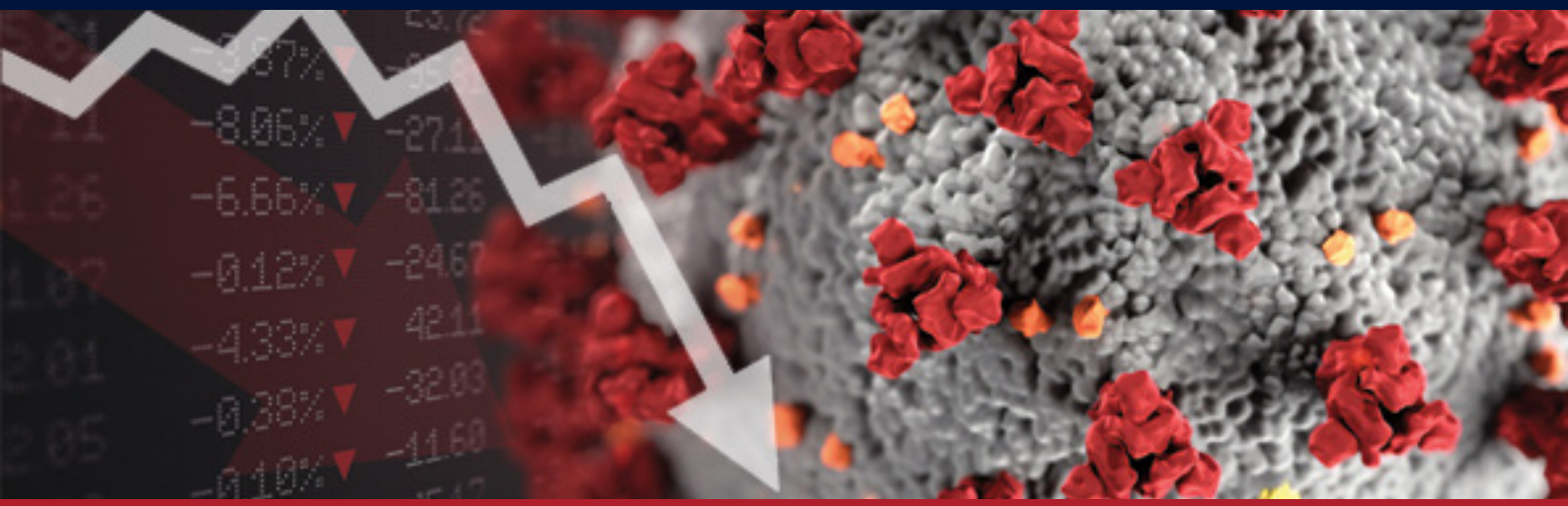
POINTS OF **INTEREST**

Autumn 2020

Issue 30

Welcome to the latest edition of our quarterly look at Australian and global economic and market developments. In this issue we review the past three months, which was an unprecedented time in the three areas of global health, the stock market and the economy.



EXECUTIVE SUMMARY

- **The world is in the midst of an unprecedented medical and economic crisis, which has impacted not just stock markets, but almost every facet of life.**
- **As a result of efforts to contain the spread of COVID-19, the stock market experienced its worst quarterly performance since 1987, falling by 24% in the first three months of 2020.**
- **With extreme levels of uncertainty and volatility, and little to suggest a quick end to the crisis, we remain wary of over-committing capital to the market at this time.**

BAIOCCHI GRIFFIN
PRIVATE WEALTH
INVESTMENT PORTFOLIO MANAGERS

An economic and health crisis unlike any other

Events during the first three months of 2020 (and the many months yet to come) will live long in the memories of everyone alive today. Past crises in recent memory, such as the 1987 stock market crash, the 1990's recession, 9/11 and the GFC, seem to be almost minor events when set against the onset of COVID-19.

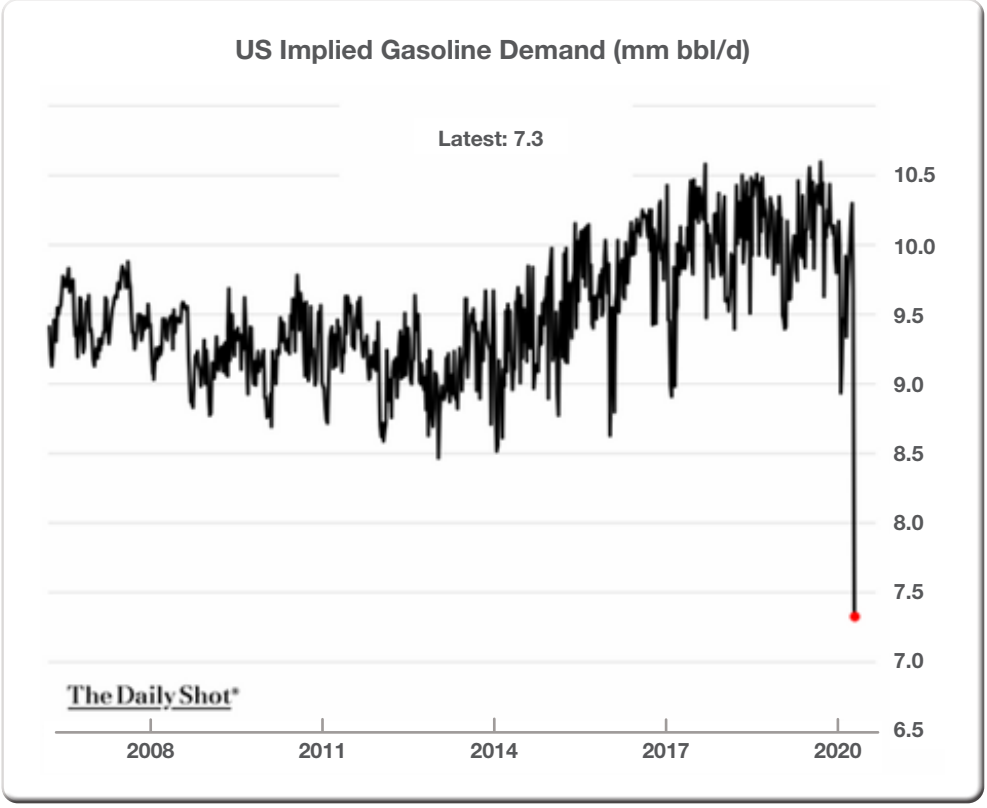
Global lockdowns, panic buying and hoarding, widespread job losses, the collapse of entire industries and a daily count of the global death toll – this is the new normal as we enter the second quarter of 2020. Add in an oil crisis, a credit crunch and saturation across both traditional and social media - is it any wonder that the stock market, a barometer of business and community confidence and outlook, has fallen to multi-year lows?

That said, rather than add to the many words (and news broadcasts and social media posts) written about COVID-19 and its impact on the world, we thought that a series of charts would illustrate the current economic and social environment best.

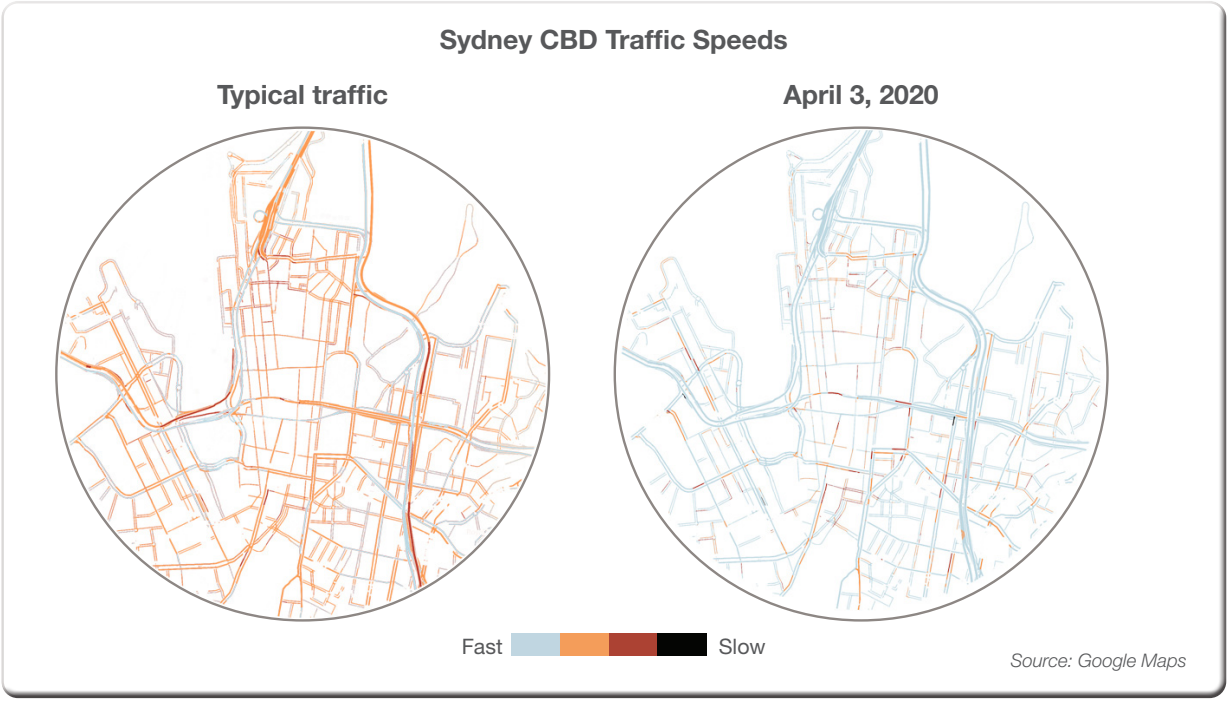
Firstly, a look at the impact of the virus on something we take for granted – travel and getting around.

COVID-19 and Travel

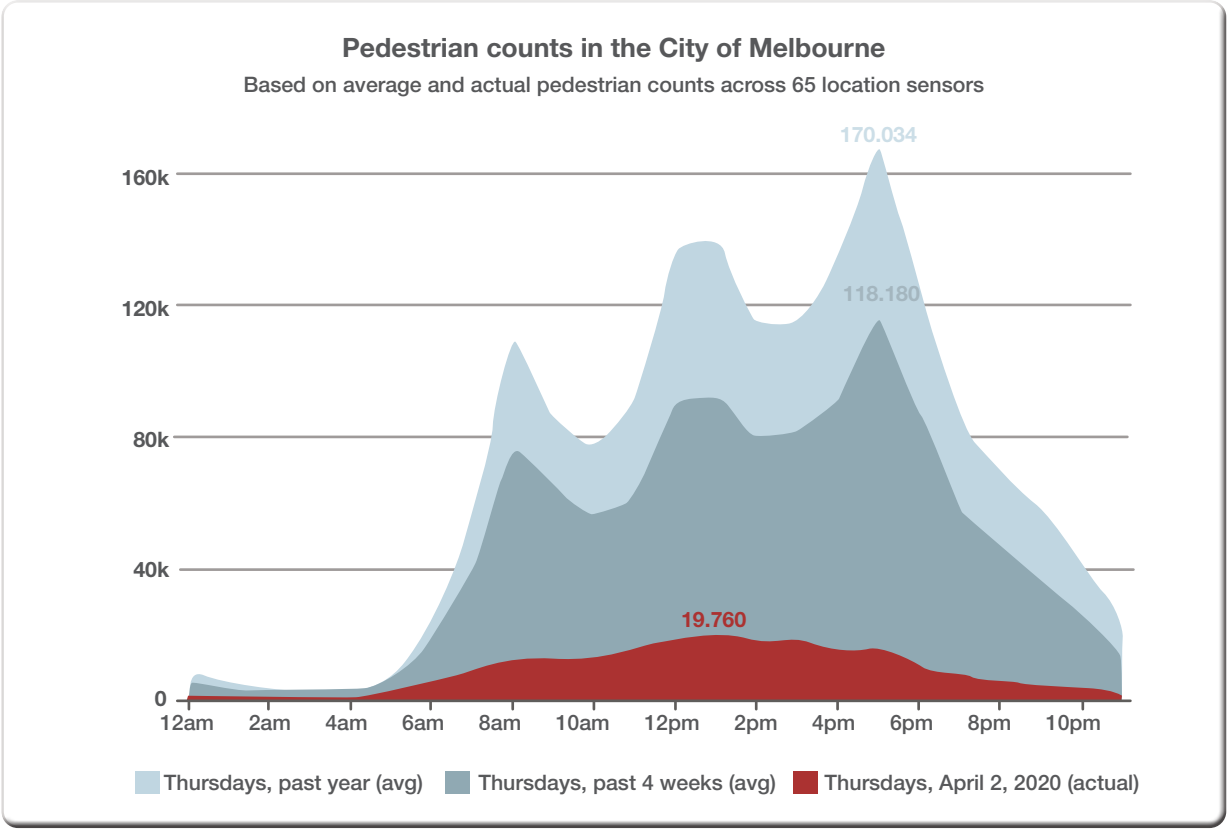
This chart shows the impact of 'stay at home' orders on demand for gasoline (petrol) in the United States. Unsurprisingly, fewer people driving to work or simply to get around has caused a collapse in demand for fuel.



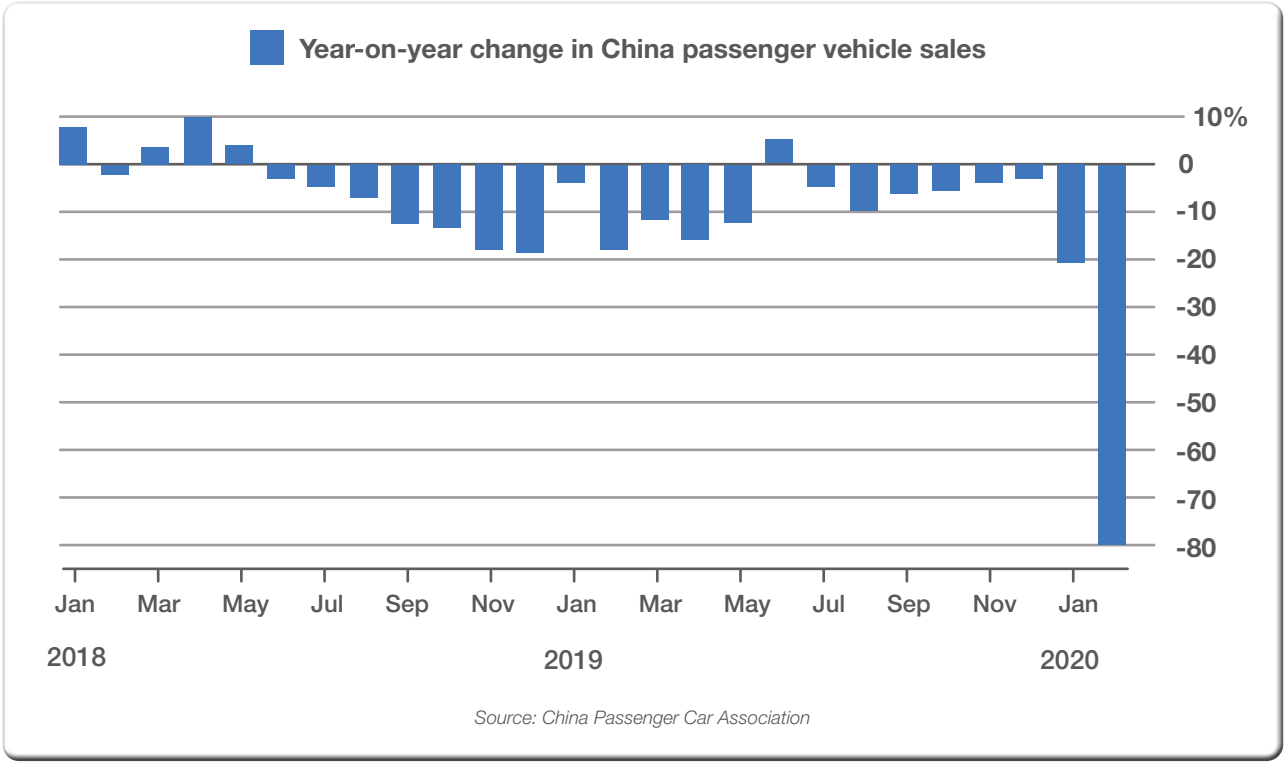
As workers increasingly work from home and avoid their workplaces, traffic in city CBDs has fallen significantly. Data from Google Maps, which tracks traffic levels in major cities, shows the almost complete absence of peak hour traffic in Sydney, as people heed the warnings to stay home.



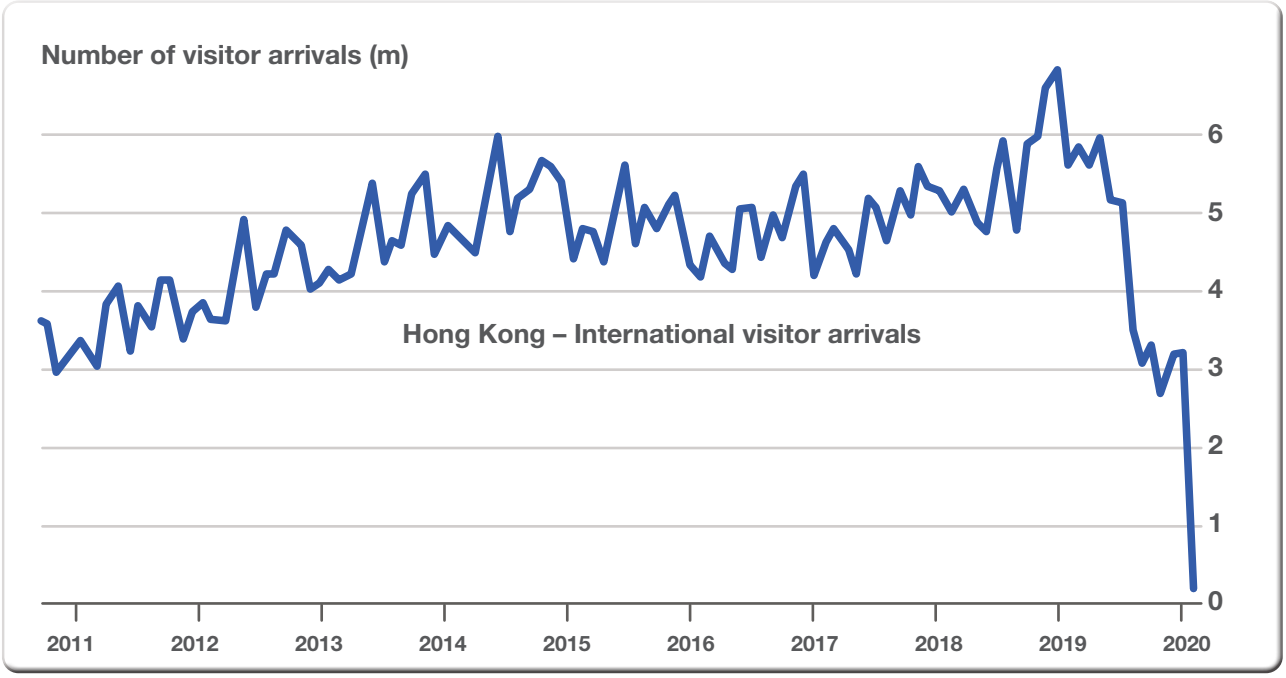
Similarly, foot traffic in city centres has fallen sharply. The chart below shows the number of pedestrians observed in the Melbourne CBD. A typical Thursday would average around 170,000 pedestrians at around 5:00pm. On Thursday the 2nd of April, only just over 19,000 pedestrians were observed in the CBD.



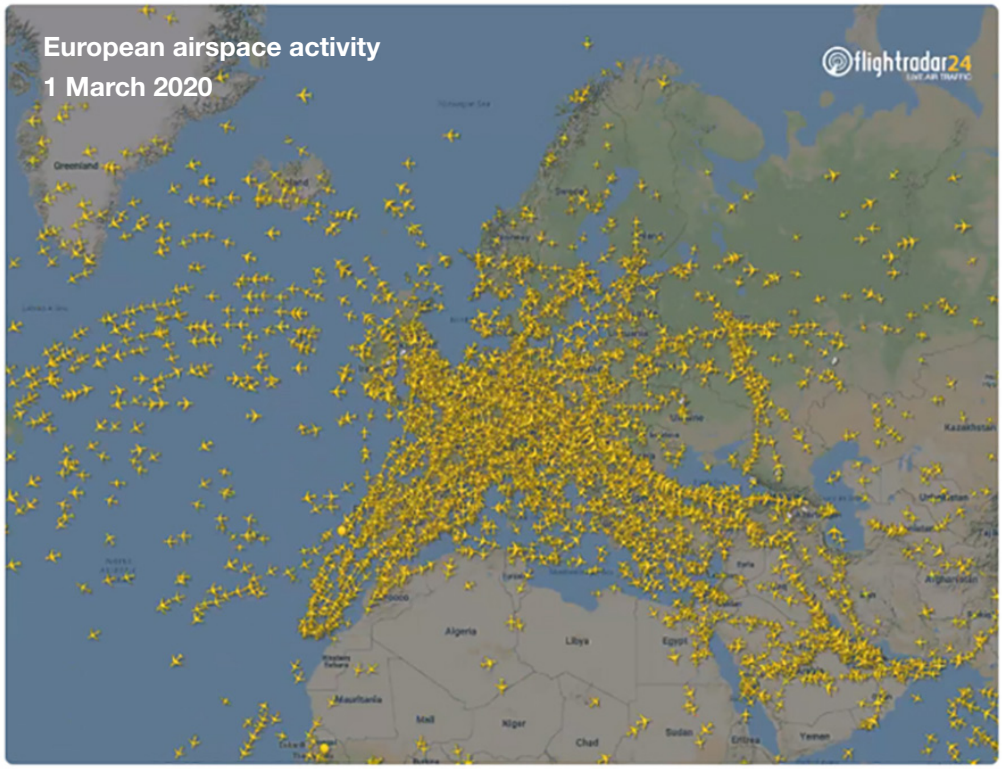
If you're under lockdown orders or working from home, you're also unlikely to be out shopping for a new car. In China, new car sales fell by 80% in February, as compared to the year before. New car sales numbers for Australia will be released in coming weeks and we expect to see a similar outcome.

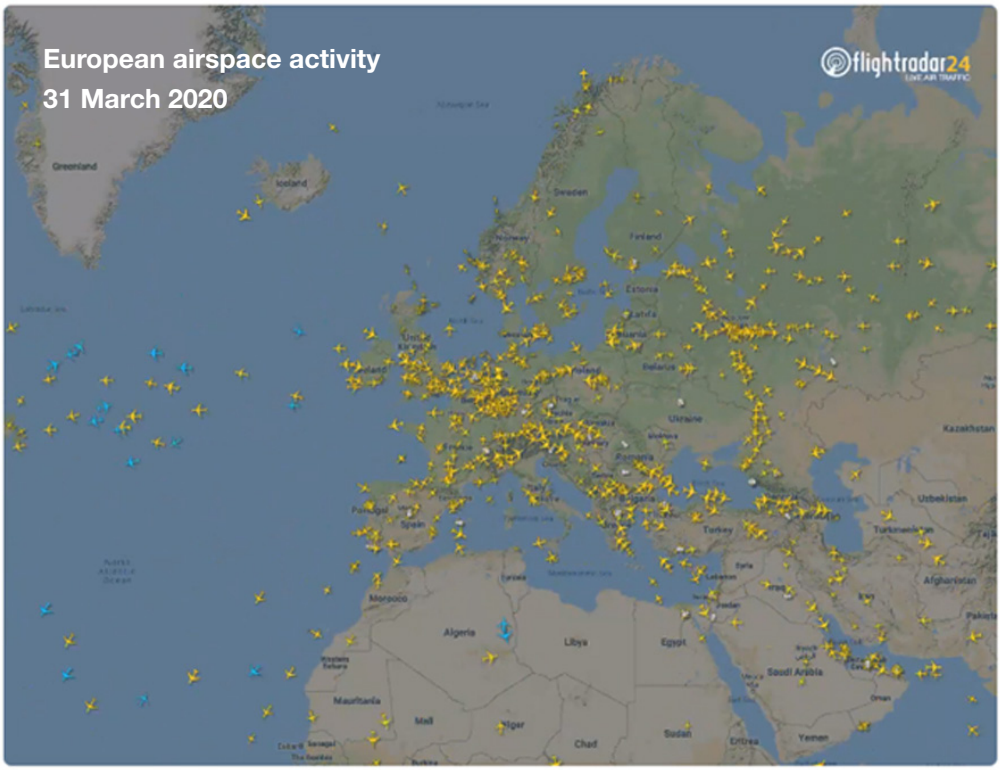


International air travel is another area impacted by the spread of the COVID-19, with the chart below showing the number of international travelers arriving in Hong Kong, which has been a global transit point for many years. In February, the number of international visitors fell by 96% as compared to previous months.

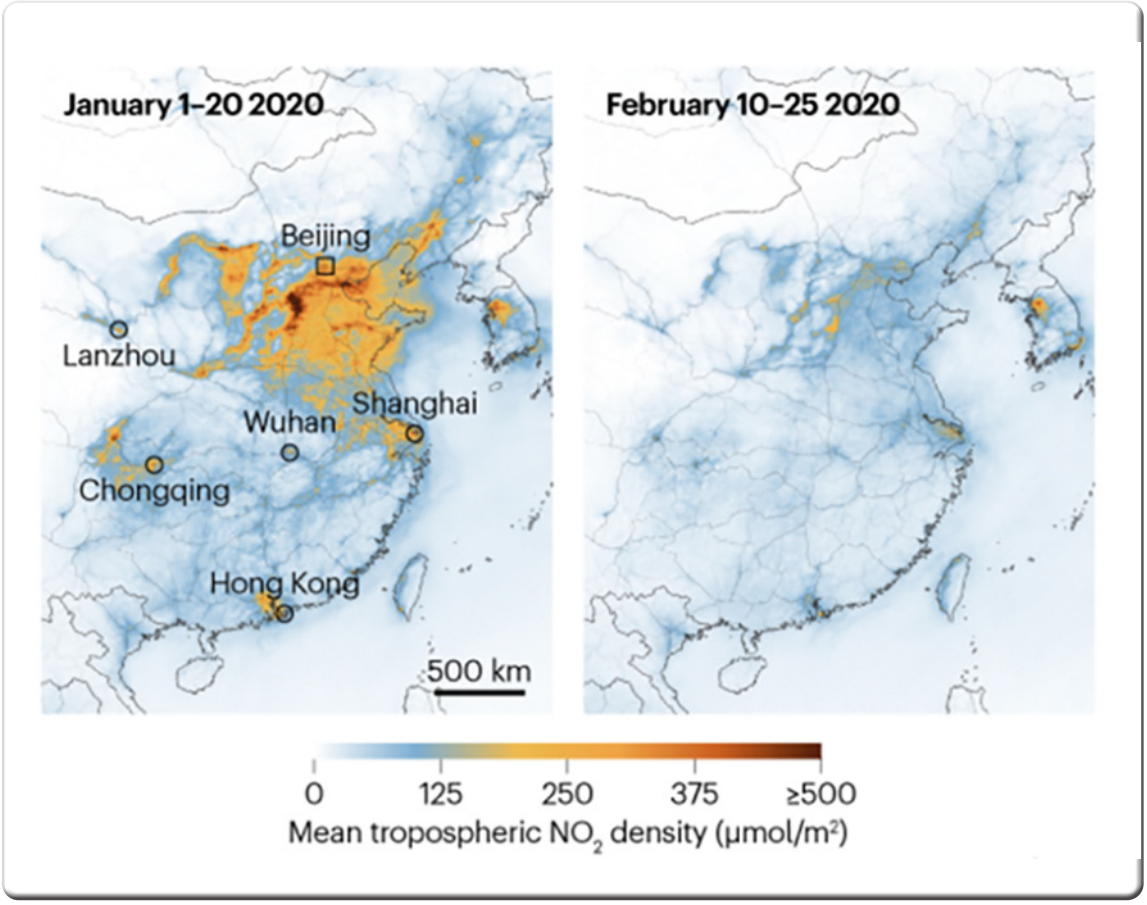


As airlines around the world (Qantas and Virgin included) have grounded planes, laid off staff and cut routes, the number of planes in the air has fallen dramatically. The two images below show the number of planes in the air over Europe (each yellow marker represents a plane mid-flight). The first image shows the number of planes on the 1st of March, the second image shows the number of planes at the same time of day on the 31st of March. The actual count changed from 4,592 flights on the 1st, to just 865 flights at the end of the month.

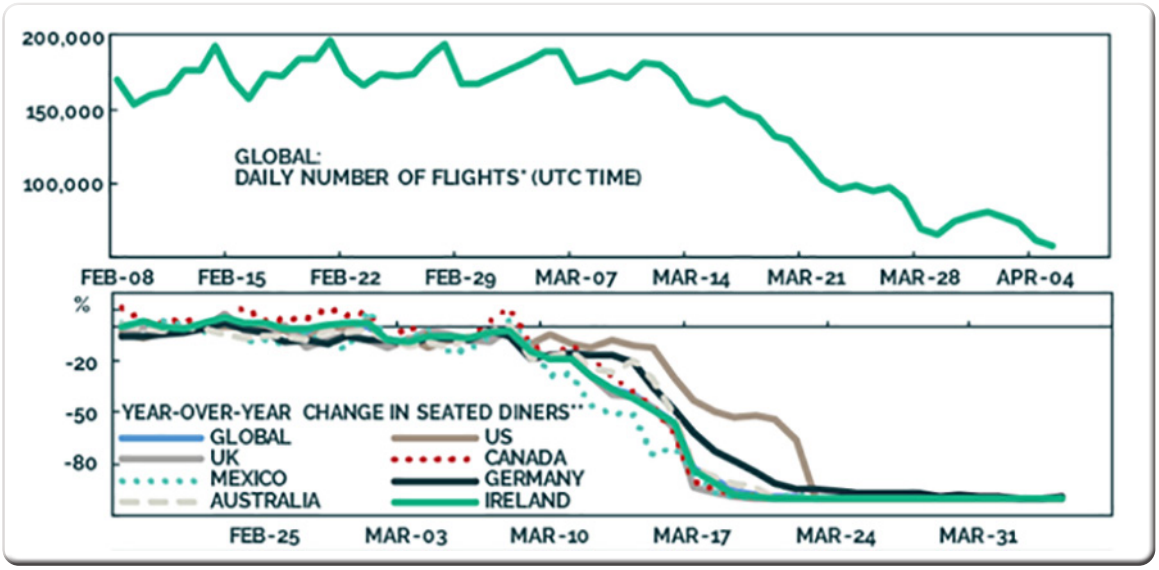


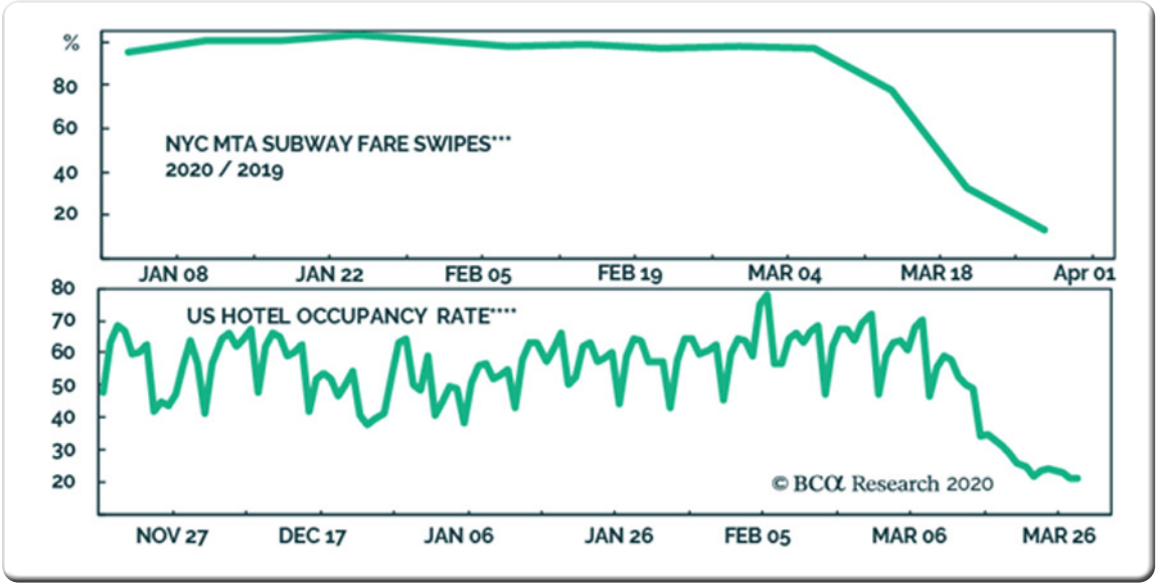


Perhaps the only beneficiary of the pandemic has been the environment. Travel restrictions and the closure of workplaces (including factories) has meant that pollution levels have fallen in many countries. In China, where air quality is a serous health issue, the impact of the shutdown has been notable, with the chart below showing the difference in air pollution over China before and during the lockdowns.



A range of other global activity measures show a similar pattern as lockdowns and movement restrictions grow. The next four charts all measure different activities, but the pattern in each case clearly shows the impact of the virus.

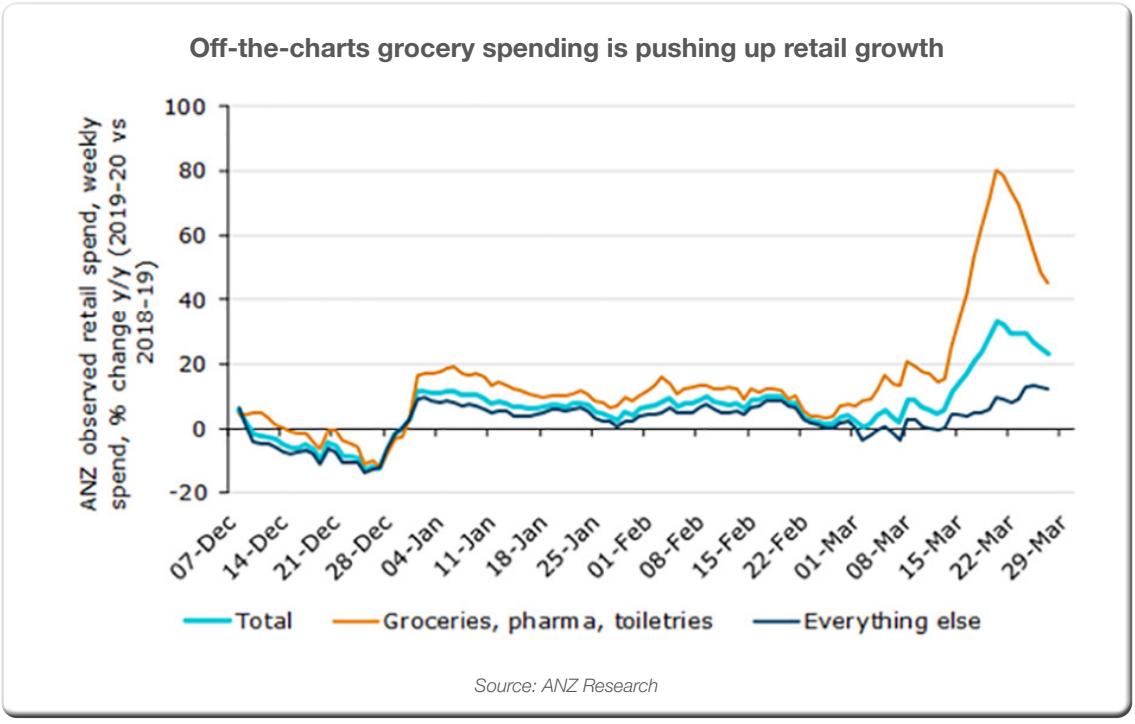




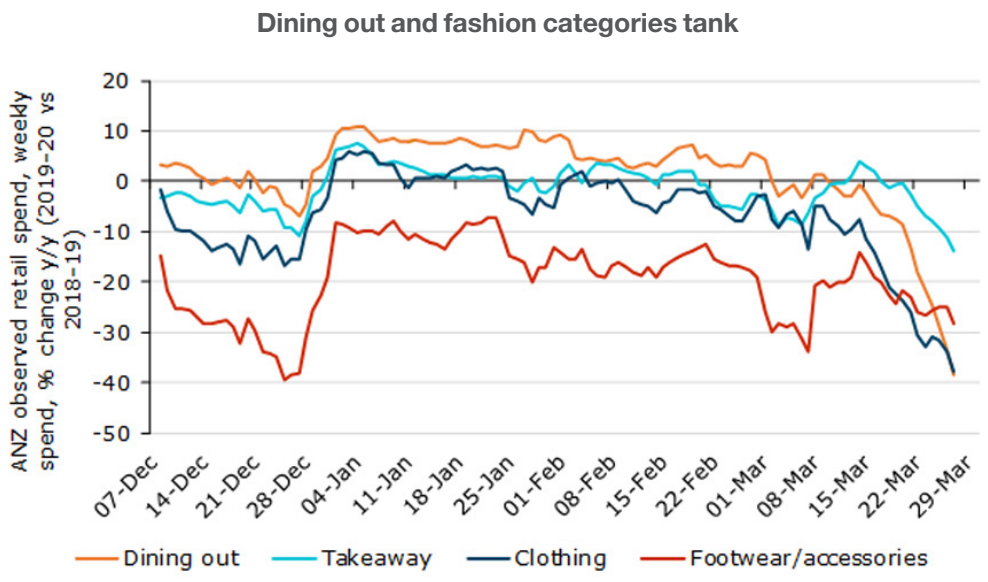
COVID-19 and Shopping Patterns

Proving that people around the world are the same at heart, the COVID-19 pandemic will also no doubt be remembered as the time of toilet paper hoarding. From Beijing to Boston to Brisbane, bare shelves in the toilet paper aisle is still a daily disheartening sight. Of course, it's not just toilet paper that is impossible to find: paper towel, serviettes, tinned food, pasta, flour and a wide range of other products are all victims of panic-buying.

This has been reflected in the retail sales figures, where spending on groceries has increased exponentially as worried consumers stock up. Fortunately, panic-buying (in Australia) appears to have peaked in late March, as shown in the following chart, although demand for groceries, pharmaceuticals and toiletries (read pasta, paracetamol and toilet paper) still remains well above normal levels.

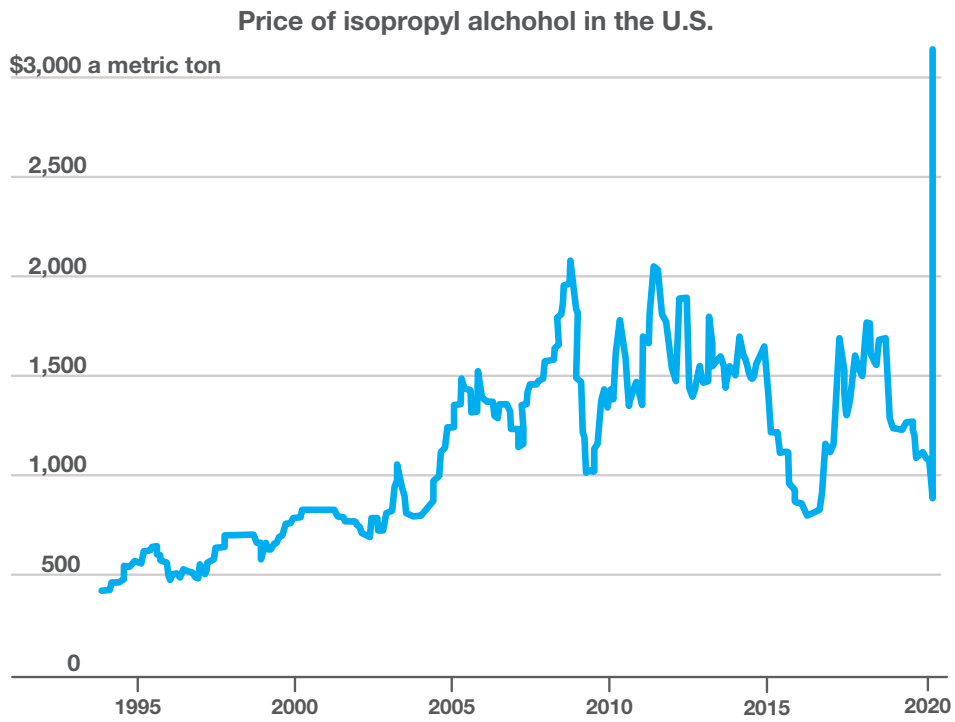


Of course, as households spend more on groceries and toiletries, spending on products and activities which entail leaving the house have fallen sharply. As shown below, the level of expenditure on dining out, in particular, has fallen sharply as authorities have moved to ban non-essential travel.

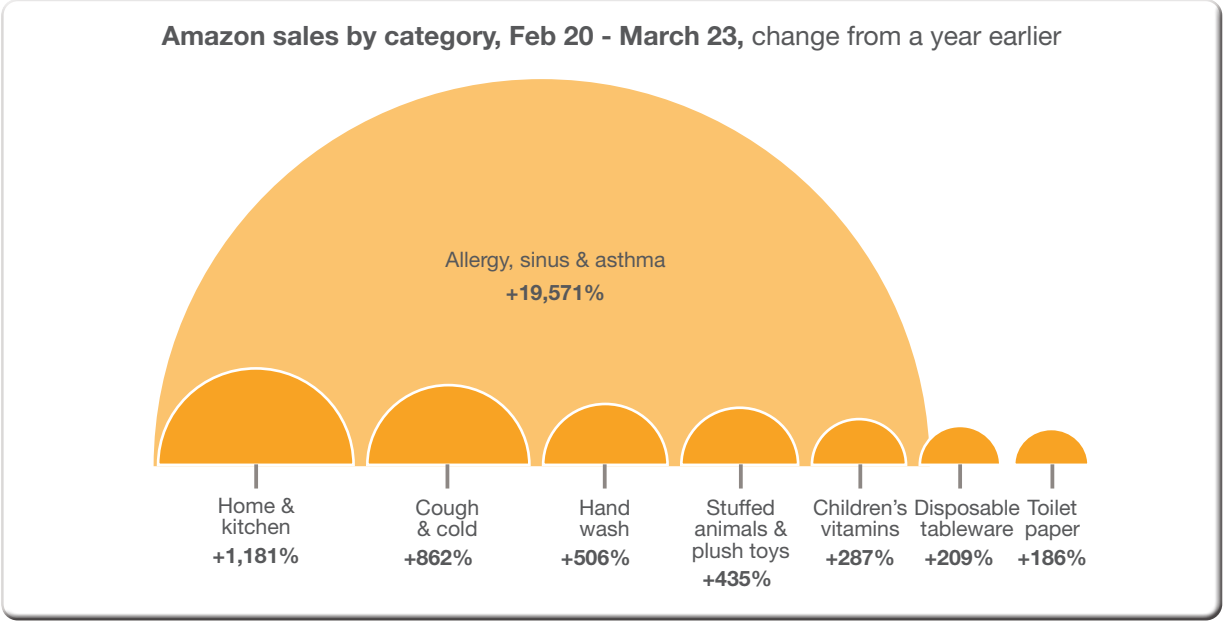


Source: ANZ Research

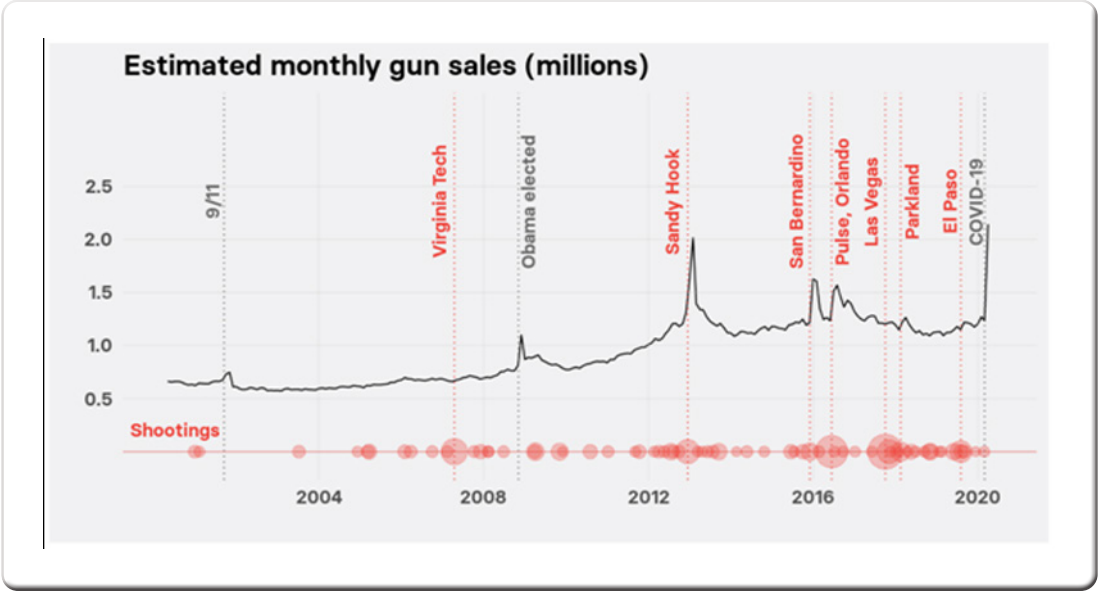
Joining toilet paper in the 'impossible to find' category is also hand sanitiser. One of the few beneficiaries of the COVID pandemic has been companies which supply the basic ingredient of hand sanitiser, isopropyl alcohol, with prices surging due to increased demand (as shown below).



Sales at Amazon have provided a useful picture of the changes in behavior as COVID-19 swept the world, with significant increases in specific products purchased through Amazon's online store. Toilet paper shortages appear less of an issue, especially when compared to a 19,000% increase in sales of allergy, sinus and asthma treatments as compared to a year ago.



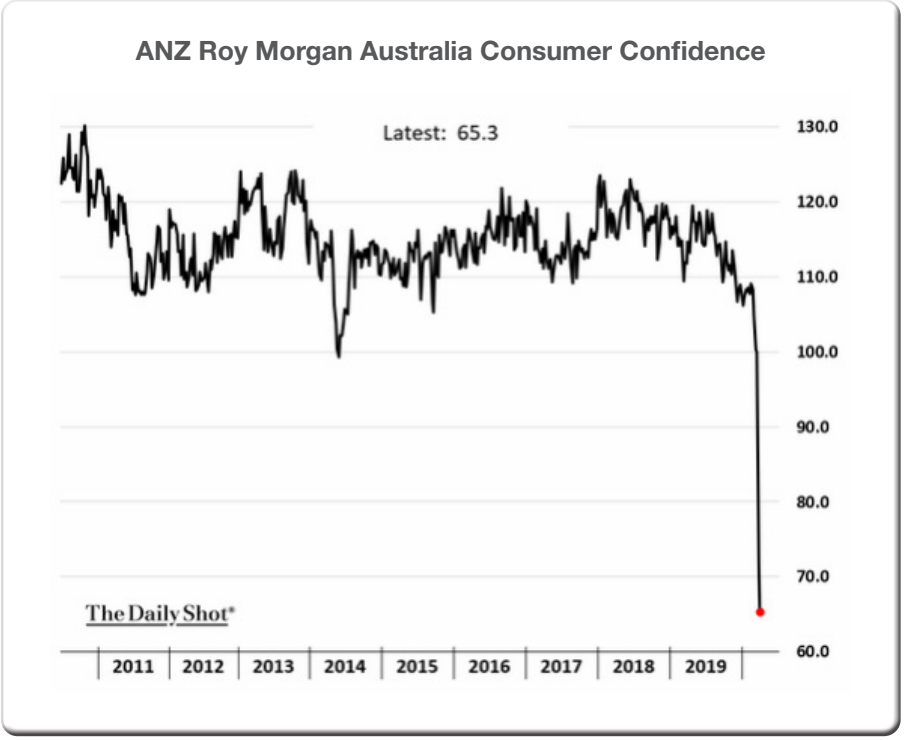
Of course, America being America, there has also been a record spike in gun sales as Americans arm themselves at alarming rates. Such a finding is somewhat surprising, given there is little evidence to suggest that COVID-19 can be shot.



COVID-19 and the Economy

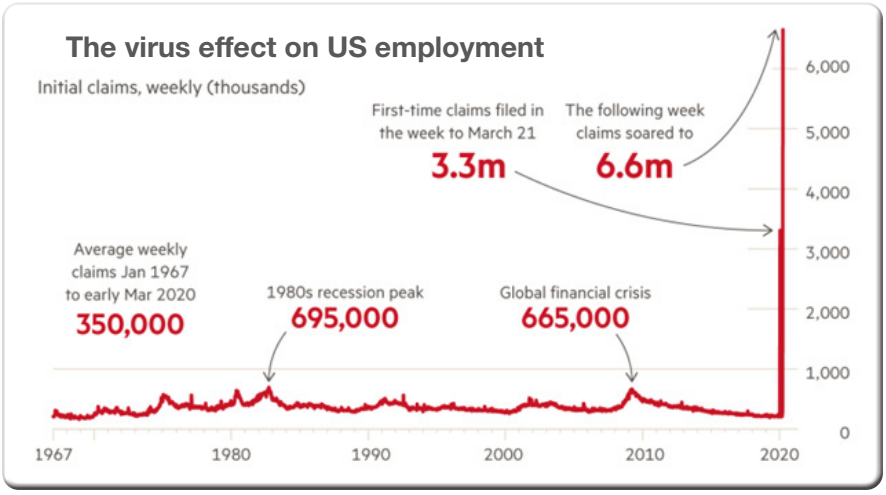
The economic impact of COVID-19 has proven to be more extensive and far deeper than initially expected. Measures taken by governments around the world to limit the spread of the virus have focused on restricting movement and the gathering of people, which has manifested itself in the shutdown of a large proportion of economic activity.

In the light of widespread job losses and concerns over both their economic and personal wellbeing, consumer confidence levels in Australia have dropped to record lows.

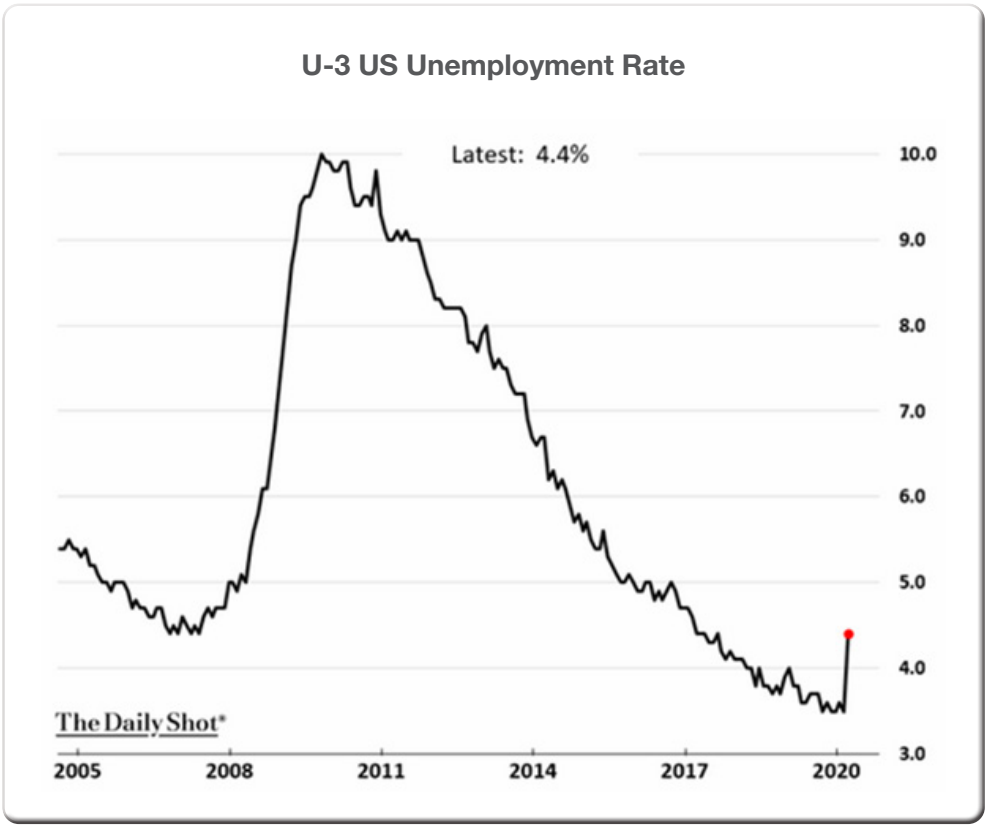


One of the most significant economic impacts of the pandemic has been the widespread loss of jobs around the world as countries have moved to progressively shut down their economies in response to the virus. In the United States, initial jobless claims (which is a weekly measure of the number of people registering for unemployment benefits) experienced a record increase in the last two weeks of March. Over a two-week period, around 10 million Americans registered for unemployment benefits, the highest increase since the data series began in 1967. To put that into context, the entire Australian labour force is around 13 million, so in the space of two weeks the number of Americans who lost their jobs was nearly equivalent to every person in Australia losing theirs. Similar job losses are expected in most countries (in France around a quarter of the private sector workforce has been laid off), however in Australia unemployment data is only reported on a quarterly basis, so the full extent of losses is not yet known.

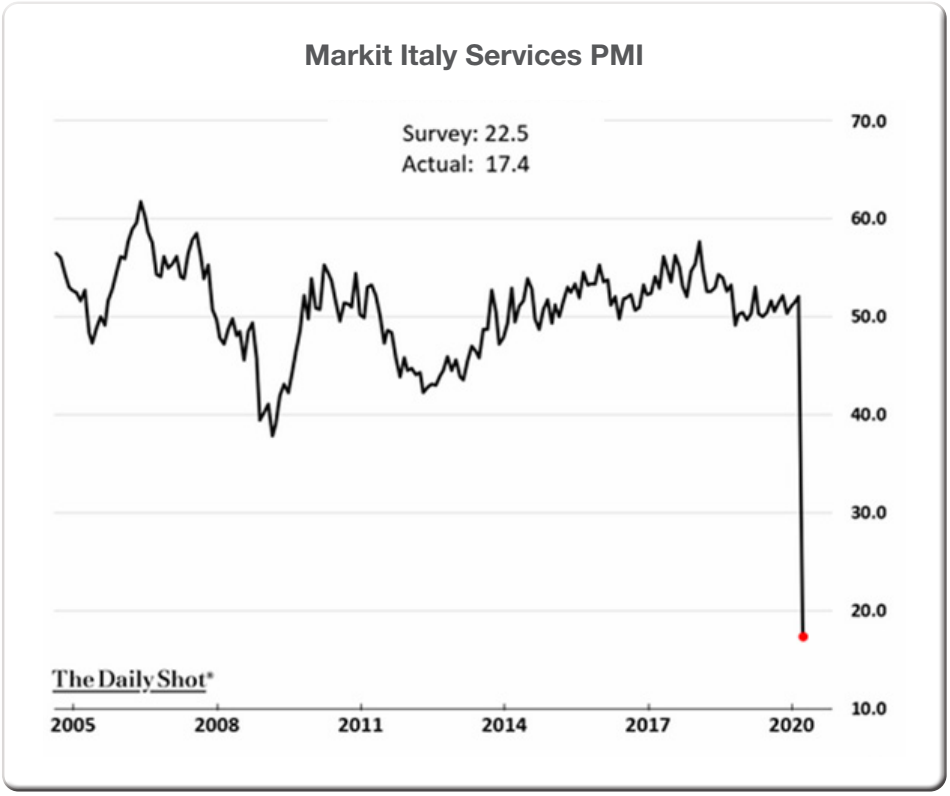
This chart shows the record surge in US initial jobless claims, which dwarfs that seen during the global financial crisis.



Unsurprisingly, the unemployment rate in the US also jumped, increasing by 700,000 people in March. The chart below shows the increase in the unemployment rate to around 4.50%. Based on the level of initial jobless claims however, expectations are that US unemployment may reach as high as 16%, which would be the highest level since the Great Depression (where it reached 25%).

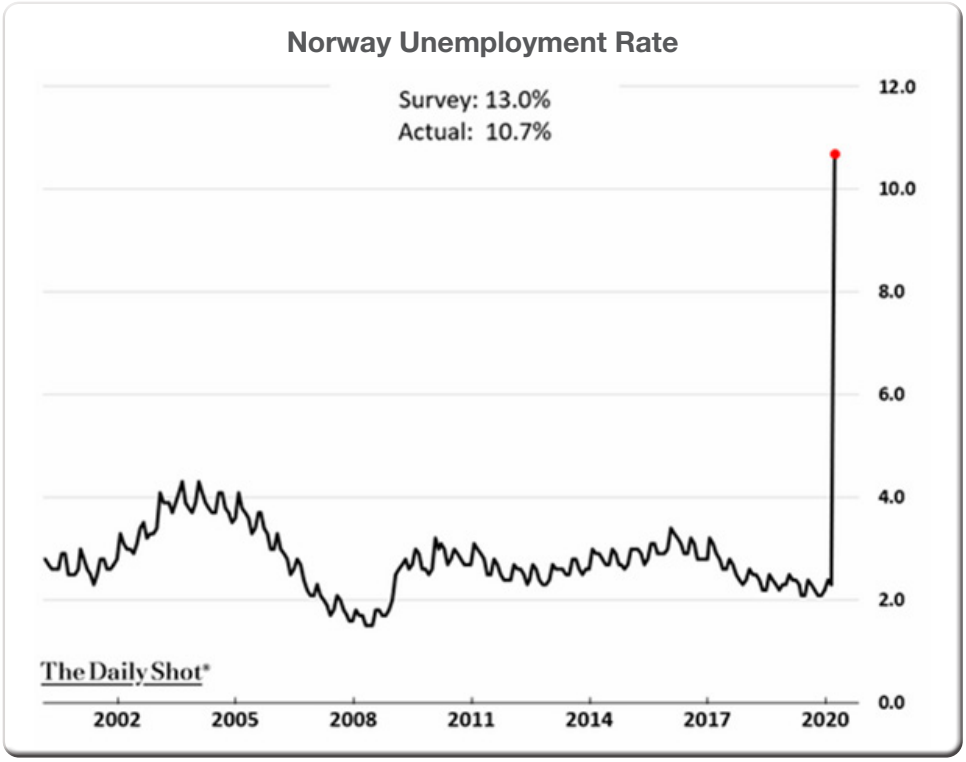


Italy has been one of the countries hardest hit by COVID-19, with deaths currently over 16,000 and over 130,000 confirmed cases. Measures to stop the spread of the virus have included some of the world's most severe stay at home restrictions, with a corresponding collapse in economic activity. The PMI index is used as a measure of manufacturing activity and is derived by surveying the intentions of private companies with regard to new orders, production, unemployment and a range of other measures. Unfortunately for Italy, as shown below, the level of manufacturing activity has fallen to record lows.

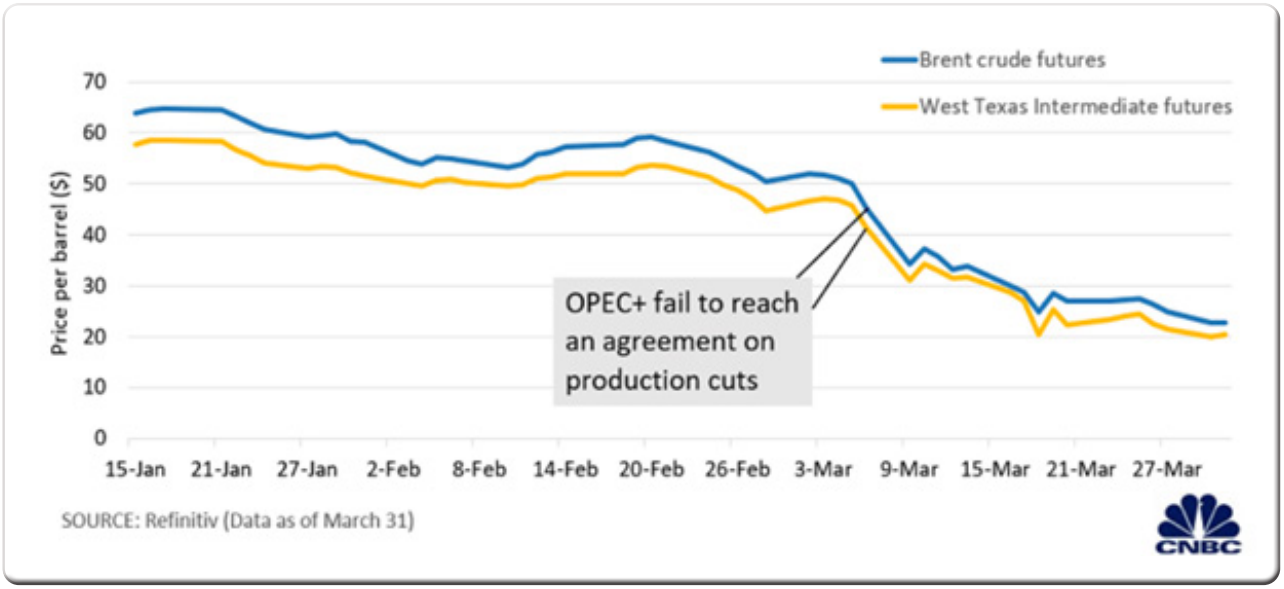


Compounding the economic impact of COVID-19, has been the fallout from the effective disintegration of OPEC. Due to the inability of Saudi Arabia and Russia to reach agreement on continued oil production cuts, negotiated agreements on restricting global oil production to specific levels have fallen apart. In an effort to force Russia back to the negotiating table, Saudi Arabia has indicated that it will flood the oil market with supply, severely damaging the fiscal budgets of countries who are heavily dependent on oil revenues.

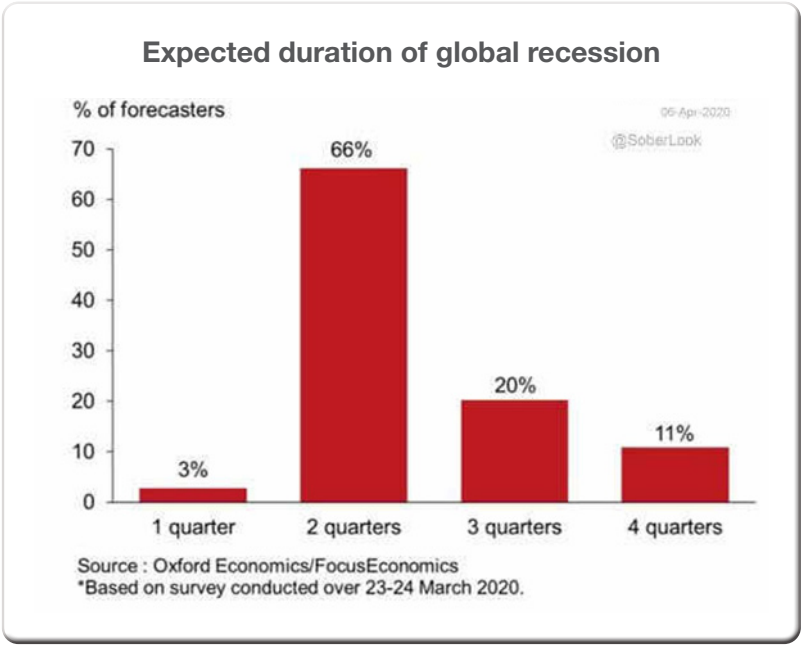
In Norway for example, where the oil and gas sectors are major components of the economy, unemployment has already soared to over 10%, as shown in the following chart.



The actual impact of the OPEC/Russia fallout on the oil price is shown in the chart below, with oil prices falling by a record amount during March. Usually a lower oil price is beneficial for the global economy, however in this instance it is the sudden collapse in price which has raised concerns as it threatens the viability of the energy sector in many countries. In the US for example, 5% of workers are employed in the energy sector and energy companies are large issuers of bonds held by pension funds and other investors.



At this stage, the majority of economists are predicting the global recession to last no more than two quarters, which should see global growth recover in the second half of the year. The hope is that global economic activity recovers swiftly once restrictions on movement and social distancing are removed.

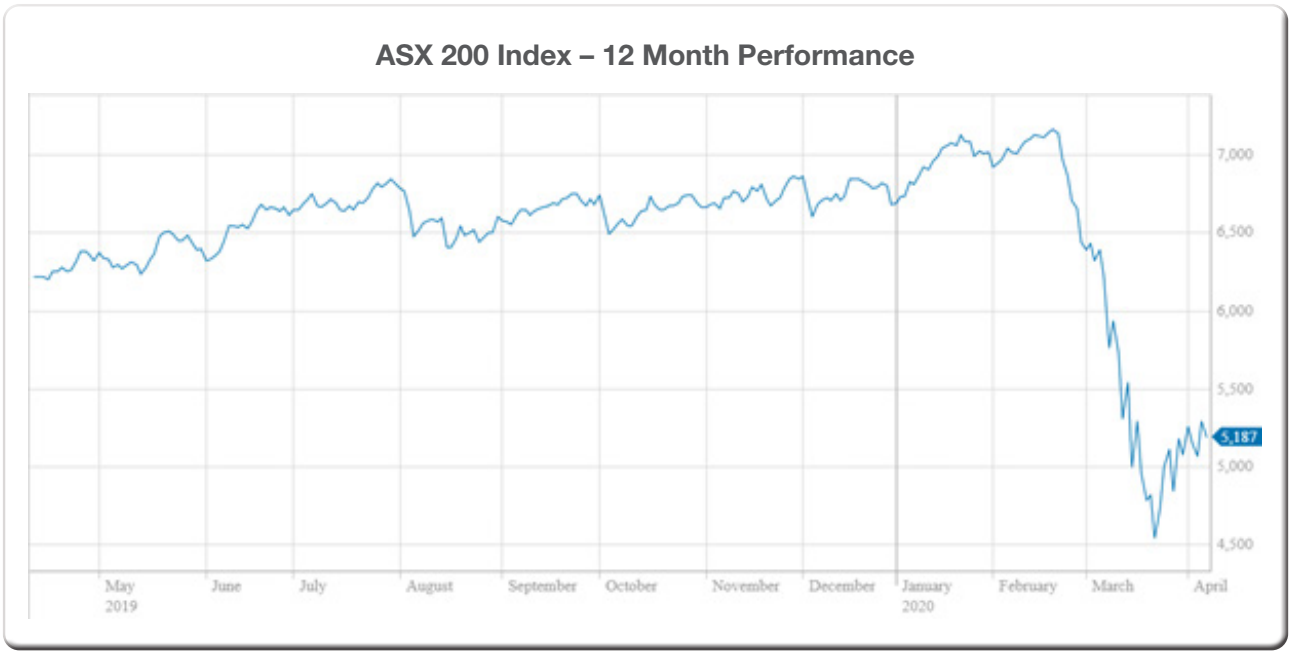


As far as the Australian economy is concerned, the record-setting run of consecutive years without a recession will unfortunately end in 2020. The Australian economy is tipped to experience its first recession since 1991, a record 29 years of uninterrupted economic growth.

COVID-19 and the Stock Market

As a barometer of economic health and consumer confidence, the stock market has been heavily impacted by the COVID-19 pandemic. The first three months of the year have been extraordinary in regard to the scale and speed of market movements. After reaching an all time high of 7,197 points on the 20th of February, the benchmark ASX 200 Index fell by 24% at the end of March, losing nearly $500 billion in value. In March alone, the index fell by 21.20%, making it the worst monthly performance since October 1987. At one point, during trading on the 24th of March, the market was down just over 40% from its peak, before a strong intra-day rally pushed it off the lows.

The chart below shows the performance of the ASX 200 Index over the past 12 months.



The past few months have also seen extreme levels of volatility, with daily gains and losses well above normal average. For example, on the 16th of March the ASX 200 index fell by 9.7%, which was the biggest daily drop since October 1987. Similarly, some of the days in which the market rose witnessed changes in the magnitude of 6% or 7%, which are also well above long term averages.

No sector or company was immune from the falls, although gold mining companies enjoyed their usual once-in-a-decade opportunity to shine. There were certain companies however which were particularly hard hit, such as Flight Centre, Qantas, Virgin Airlines and Webjet. Any companies involved in travel, discretionary retail or hospitality services were heavily sold off, as were shopping center landlords such as Vicinity Centres.

Of some concern to us is the outlook for the banks, specifically the big four – CBA, ANZ, Westpac and NAB. The banks have announced an unprecedented range of measures to support their customers and the economy, which have been well received by the general public and the federal government. Loan holidays, interest rate reductions, easy access to funding, waiving of certain fees and charges…these are just some of the measures announced by the banks. Such largesse will come at a cost however, and we expect that the banks will have to significantly cut their dividend payments later this year (if not withhold them entirely). While such an event would be unwelcome, we (and the banks) recognise that the banks have much lost goodwill to regain as a result of the disastrous 2019 Royal Commission and their actions over the past few weeks will go some way to restoring their battered reputations (at some cost however). With share prices down between 23% to 35% since the start of the year, it's possible that the market has already priced in such an event.

Despite the severity of the stock market falls over the past few months, we are satisfied that client portfolios are in a position to withstand current market volatility insofar as possible, with exposure to a diverse range of asset classes and little or no exposure to the speculative investments which are usually responsible for permanent capital losses during crises like the current pandemic.

V, U or L?

An important question is the expected duration of the recession and how long it will take the economy to return to a normal level. This is relevant to the stock market as a short-lived recession and a rapid return to growth should see a significant improvement in the market in the short-term. A more prolonged recession however, with potential second order impacts may cause long term market weakness. A V-shaped recovery entails a quick fall and an equally speedy rebound and would be the preferred outcome. A U-shaped recovery will take longer for both the economy and the stock market to return to pre-COVID levels, while an L-shaped recovery is more akin to the Great Depression, an outcome best avoided.

A further question, with long term implications, is how the various fiscal announcements made by governments around the world will be funded. It was not long ago that the world's most pressing economic issue was the relative indebtedness of many European countries such as Greece, Italy and Spain. The state of government balance sheets (and not just European governments) at the end of this particular crisis is likely to be far worse than those which precipitated the European sovereign debt crisis. That said, attention has rightly been focused on doing whatever it takes to get on top of the medical crisis, preserve as many jobs and businesses as possible, and worry about the bill later.

The outlook for the remainder of 2020

It is our usual practice to conclude Points of Interest with a discussion of the outlook for the period ahead. As can be appreciated however, this is no easy task in the current environment. The number of potential outcomes and events over the next few months is vast. Will the economy bounce back as it emerges from 'hibernation'? As Australia manages to control the spread of COVID-19, what about the ongoing existence of the virus in places like Africa and South America? Will there be a 'second wave', as infected international travellers reintroduce the virus to Australia? Or will our international borders remain closed for months or years to come? Alternatively, will a vaccine be discovered in just a few months' time, allowing for an immediate return to normal life and a sudden jump in economic activity and the stock market? These are just a few of the potential outcomes in coming months as the world and Australia moves on from the immediate health crisis to 'what's next?'.

Given the unique nature of the event, it is our view that most forecasters and market commentators are mostly guessing as to the duration and severity of the virus-induced economic slowdown. This is not a re-run of the Global Financial Crisis, the European sovereign debt crisis, the end of the dot-com bubble or even the 1991 recession. As such, the journey back to a more normal economic and investment environment may encompass any number of unforeseen and unexpected events. At this time, given the high level of uncertainty, coupled with ongoing extreme volatility, we remain reluctant to invest considerable amounts of capital back into the market. That said, in time both the economy and the stock market will recover. Sound investments, backed by a credible and robust investment strategy, have proven their worth time after time and we expect that relationship to hold even as we navigate through these uncertain times.

Warren Buffett, the famed investor and head of Berkshire Hathaway, is often quoted for his insightful views on investing and the markets, but perhaps this quote of his says it best when thinking about the current environment…

> "In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497"

Mr Buffett's point is that crises, disasters, unwelcome events and catastrophes have always been with us as we move through time, yet none of these have permanently impacted the economy and the stock market. As uncertain and dire as the current situation may appear right now, it too shall pass and the economy and the stock market will likewise, one day, return to normal. Notwithstanding such wise words drawn from lengthy experience, we remain committed to keeping you informed of key developments as the world finds its way through the crisis.

BAIOCCHI GRIFFIN
PRIVATE WEALTH

Justin Baiocchi

Ray Griffin

Michelle Higgerson

We trust you have found this somewhat different edition of our quarterly newsletter to be informative; we would be interested in any feedback you can give us on the changed format for future editions of Points of Interest. Finally, we hope you and your family remain safe and healthy during these troubled times. As always, should you have any queries, questions or feedback, please do not hesitate to contact us.

With kind regards,

Justin, Ray & Michelle

FACTS & FIGURES AT A GLANCE

	Rate / Value	Change from last reading
Australian inflation rate (annual)	1.7% (Dec)	+0.1%
Australian unemployment rate	5.1% (Feb)	-0.1%
RBA Cash rate	0.25% (Mar meeting)	-0.50%
ASX 200 Index	5,076	-1,608 points
Australian $ vs. US $	$0.6175	-8.31c
Australian $ vs. UK £	$0.5006	-3.34c
Australian $ vs. Euro €	$0.5605	-6.49c

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