WILL THE GOVERNMENT'S STIMULUS PACKAGE HELP THE ECONOMY RIDE THROUGH THE DOWNTURN?

PERPETUAL PRIVATE INSIGHTS
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By Sunday evening of 22 March 2020, the Australian Federal Government announced a second package of measures worth A$66bn, focusing on supporting employees and businesses through the economic downturn as a result of the coronavirus (COVID-19).

If we include the actions of the Australian Prudential Regulation Authority (APRA) and the Reserve Bank of Australia (RBA), this brings the total amount of stimulus to A$189bn. We've seen a wide variety of measures including:

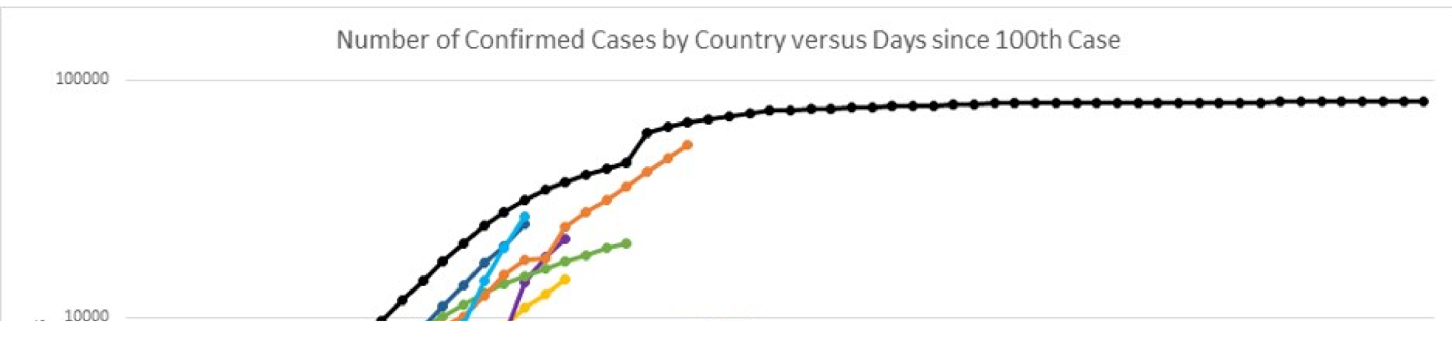
- Support for banks with cheaper financing and lower capital ratios;
- 50% government guarantees on loans;
- Interest payment holidays;
- Increased payments and allowances for people on the Jobseeker (formerly Newstart) allowance;
- Tax concessions for small business; and
- An allowance for people to draw on their superannuation balances (tax-free).

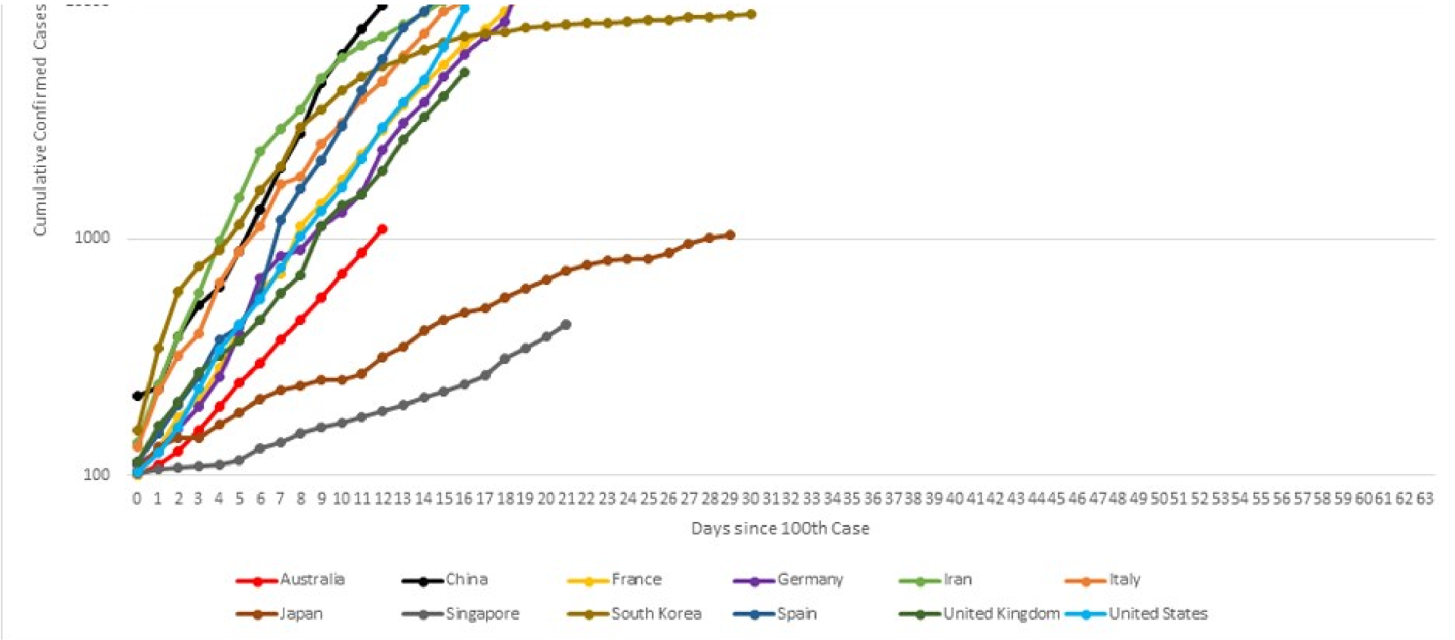
The RBA has also reduced the cash rate to 0.25% and announced its intention to commence buying Australian Government Bonds in order to control the overall yield curve (income distribution) and keep bond rates low.

As the spread of COVID-19 accelerates, tighter lockdown is required

The spread of the virus is accelerating in Australia and around the world: on Sunday 22 March 2020, Australia had a 25.6% increase in COVID-19 cases bringing the total to 1,349 confirmed cases. Italy has overtaken China in terms of deaths caused by the virus with a death toll of 4,825 and an increase of 6,600 infections in a single day – the greatest seen so far.

The following graph shows the increase in infections for various countries after their 100th case was recorded. Australia reached 1,349 confirmed cases, an increase of 25.6% as at 22 March, 2020. It's worth noting while the acceleration in confirmed cases in Australia is concerning, it has as much to do with an increase in testing as people actually contracting the virus.





Source: Johns Hopkins University, Perpetual as at 23 March 2020

It's not a case of communism vs democracy, it's being prepared

Of note, Japan (in dark brown) and Singapore (in grey) have successfully contained infection rates from the outset. While Japan, South Korea and China all put in place significant lockdowns of around 15-30 days, Singapore has succeeded in controlling the outbreak without lockdowns, a result of health measures put in place after SARS and Swine Flu outbreaks during the 2000s. It also indicates that being able to effectively control the virus is not a 'communism vs democracy' difference, with Japan, South Korea and Singapore all representing relatively free democratic societies – it's one of preparedness and getting on the front foot in reaction to these types of outbreaks. At the moment Australia, being in red, seems to be faring better than most Western countries. However, at the current acceleration rate, we are still not on track to keeping infections in a range that will be manageable by our healthcare systems.

United States

In the US, Republicans announced a US$1.4-1.6trn package, with a third of the US population now subject to lockdowns. The Democrats are looking to introduce another bill dealing directly with people who are laid off as a result of the economic crunch. Banks in the US have been forecasting anything from 15-24% drop in Gross Domestic Product (GDP), which points not just to recession, but a slowdown akin to the great depression. We can now clearly see the economic impact being caused by the increase in social distancing measures put in place to control the spread of COVID-19.

Australia

By Sunday evening on 22 March 2020 , the Australian government announced further lockdown measures on places of mass gathering, such as pubs, clubs, restaurants, gyms and places of worship. Victoria and the Australian Capital Territory (ACT) have brought forward school holidays, however all government heads have agreed that schools will resume following the break in April 2020.

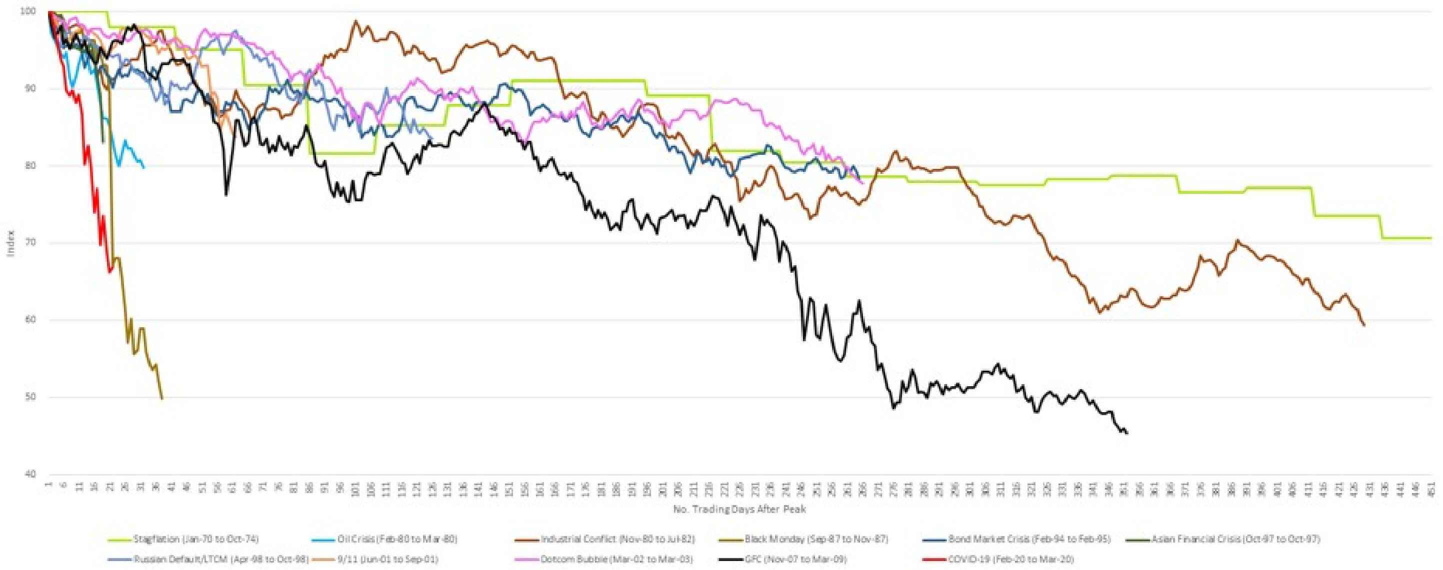
Some of the best news that we've seen came on 18 March 2020; with China reporting no new cases of domestically transmitted COVID-19 in the country and no new cases of any kind reported in Hubei province – a first since data began being tracked on January 20. While the data could be treated somewhat sceptically, at least the trend holds promise for now.

What we've seen in markets

Markets have continued to experience significant volatility as the prospects for a deeper and steeper economic downturn become a much more likely outcome of the pandemic. The Dow was down 17% and the Australian dollar has seen a sharp decline over the past seven days to end up around the 58 US cents mark by the end of day on 20 March 2020. In the meantime, US markets had another sell-off, ending down 4.5%. Post the announcement of an increase in lockdown and containment measures, the Australian market opened steeply down, trading down 7.1% at around midday 23 March 2020.

Bond yields resumed their downward trajectory, with the US 10-year down 0.29% to 0.85%, while oil sold off again; global oil benchmark West Texas Intermediate (WTI) closing below $23 (13% down for the day; 30% down for the week) as at 20 March 2020. The headwinds in the oil market remain and given it is likely that 'external lockdowns' such as bans on arrivals and international travel will be maintained for much longer, there is no clear end to the sell-off in oil unless supply can be constrained; the reason we are seeing such pricing extremes in this market.

Referring to the chart and table below, you can see that in the context of historic moves of the Australian sharemarket, this one has been most akin to the Black Monday crash in 1987 in terms of its speed and steepness. Year-to-date we are yet to see the depths of other similar market events, being just over halfway to the depths that were experienced during the Global Financial Crisis (as represented by the black line). Of note is the 'daily velocity' or average move, has been the most significant across all these market events. Clearly, there is the possibility of more downside in equity markets as we work our way through this crisis and the prospects of a broad-based global recession become more likely.



Source: All Ordinaries, Factset, Perpetual, 23 March 2020

Summary of largest drawdowns (price return basis)

Event	Peak - Trough	Drawdown %	No. Days	Average Daily Velocity
Stagflation	30/01/1970 - 31/10/1974	-55.1%	1239	0.0%
GFC	01/11/2007 - 06/03/2009	-54.6%	351	-0.2%
Black Monday	21/09/1987 - 11/11/1987	-50.1%	37	-1.4%
Industrial Conflict	17/11/1980 - 08/07/1982	-40.6%	428	-0.1%
COVID-19	*20/02/2020 - 19/03/2020*	*-33.7%*	*20*	*-1.7%*
Dotcom Bubble	07/03/2002 - 13/03/2003	-22.3%	265	-0.1%
Bond Market Crisis	03/02/1994 - 08/02/1995	-21.7%	264	-0.1%
Oil Crisis	14/02/1980 - 28/03/1980	-20.3%	31	-0.7%
Cold War Jitters	30/09/1960 - 30/12/1960	-19.2%	65	-0.3%
Hawkish Fed	09/01/1984 - 18/06/1984	-18.0%	115	-0.2%

Source: Factset, Perpetual, as at 19 March 2020

In addition to the drawdowns in equity markets, fixed income markets have also been experiencing higher levels of illiquidity through this crisis, although are still largely functioning. Fixed income funds across the board have increased buy/sell spreads which reflects this illiquidity – buy/sell spreads reflect the cost of transacting in relevant markets in order to make applications and redemptions from a fund – they in effect compensate unitholders for the costs of other unitholders' transactions. The fact these have blown out significantly for fixed income markets shows the cost or 'market impact' of trading these securities has jumped during this period of time.

Listed property or real estate investment trusts (REITs) have also been sold off, as the ramifications of an economic slowdown work their way through the economy to impact landlords, through higher vacancy rates, lower rents and the need for a higher level of incentives to attract tenants.

Within unlisted or direct property, retail and commercial property sectors have been the most impacted, whereas industrial/logistics and multifamily sectors have been more resilient through these markets.

What does this mean for investors?

Equity markets have continued to sell off and display extreme volatility in the face of uncertainty around COVID-19. Questions around the length and depth of the recession, possibilities of increased unemployment due to broad based business failure, which in turn will have knock-on effects to housing values and loan arrears, affecting the financial sector.

The prospects of a global and prolonged recession are becoming more certain as major economies such as Europe and the US have not been able to get ahead of the virus and put appropriate measures in place, making the economic pain more serious in an attempt to play catch-up. We are still waiting to see some sort of turning point when it comes to meeting the challenges this virus represents.

While equity values are well off their 20 February 2020 highs, there is still plenty of downside possible in equity markets. Rebalancing to targets is necessary to remain within given risk profiles and top up assets that have been oversold, however setting broader ranges when markets are so volatile helps ensure that portfolios aren't 'over-transacted'. This has become even more important with transactions costs increasing in certain sectors and asset classes.

The need for good advice is increasingly apparent – key measures of the $66bn package are based around an ability for people to access up to $20,000 of their superannuation savings tax-free. However, withdrawing at these levels has the potential to amplify the damage to long-term returns from poor markets – having to sell assets at depressed levels can effectively 'lock-in' losses with less money exposed to markets when they ultimately recover. Understanding how this can affect long-term savings and retirement plans is vital to ensure investors respond from a fully informed position.

Changes in the income measurements and asset tests in order to access the Jobseeker allowance, as well as additional payments and benefits that being on income support can also provide access to, such as family tax benefits, childcare subsidies and healthcare benefits. The complexity of our tax and superannuation systems can make even just knowing about these benefits, let alone accessing them, confusing and overwhelming.

Not-for-profit organisations

Not-for-profit and charitable investors need to ensure liquidity needs can be met by portfolios in the face of volatile markets, as well as cater for the possible increase in funding requirements as a recessionary environment results in a greater number of people that need access to programs. Spending policies will usually help smooth the impact on current distributions by spreading out the impact from a large drawdown in portfolios, however future spending plans should be reviewed with an eye on declining distributions, as well as ensuring that withdrawals can still be made while maintaining sustainability.

Our position

It is important to note that despite the string of serious market events that we've seen over the past 50 years, asset markets have still delivered investors positive real returns over the long-term. We maintain our belief that a well-managed, diversified portfolio that is actively managed is the best way to navigate these markets. Some of our managers in our portfolios have used the opportunity to rotate portfolios into oversold assets, as well as provide capital into markets that have become increasingly constrained as uncertainty creates opportunities. Combined with the provision of expert advice in the evolving government and investment landscape, we believe our clients are well placed to navigate the current market disruptions.

FURTHER READING - COVID-19

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