View from the hill

MARCH 2020

HILLROSS

Market update

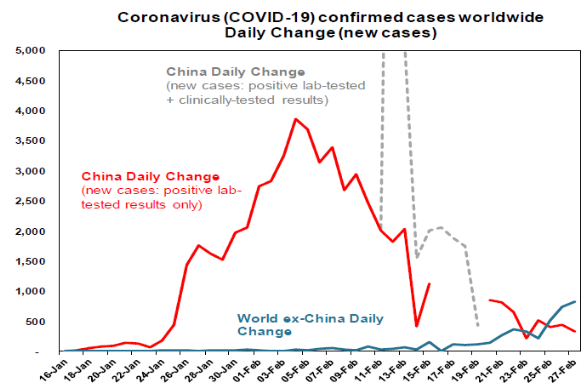
The table below provides details of the movement in average investment returns from various asset classes for the period up to **29 February 2020.**

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	-7.7	-5.2	8.6	8.6
Smaller companies	-8.7	-5.9	1.6	8.3
International shares (unhedged)	-4.9	-1.6	15.6	13.9
International shares (hedged)	-8.1	-6.3	5.2	7.0
Emerging markets (unhedged)	-1.6	1.8	8.3	11.2
Property – Australian listed	-4.7	-3.0	12.3	10.3
Property – global listed	-8.0	-6.9	3.2	5.5
Australian fixed interest	0.9	1.5	9.0	6.0
International fixed interest	1.2	2.8	9.3	5.0
Australian cash	0.1	0.2	1.3	1.7

Past performance is not a reliable indicator of future performance. The Global Listed property reference index changed to FTSE EPRA/NAREIT Developed Rental NR Index (AUD Hedged) as of August 2019

Overview & Outlook

The response to the coronavirus, now officially named COVID-19 remained the single biggest issue for financial markets through February. The virtual shut down of the Chinese economy is reverberating around the world affecting global companies to local suburban restaurants.



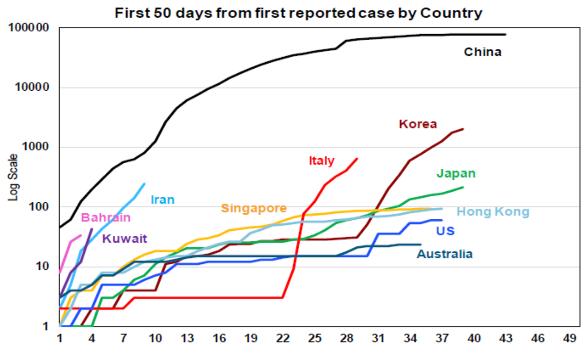
Source: PRC National Health Commission, Bloomberg, AMP Capital

With the virus having spread to South Korea, Italy, Iran and Japan through the month we saw confirmed cases increase to 90,912 globally (at the time of writing) with 3,117 deaths as a result of the virus. This has further impacted global trade and travel with trade shows, conferences and other events being cancelled around the world. While China's aggressive measures appear to have slowed the spread of the disease within China, unfortunately the spread outside has been accelerating which has been the driver of falls in markets around the world.

The ensuing effect on economic activity is now being felt with companies around the world experiencing direct impacts to supply chains and the demand for goods and services. As February came to a close a range of companies announced the expected negative impact on their next full year or half year revenues.

The level of certainty around future earnings has evaporated and the uncertainty for earnings over the short term is in our view the driver of increased market volatility and the fall in prices. It is quite clear that the caution that has arisen as a result of the outbreak is depressing consumption and potentially investment not just in affected areas but also here in Australia.

Virus containment is critical to the normalising of activity across all impacted regions. Clearly fear of contagion is driving individual action which is the only explanation to why restaurants in the suburbs of Australia are seeing significantly decreased patronage. Confidence that the virus is contained or that it is no worse than the regular influenza strain that impact us every winter are key to people resuming their daily lives as normal and businesses going to a business as usual.



Source: PRC National Health Commission, Bloomberg, AMP Capital

It is clear that the first quarter economic growth in China has been severely impacted by the measure that government and citizens have taken in light of the outbreak. The manufacturing PMI which indicate the intentions of manufacturers in the near term collapsed to 35.7 in February from 50 the previous month, according to data released by the National Bureau of Statistics which is a recessionary type data point.

The OECD has recently said that it expects global GDP growth to drop to 2.4% in 2020 from an already weak 2.9% in 2019, with growth possibly being negative in Q1. The longer the virus continues to spread then further economic weakness is likely given the measures being taken by governments, individuals and businesses.

Domestically the economic conditions are exacerbated by the recent bushfires which were thankfully extinguished by a deluge of rain early in the month. This will enable the government and communities to commence the rebuild of devastated towns.

Share markets

The Australian share market (-7.7%) reached an all-time high on the 20th of the month seemingly ignoring the impact that coronavirus was having on economic activity. As market became uncertain of earnings the market fell precipitously over the next week erasing most of the last 12 months of returns.

Source: FactSet, AMP

All sectors saw declines with utilities (-3.6%) least affected. Other defensive sectors such as health care (-3.7%) and gold stocks (-3.8%) were the better performers for the month. The most expensive sector, information technology (-17.3%), was hardest hit while energy (-17.2%) due to the impact on the demand for oil and gas was a close second with resources (-13.3%) next in line.

International shares (-8.1%) on a currency hedged basis underperformed the local market. Chinese stocks (+2.2%) despite being the epicentre of the outbreak gained over the month helping emerging markets (-1.6%) more broadly to outperform developed markets. US shares having achieved an all-time high during the month saw a 12.7% decline over the last six trading days to end the month down (-8.2%).

Currency movements were supportive to unhedged international exposure and international shares (-4.9%) on an unhedged basis lost less ground than the local market.

Interest Rates

Despite the expectations of some, fixed interest did provide diversification benefits with Australian fixed interest (0.9%) and International fixed interest (1.2%) helping to offset losses experienced in growth assets.

The US 10-year government bond yield fell over 34 basis points to 1.16% while in Australia the government 10-year yield fell 11b basis points to 0.85%. With rates so low it is challenging for very conservative investors to generate returns.

The troubling trend of buying higher risk assets brings its own set of risks as this episode has seen. High yield (or sometimes referred to as sub investment grade or junk bonds) saw their spread to government bond yields rise sharply. As such they declined in value at precisely the time defensive assets are meant to cushion the falls experienced in growth assets. Some recently launched products fell significantly more than the 2% that the Bloomberg Barclays Global High Yield index fell.

Just this month following the bushfires and more recent outbreak of the coronavirus the RBA cut interest rates by 25 basis points to a new record low policy rate of 0.50% in an endeavour “to provide additional support to employment and economic activity” as the RBA statement read. Further cuts are likely, as the RBA said it is “prepared to ease monetary policy further.”

Property

The Australian listed property market (-4.7%) outperformed international REITs (-8.0%) with growth assets being sold somewhat indiscriminately toward the end of the month.