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MONTHLY UPDATE ON THE INVESTMENT ENVIRONMENT

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MARKET UPDATE

The COVID-19 pandemic continued to be the major factor shaping the global economy over the quarter, as the world continues to grapple with the worst pandemic in a century. However, unlike the first quarter, when risk assets plummeted, the second quarter was characterised by a remarkable about-turn, with unprecedented central bank and government stimulus propelling equities to claw back much of the ground lost earlier in the pandemic.

By the end of the quarter, over eleven million cases of COVID-19 had been confirmed globally, with deaths exceeding half a million. Active cases eased in early hotspots such as China, Italy and Spain, however these were more than offset by soaring cases in a number of other regions. The US remains by far the worst-affected nation, with over 1.5 million active cases as the pandemic spreads throughout the country. Similarly, a number of developing nations are now experiencing a surge, particularly Brazil, Mexico, and India. Australia fared well in the first wave of the virus, with its geographic isolation and prompt enaction of social distancing measures leaving it relatively unscathed.

Considerable uncertainty around the economic impact of the pandemic remains, and the likelihood of a prompt, 'V-shaped' recovery appears far less likely than earlier in the quarter. The IMF revised its initial April global economic forecasts in June, significantly cutting expected GDP growth over 2020 and 2021 in most countries. It now anticipates global GDP growth of -4.9% in 2020 (a cut of 1.9% to April's estimate), with sizeable cuts to countries in western Europe (chiefly France, Spain, Italy and the UK), India, and across Latin America. Australia's initial success in containing the virus saw the IMF actually lift its Australian 2020 GDP forecast, expecting growth of -4.5%, up from -6.7% in April.

Despite the more prolonged pandemic now anticipated by the IMF, equities markets had a stellar quarter. Australian and hedged developed overseas equities returned 16.8% and 17.8%, respectively. The S&P 500 Index, a benchmark for US equities, had its best quarter since 1998, while the more technology-oriented Nasdaq Composite Index completely recovered from its pandemic-era decline to reach new record highs in June. Market volatility also stabilised. The VIX Index, which measures forward-implied US equities market volatility, declined from a record of over 80 in March to low (but slightly elevated) levels of around 30 by quarter-end.

The Australian dollar similarly recovered as investors retreated from safe haven currencies such as the US dollar and Japanese yen, rising from its March low of 58 US cents to 70 US cents by early July. Commodities similarly benefitted from the rally, with the price of West Texas Intermediate oil surging from a brief negative price in late April to over US$40 per barrel by late June. Nonetheless, oil prices remain well below their pre-pandemic peaks as global output slows.

Fixed interest also had a positive quarter, with credit spreads narrowing (and prices rising) across both investment grade and high yield issuers, while central bank policies have contained sovereign yields. Nonetheless, concerns about future credit issuer downgrades and defaults remain – especially among industries worst-affected by the pandemic, such as airlines and US shale oil producers.

AUSTRALIA

Economic output and conditions generally improved as the quarter progressed and the pandemic appeared to have been contained. However, a spike in cases in Victoria in late June now presents risks of further lockdowns (indeed this eventuated in Melbourne in early July) and is likely to hinder the local economy's recovery.

The RBA started to taper its first-ever quantitative easing program, having achieved its yield curve control target while also implementing measures to improve financial institution liquidity – in the process leading to the Official Cash Rate falling below its 0.25% target for the first time since the GFC. The Commonwealth Government's considerable stimulus package benefitted from a $60 billion overestimate, providing additional scope for fiscal stimulus in the coming months.

Australian house prices continued to prove relatively resilient, moderately declining over the quarter. Turnover is now also rising as activity in the residential market improves, suggesting further declines are likely amid rising supply and tepid demand.

The nation's jobs market recorded an increase in the unemployment rate to 7.1% by quarter-end, however the figure benefitted from a decline in the participation rate; had participation remained unchanged, unemployment would likely be above 8%. The looming September end date of the temporary JobKeeper program will, if not extended, present a significant near-term risk for the local jobs market.

Otherwise, retail sales rebounded as consumers returned to shopping centres in droves, and sentiment data continuing to improve; albeit from historic lows. That said, the data reflects optimism prior to the spike in Victorian cases, and will likely trend downwards in the coming months.

UNITED STATES

As would be expected, the pandemic-induced economic slowdown has had a significant impact on the US. States originally insulated from the worst of the virus, such as Texas and Florida, are now struggling to cope with significant numbers of new daily cases.

The unemployment rate soared from 4.4% to 14.7% in April before falling to 11.1% by June. At one point in early May, the total number of workers seeking unemployment benefits peaked at nearly 25 million. Headline CPI also deteriorated to just 0.1%.

Following monetary stimulus measures announced in March, in April the US Federal Reserve increased the size of existing bond purchase programs and expanding their scope to include securities such as 'fallen angels' (investment grade credit downgraded to high yield) and high yield credit ETFs. The measures have so far helped normalise market liquidity and support prices. The US Federal Reserve remained highly accommodative in its policy settings, with guidance in June suggesting the Fed is committed to doing whatever it takes to support the US economy.

Additionally, there was heightened civil unrest in late May and early June following the death of African-American George Floyd at the hands of Minneapolis Police. Significant rioting and looting occurred in a number of US cities, however dissipated as June progressed.

EUROPE

The European economy bore the brunt of the pandemic, however by June lockdown restrictions eased as the worst of the crisis seemed to pass.

The European Union's unemployment rate increased to a below-expected eight-month high of 6.7%; albeit benefitting from over forty million furloughed (but still employed) workers. Inflation, meanwhile, fell well below the ECB's target, with the headline rate hitting an annual 0.1% during the quarter.

The ECB announced a €600 billion expansion to its pandemic bond purchase programme in May, taking its total size to €1.35 trillion – much to the chagrin of German courts, which considered the magnitude and risks inherent in the programme 'unconstitutional'. Meanwhile, fiscal stimulus continues to be discussed between EU member states, with nations favouring more restrained spending at odds with those that prefer extensive budgetary support to lift the continent's economy out of its COVID-19 stupor. A member summit in late June ended without agreement. At present, a €750 billion plan has been proposed by the EU.

In the UK, the Bank of England increased the scale of its quantitative easing programme by £100 billion to £745 billion, while Prime Minister Boris Johnson has promised considerable fiscal stimulus, vowing to 'build, build, build' via billions in capital investment projects, including hospital, school and road projects.

CHINA

While the world's major economic powers grapple with the pandemic, China has seemingly taken the opportunity to flex its geopolitical muscle. Following the passage of new, tighter security laws in Hong Kong, arrests of pro-democracy dissidents have commenced despite the US threat of sanctions. Chinese troops also engaged in a clash with Indian soldiers at their shared border, damaging relations between the two.

Despite the geopolitical sabre-rattling and the scare of a COVID-19 outbreak in Beijing, soft data has become increasingly sanguine; the Caixin services PMI soared to its highest level in a decade in June, while the benchmark equities index, the CSI 300, hit a five-year high by early July.

Table: Index Returns to 30 June 2020

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	2.4	16.8	-7.6	-7.6
S&P/ASX Small Ordinaries Accumulation Index	-2.0	23.9	-5.7	-5.7
International Equities				
MSCI World (ex Australia) Index (hedged A$)	2.3	17.8	1.3	1.3
MSCI World (ex Australia) Index (unhedged A$)	-1.1	5.9	5.2	5.2
MSCI Emerging Markets Index (unhedged A$)	3.5	5.0	-1.5	-1.5
Property				
S&P/ASX 200 A-REIT Accumulation Index	-1.4	19.9	-21.3	-21.3
Australian Fixed Interest				
Bloomberg AusBond Composite Index	0.3	0.5	4.2	4.2
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	0.3	1.0	6.1	6.1
Barclay's Global Capital Aggregate Bond Index (hedged A$)	0.5	2.3	5.2	5.2
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.1	0.8	0.8
Commodities				
Gold (US$ per ounce)	2.4	10.6	25.2	25.2
Copper (US$ per metric tonne)	11.9	21.5	0.4	0.4
WTI Crude Oil (US$ per barrel)	10.7	91.7	-32.8	-32.8
RBA Index of Commodity Prices (A$)	-3.1	-9.0	-11.2	-11.2

Table 1: Australian Dollar versus Foreign Currencies to 30 June 2020

AUSTRALIAN DOLLAR VERSUS	AS AT 30 JUNE 2020	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.68	2.9	12.4	-2.2	-2.2
British Pound Sterling	0.56	3.3	13.3	1.1	1.1
Euro	0.61	2.1	9.8	-0.8	-0.8
Japanese Yen	73.77	3.4	11.5	-2.2	-2.2