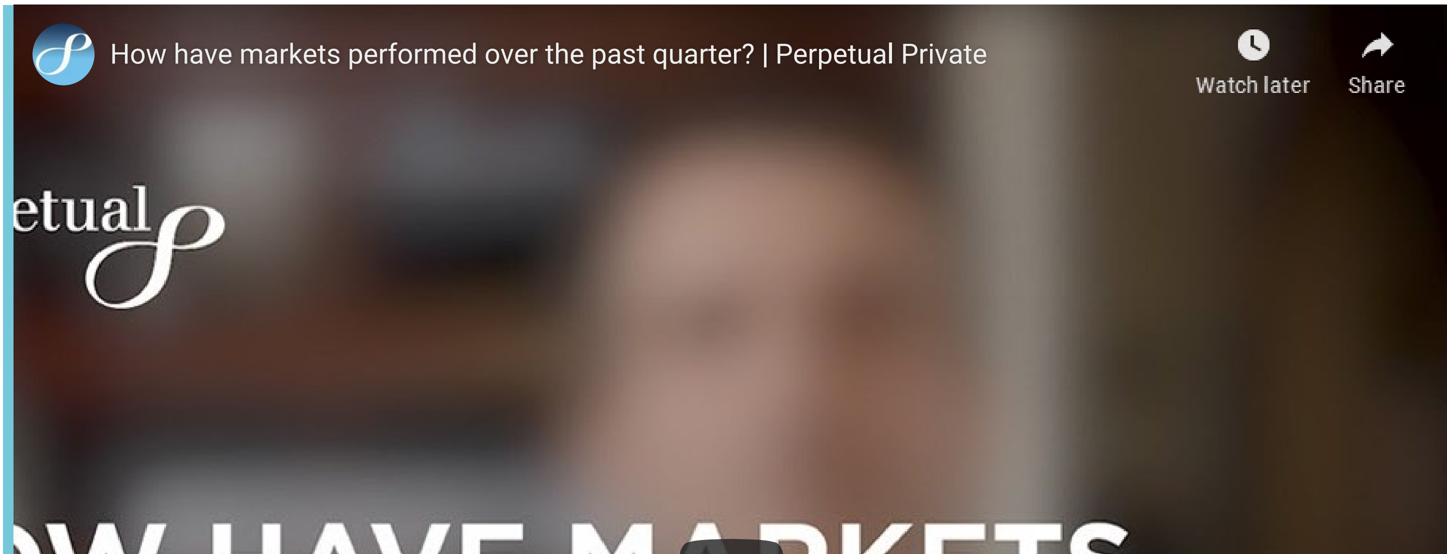


November 2019, it has now developed into a widespread economic crisis as governments around the world have restricted travel and implemented a range of measures to stimulate growth and minimise the economic and social impact of the rising pandemic.

In this environment, the task at hand is significant. Never before have economies been intentionally placed into hibernation. In the words of the International Monetary Fund: “This requires substantial targeted fiscal, monetary, and financial measures to maintain the economic ties between workers and firms and lenders and borrowers, keeping intact the economic and financial infrastructure of society”[2] . Restarting economies will be a challenge. The idea is to try and move past the medical crisis with the hope that we can then transition and deal effectively with the economic crisis.

Only time will tell if the cure has been worse than the disease. As the presence of the virus begins to subside over the coming months, we will increasingly have to reckon with the economic aftershocks. This will likely cascade from first order effects (such as the impact to the global travel industry), to second and third order effects which, by their very nature are less predictable.

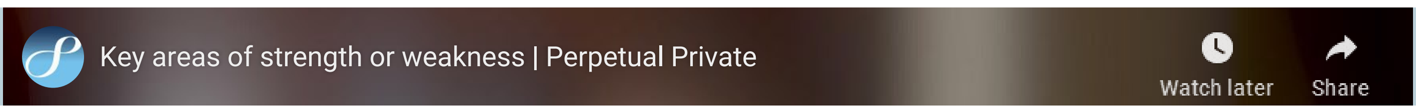
HOW HAVE MARKETS PERFORMED OVER THE PAST QUARTER?

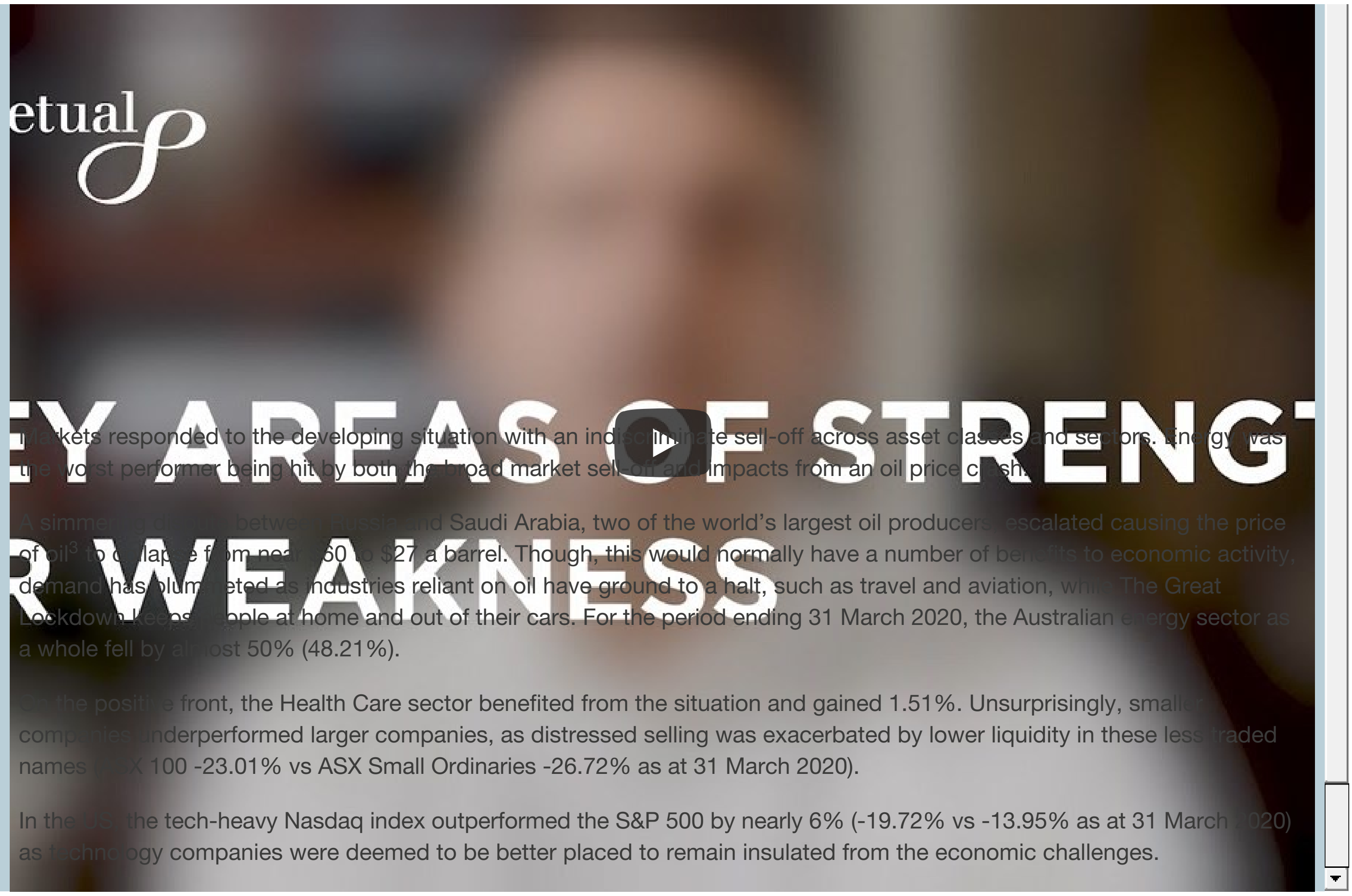


Over the quarter, we've seen markets exhibit a fair amount of volatility and it's been a quarter of two halves. We saw a gentle start to the year with markets ticking up calmly right up until 20 February 2020. While COVID-19 had been around – reports were coming out of China as far back as November 2019 -- markets had really seen that as a China-centric issue till about mid-February 2020, which was the peak before we saw the sell off.

- **Australian equities:** The ASX 300 made a great start to the year before being impacted by the effects of the coronavirus and oil price war. Having made steady gains until 20th February 2020, it sold off heavily before finding composure towards the end of March 2020. By the end of the quarter, it was 23.41% below where it finished 2019.
- **International equities:** Global stock markets lost 9.69% over the period (as measured by the MSCI All Country World) on an unhedged basis. However, in local currency terms, the index dropped 19.97% over the quarter, demonstrating the impact of a weakening AUD as markets became increasingly risk-averse.
- **Fixed income:** Australian bonds were key beneficiaries of central bank actions, gaining 2.99% as the RBA reduced rates to their stated lower bound of 0.25%. Overseas bonds (hedged to AUD) also gained, though not to the same extent, delivering 1.27%. With uncertainty high for the coming months, it is unlikely we’ll see monetary authorities expressing a desire to increase rates any time soon. This is supportive for bond values for the foreseeable future.
- **Real estate:** Australian Real Estate Investment Trusts (as measured by the S&P/ASX300 A-REIT index) were heavily impacted by the market stress, as isolation measures and falls in economic activity has led to tenants being unable to pay their rent. A-REITs were down 34.31% over the quarter, particularly impacted from a structural overweight to retail assets. Global Real Estate Trusts (G-REITs) were down just 17.93% on an unhedged basis, losses partially offset by the drop in the AUD relative to foreign currencies.

KEY AREAS OF STRENGTH OR WEAKNESS





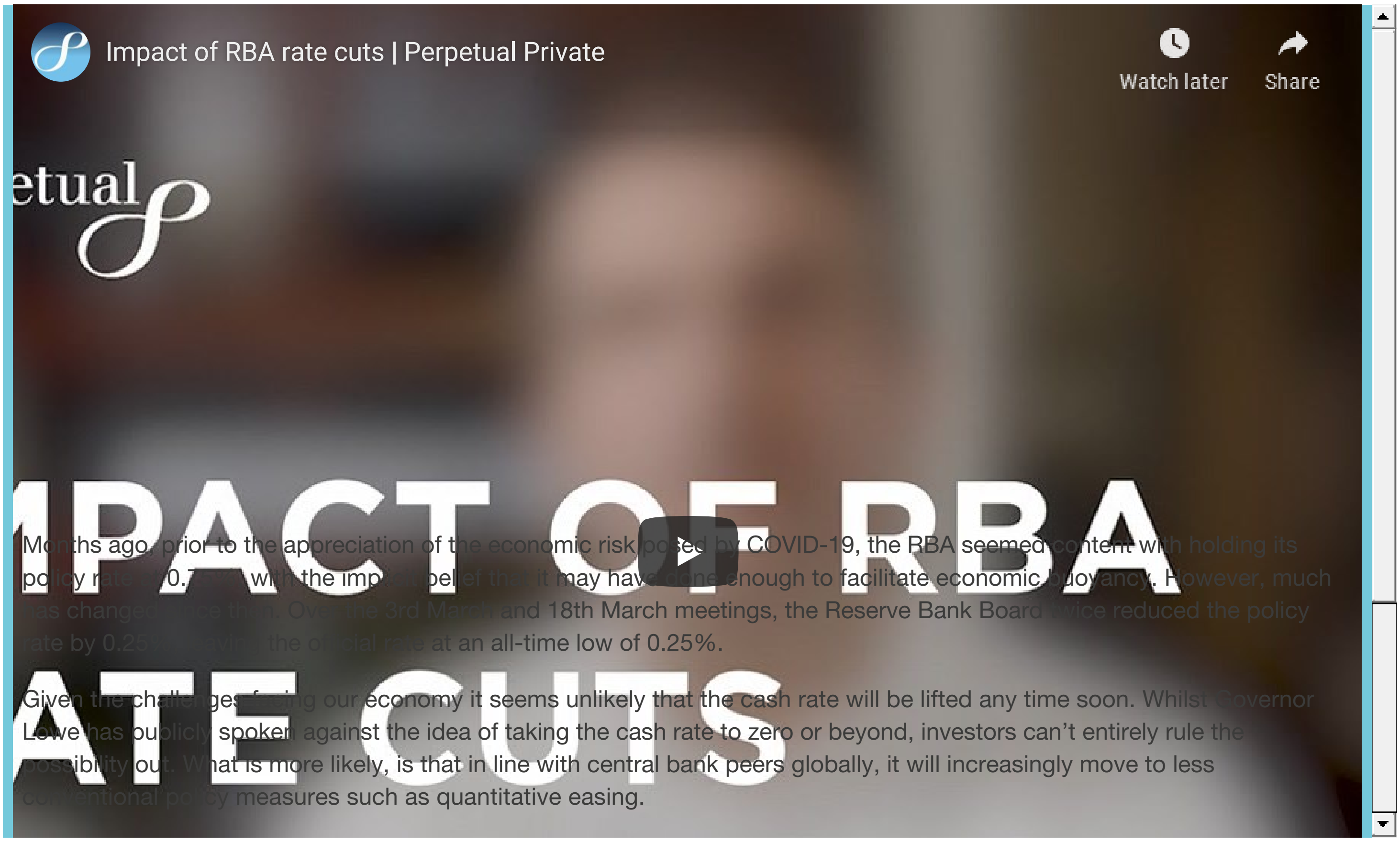
Markets responded to the developing situation with an indiscriminate sell-off across asset classes and sectors. Energy was the worst performer being hit by both the broad market sell-off and impacts from an oil price crash.

A simmering dispute between Russia and Saudi Arabia, two of the world's largest oil producers, escalated causing the price of oil[3] to collapse from near $60 to $27 a barrel. Though, this would normally have a number of benefits to economic activity, demand has plummeted as industries reliant on oil have ground to a halt, such as travel and aviation, while The Great Lockdown keeps people at home and out of their cars. For the period ending 31 March 2020, the Australian energy sector as a whole fell by almost 50% (48.21%).

On the positive front, the Health Care sector benefited from the situation and gained 1.51%. Unsurprisingly, smaller companies underperformed larger companies, as distressed selling was exacerbated by lower liquidity in these less traded names (ASX 100 -23.01% vs ASX Small Ordinaries -26.72% as at 31 March 2020).

In the US, the tech-heavy Nasdaq index outperformed the S&P 500 by nearly 6% (-19.72% vs -13.95% as at 31 March 2020) as technology companies were deemed to be better placed to remain insulated from the economic challenges.

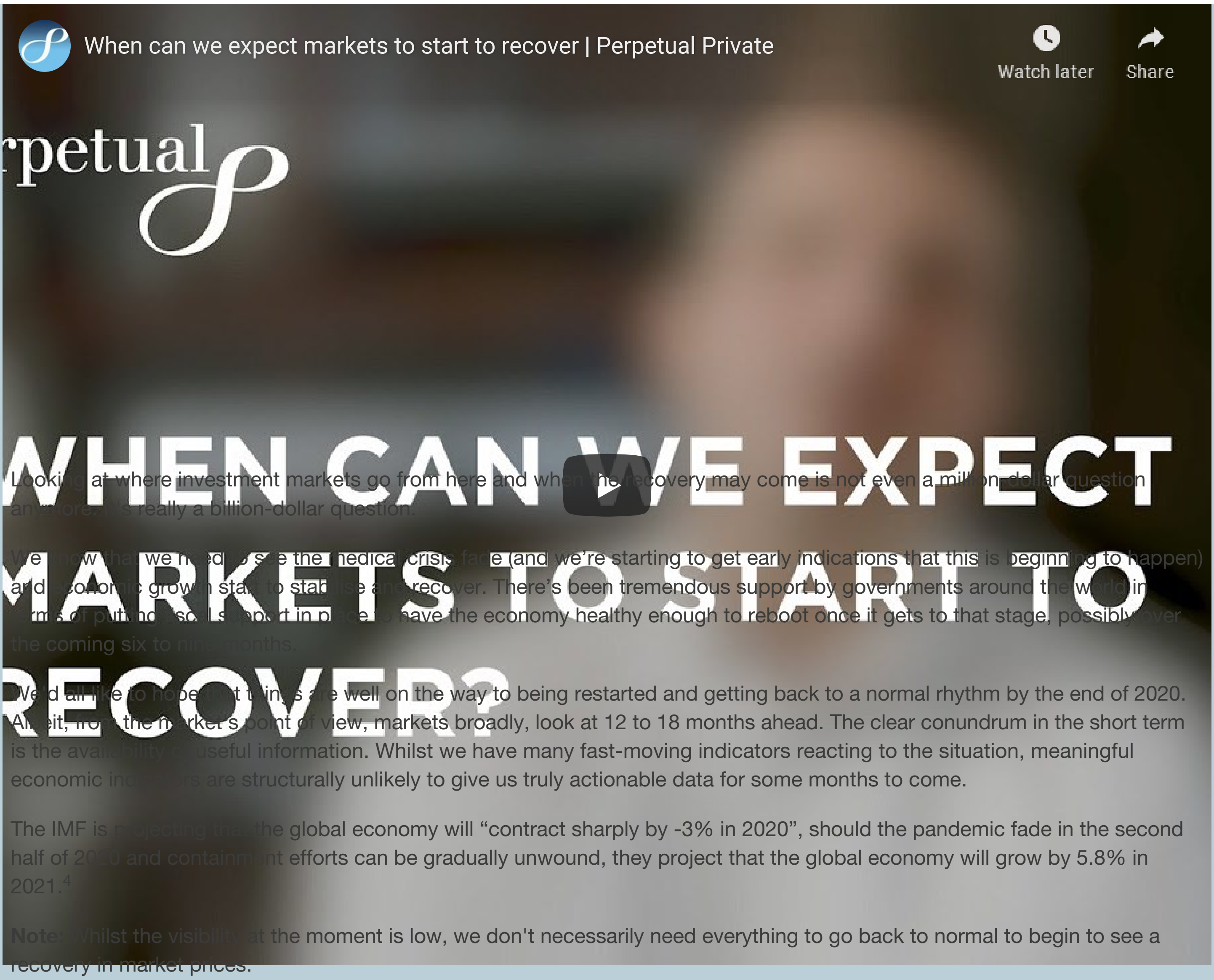
THE RBA STEPPED IN TO PROVIDE MONETARY SUPPORT TO THE AUSTRALIAN ECONOMY, CUTTING RATES TWICE IN MARCH 2020



Months ago, prior to the appreciation of the economic risk posed by COVID-19, the RBA seemed content with holding its policy rate at 0.75% with the implicit belief that it may have done enough to facilitate economic buoyancy. However, much has changed since then. Over the 3rd March and 18th March meetings, the Reserve Bank Board twice reduced the policy rate by 0.25%, leaving the official rate at an all-time low of 0.25%.

Given the challenges facing our economy it seems unlikely that the cash rate will be lifted any time soon. Whilst Governor Lowe has publicly spoken against the idea of taking the cash rate to zero or beyond, investors can't entirely rule the possibility out. What is more likely, is that in line with central bank peers globally, it will increasingly move to less conventional policy measures such as quantitative easing.

WHEN CAN INVESTORS EXPECT MARKETS TO RECOVER?



Looking at where investment markets go from here and when the recovery may come is not even a million-dollar question anymore. It's really a billion-dollar question.

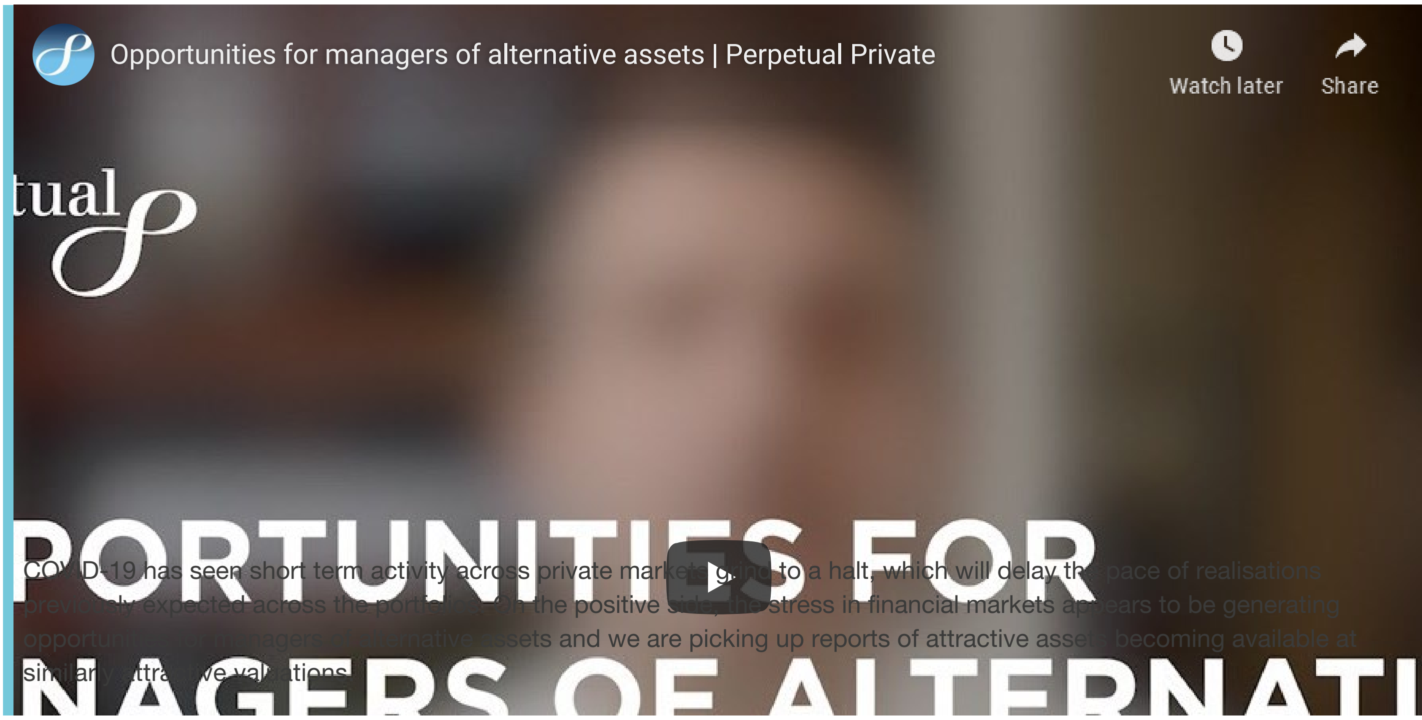
We know that we need to see the medical crisis fade (and we're starting to get early indications that this is beginning to happen) and economic growth start to stabilise and recover. There's been tremendous support by governments around the world in terms of putting fiscal support in place to have the economy healthy enough to reboot once it gets to that stage, possibly over the coming six to nine months.

We'd all like to hope that things are well on the way to being restarted and getting back to a normal rhythm by the end of 2020. Albeit, from the market's point of view, markets broadly, look at 12 to 18 months ahead. The clear conundrum in the short term is the availability of useful information. Whilst we have many fast-moving indicators reacting to the situation, meaningful economic indicators are structurally unlikely to give us truly actionable data for some months to come.

The IMF is projecting that the global economy will "contract sharply by -3% in 2020", should the pandemic fade in the second half of 2020 and containment efforts can be gradually unwound, they project that the global economy will grow by 5.8% in 2021.[4]

Note: Whilst the visibility at the moment is low, we don't necessarily need everything to go back to normal to begin to see a recovery in market prices.

THE STRESS IN FINANCIAL MARKETS APPEARS TO BE GENERATING OPPORTUNITIES FOR ALTERNATIVE ASSETS



COVID-19 has seen short term activity across private markets grind to a halt, which will delay the pace of realisations previously expected across the portfolio. On the positive side, the stress in financial markets appears to be generating opportunities for managers of alternative assets and we are picking up reports of attractive assets becoming available at similarly attractive valuations.

ADVICE FOR INVESTORS (INCLUDING RETIREES)

We now face a conundrum, where on one hand we face a significant economic shock, even once the virus subsides. On the other hand, global authorities are responding with the largest ever fiscal and monetary stimulus packages. With the immediate outlook unclear and the inevitable emergence of new issues arising from both the medical and economic responses, we are fortunate that history provides some guide to how to navigate the coming months and years. Though the current situation is unique in many ways, the behaviour of markets during periods such as these bear many similarities across time. As the saying goes, “history doesn’t repeat, but it often rhymes”.

1. **Stay calm** – This too shall pass. Studies have shown that investors tend to overtrade and destroy value when reacting to market events in the heat of the moment.
2. **Stick to the plan** – Investment strategies have been devised for the long term. Our asset allocations have been optimised using many years of data which include numerous periods like this.
3. **Rebalance** – Where asset exposures have moved meaningfully away from their long-term target, we believe there is potential to add long term value by reducing expensive assets in favour of cheap assets.
4. **Scan the market** – Whilst we don’t seek to trade heavily during times like these, the extreme levels of volatility are likely to provide opportunities for patient investors. We do this by continuing to favour active asset management in client portfolios.

It is clear that the coming months will feature many twists and turns, with heightened volatility likely to remain a feature. Just as the isolation measures which we are all currently adhering to are uncomfortable, market volatility is never pleasant. Accepting the discomfort and battening down the hatches, will help preserve mental and emotional energy for making key decisions once the path ahead becomes clearer.

› FURTHER READING - COVID-19

Visit our COVID-19 Insights Hub for economic and market updates to keep you informed as the situation evolves.

1. As at 31 March 2020
2. IMF World Economic Outlook, April 2020
3. As measured by Brent Crude
4. IMF World Economic Outlook, April 2020

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