Economic Wrap

May Monthly Wrap 2020

Summary

- Market performance was broadly positive during May
- Coronavirus cases continued to slow down in developed economies but outbreaks in emerging countries remain an ongoing issue with Brazil having the second-highest case count globally.
- Several leading indicators such as the ECRI Weekly Leading Indicator (for the US economy) and the JP Morgan Global Composite PMI are signalling economic weakness in the near term but improvement over recent weeks suggests the worst of the decline in growth is passing. However, the scale of job losses to date suggest getting back to pre-Covid-19 levels of economic activity will take time and varies widely on a country-specific basis with some expected to recover late next year and others take considerably more time.

Markets – Positive performance for riskier asset classes (see page 11).

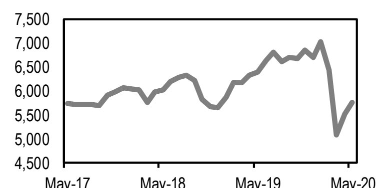
- Risk assets including equities and high-yield bonds continued to claw back some of the losses from the March quarter while safe havens such as the US dollar were under pressure.
- Australian equities outperformed vs global peers (see chart 2) while value stocks made a notable surge this past month (see chart 3). Emerging market weakness continued (see chart 4) after a poor month for Chinese stocks due to rising trade and political tensions.

Key economic news –

- Government stimulus programs and their apparent need continues given the scale of unemployment. A pan-European Recovery Fund appears to be gaining strong support.
- Lockdown restrictions continued to be relaxed globally. This has not, to date, seen a pronounced surge in a second wave of cases. Economic activity is recovering but the scale of job losses makes the speed of this recovery difficult to quantify.

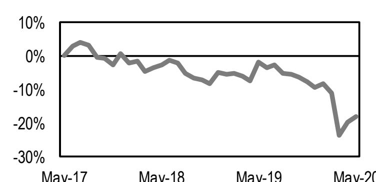
Key company news – In May we saw a continuation of the trend observed in April with the worst hit in the previous quarter amongst the top performers and vice-versa. Some companies have removed the immediate threat of insolvency via capital raisings and continued to perform well as lockdown restrictions were relaxed e.g. Webjet (ASX: WEB).

1. S&P/ASX 200 Price Index



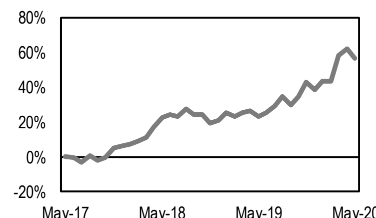
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



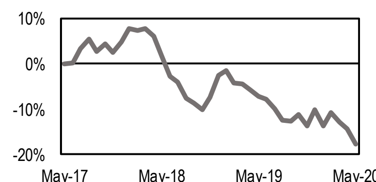
Source: Bloomberg, IOOF

3. MSCI Australia Growth relative to MSCI Australia Value



Source: Bloomberg, IOOF

4. Emerging markets vs Developed Markets, (In USD)



Sources: Bloomberg, MSCI, S&P, IOOF

Sector and stock returns

	ASX/S&P 200 Sectors (GICS)			
	8.5	%∆	Quarterly	%∆
▲	Consumer Discretionary	6.49	Consumer Discretionary	-8.72
▼	Consumer Staples	-0.40	Consumer Staples	-2.48
▲	Energy	4.70	Energy	-18.95
▲	Financials ex Property	4.74	Financials ex Property	-22.23
▲	Financials	4.74	Financials	-22.23
▼	Health Care	-5.34	Health Care	-6.99
▲	Industrials	3.69	Industrials	-10.21
▲	IT	14.51	IT	15.11
▲	Materials	7.98	Materials	5.01
▲	Property Trusts	6.97	Property Trusts	-21.27
▲	Telecommunications	8.44	Telecommunications	-3.62
▲	Utilities	2.77	Utilities	-1.37

Best and Worst S&P/ASX 200 Performers			
Top five stocks		Bottom five stocks	
Monthly			
Southern Cross Media Grp	+67.9%	Incitec Pivot Ltd	-15.9%
Afterpay Ltd	+52.0%	Alumina Ltd	-14.4%
Nearmap Ltd	+50.2%	Unibail-Rodamco-Westfd	-14.3%
Webjet Ltd	+35.3%	New Hope Corp Ltd	-12.6%
Janus Henderson Grp	+33.1%	CSL Ltd	-10.7%
Quarterly			
Evolution Mining	+51.0%	Flight Centre Travel Grp	-55.5%
Appen Ltd	+48.6%	Unibail-Rodamco-Westfd	-54.7%
Promedicus	+43.0%	Ooh!Media Group	-52.7%
Afterpay	+42.9%	Southern Cross Med Grp	-51.7%
Nearmap	+39.2%	Credit Corp	-48.0%

Source: Bloomberg, IOOF

Equity review

Major Market Performance, May 2020

	Australian Indices	May-20 Price	1M return (%)	Feb-20 Price	3M return (%)
▲	S&P/ASX 200	5756	4.23	6441	-10.64
▲	All Ordinaries	5872	4.90	6512	-9.82
▲	Small Ordinaries	2658	10.52	2728	-2.56
	US Indices				
▲	S&P 500	3044	4.53	2954	3.05
▲	Dow Jones	25383	4.26	25409	-0.10
▲	Nasdaq	9490	6.75	8567	10.77
	Asia Pacific Indices				
▼	Hang Seng	22961	-6.83	26130	-12.13
▲	Nikkei 225	21878	8.34	21143	3.48
	UK & Europe Indices				
▲	FTSE 100	6077	2.97	6581	-7.66
▲	CAC40	4695	2.70	5310	-11.57
▲	DAX Index	11587	6.68	11890	-2.55

Sources: Bloomberg, MSCI, FTSE, S&P, IOOF

Note: return is reported on a price basis and in local currency terms e.g. S&P500 performance is in US dollars and excluding dividends.

Global equity markets

Chinese equities were notable laggards during May with the Hang Seng index declining -6.8% during the month in contrast to gains elsewhere. This move was driven by:

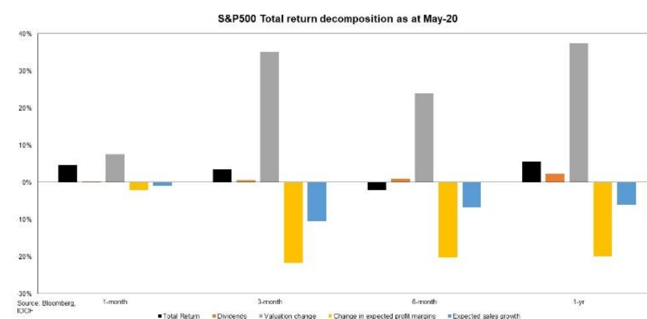
- Heightened political tensions over Hong Kong with the planned implementation of Chinese national security legislation there seeing a resumption of broad Hong Kong protests and arrests.
- Increased risk of trade-based retaliation from the US over the Hong Kong saga and coronavirus accusations by the Trump Administration. The final form of these measures is uncertain but include the prospect of removing the generous tariff rates for Hong Kong-based businesses in the US or delisting Chinese public companies in the US that are noncompliant with US laws.

Declining coronavirus case numbers in the US and Europe were a positive for developed market equities.

Tensions with China had limited impact on the prospects for US equities during the month. This may be due to other signals by politicians from both countries flagging their continued commitment to the trade deal agreed at the start of this year. This suggests a floor on how far these tensions would hurt the actual economy and contributed to markets discounting this risk in the near term. A similar rationalisation might be made over the sparking of riots in the US following the death of African American Geoff Floyd in Minneapolis at the hands of a police officer who is now facing a murder charge. While events like this spark concern and make headlines their exact transmission into the economy and markets remains unclear and at present is another discounted risk.

We capture this graphically below with a breakdown of the S&P 500 return and its drivers over the past year. Change in valuation (the grey bar) is the most noticeable helping to offset weaker sales and profit margins so overall total return in USD (the **black** bar) is positive. This illustrates the important of sentiment in the near term and parallels what we saw in 2019 where higher valuations were the dominant driver of equity returns both in the US and Australia.

5. S&P 500 USD Total return breakdown as at May 2020



In Europe, renewed efforts to coordinate fiscal stimulus across the European Union led to the French and German-backed proposal for a pan-European Recovery Fund. While such an initiative would require unanimous approval its backing by two of the strongest European economies is an important signal of the strength behind the move. In addition, any successful move here would flag improvement in the prospects for European economic integration.

Australian equity market

The S&P/ASX 200 index rose 4.4% during May with Technology the top performer (up 14.5%) while defensive names struggled such as consumer staples (down -0.4%) and health care (down -5.3%). Continued strength from Afterpay was key to the tech sector performance following strong user growth in the US and the news that Chinese Tech giant Tencent had taken a 5% stake in the firm.

In last month's update we noted the potential for Value names (specifically cyclicals) outperforming. This continued into May with the MSCI Value Index returning 5% while the smaller segments of the market such as the Small Ordinaries Index returned 10.2% vs an overall market return of 4.4%. Part of this shift was driven by outperformance from the banking sector (Financials were up 4.7%) as falling coronavirus case growth and lockdown relaxation spurred confidence in the banks. We do not downplay however

some of their longer-term challenges with net interest margins, a key revenue driver, likely to be lower for longer given the RBA guidance of a low cash rate for several years.

Fixed Income

	Fixed Income	May-20 yield	1M mvt (bps)	Feb-20 yield	3M mvt (bps)
	Australian Cash rate	0.25	--	0.75	-0.50
▼	10-year Bond Yield	0.89	-0.01	0.82	0.07
▲	3-year Bond Yield	0.26	0.01	0.50	-0.24
	90 Day Bank Accepted Bills SFE-Day	0.10	--	0.80	-0.70
▲	US 10-year Bond Yield	0.65	0.01	1.15	-0.50
▼	US 3-year Bond Yield	0.19	-0.05	0.90	-0.70
▼	US Investment Grade spread	2.02	-0.16	1.45	0.57
▼	US High Yield spread	6.37	-1.06	5.08	1.29

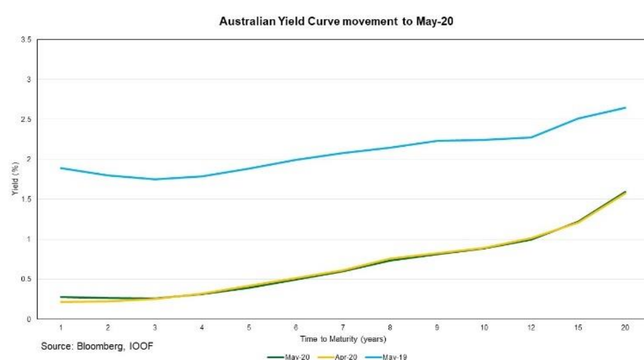
Source: Bloomberg, IOOF

Australian bond market

The Australian yield curve was flat over May with government bond yields broadly unchanged. This reflected RBA success in keeping shorter-term rates contained near its 0.25% target by promising to and purchasing bonds to that effect. Its mere promise to intervene was enough in May along with other factors to keep yields suppressed as it substantially scaled back its purchases during May so much so that the aggregate amount brought onto its balance sheet was unchanged as of early June at $50bn.

There is no change to our near-term view that the Bank will keep rates low for a prolonged period and only slowly unwind the impact of these changes given how disruptive a sudden readjustment could be for the economy. In addition, the Bank has been explicit in its guidance that both inflation and unemployment need to be approaching their target levels in a sustained fashion of 2-3% and 4.5% respectively before any changes will be made. As mentioned last month the RBA stance will benefit borrowers at the cost of savers and investors in the near term with some shorter-term cash accounts and term deposits offering negative (after-inflation) interest rates.

6. Australian yield curve movements to May 2020

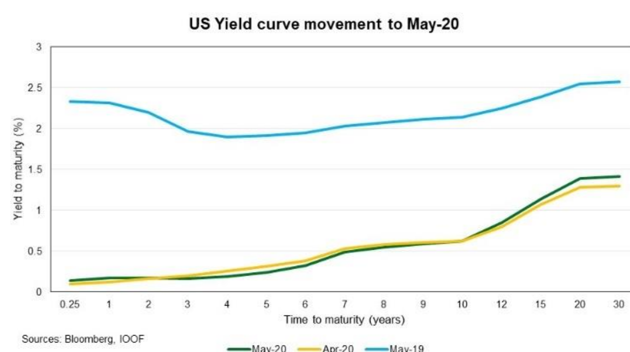


We do note Governor Lowe's remarks in early June that the depth of the economic downturn will be less than initially anticipated (a -10% fall for the first half of 2020). The -0.3% quarter-on-quarter drop in GDP for the March quarter adds support for this idea as well. That being said, the impact particularly on the jobs front is such that while this is welcome news we do not believe it will materially bring forward the RBA timeline on changing interest rates.

US bond market

US Treasury yields were also largely unchanged with substantial purchasing by the Federal Reserve (the Fed) continuing to offset weakness in foreign demand. We also saw the Federal Reserve purchase corporate bond ETFs such as LQD. This decision and market front-running beforehand contributed to credit spreads contracting further seeing riskier corporate debt outperform (see page 11).

7. US yield curve movement to May 2020



Total Fed purchases accounted for ~$US440bn over the course of May with issuers taking advantage of the Fed commitment to buy corporate debt to see over $US1tn worth of new issuance as at 28 May, a milestone reached in prior years but not typically until November. These moves will improve liquidity on corporate balance sheets. As of mid-June, the Fed had signalled increasing its corporate bond purchases to maintain strong liquidity conditions.

They do however pose an exacerbation of increasing corporate debt that was already in place after the long economic recovery following the global financial crisis. Higher indebtedness may act as a drag on corporate investment and hamper the economic recovery underway.

Outlook

The outlook for fixed income globally sees a lower rate environment persisting for a longer period. Credit risk is elevated in the near term because we are likely to see a rise in defaults even with government support to date. However even with that caveat it remains more attractive for longer-term holders able to weather the greater volatility. Allocators appear to be making that trade-off decision with continued buying seeing spreads contract further during the month.

Currencies

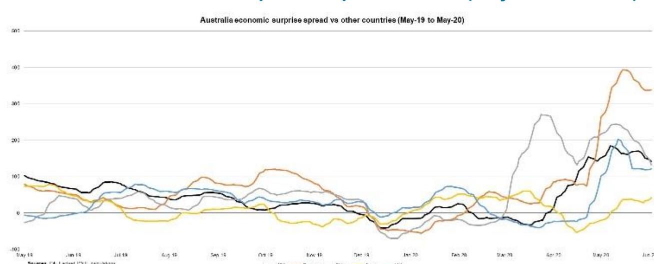
	Currencies	May-20 Price	1M return (%)	Feb-20 Price	3M return (%)
▲	$A vs $US	66.67	2.38	65.15	2.33
▲	$A vs GBP	53.98	4.40	50.80	6.26
▲	$A vs YEN	71.92	3.05	70.37	2.20
▲	$A vs EUR	60.07	1.06	59.05	1.73
▲	$A vs $NZ	107.48	1.12	104.16	3.19
▲	$A TWI	58.80	1.73	57.00	3.16
▼	$US vs EUR	90.06	-1.37	90.69	-0.69
▲	$US vs CNY	7.14	1.05	6.99	2.08
▲	$US vs GBP	80.95	1.95	78.01	3.77
▲	$US vs JPY	107.83	0.61	107.89	-0.06
▼	$US vs CHF	96.16	-0.38	96.49	-0.34
▼	US Dollar Index	98.34	-0.68	98.13	0.22
▲	JPM EM Currency Index	54.77	3.40	58.25	-5.98

Source: Bloomberg, IOOF

The Australian dollar (AUD) rose 2.4% against the US Dollar (USD) during May, from USD 0.6512 to USD 0.6667. Drivers included:

- **Economic surprises**: Data released since late March has seen the Australian economy continue to offer more positive surprises than other major countries. This can be seen in the upward trend of Chart 8 with the contraction in March quarter growth substantially less severe than that of other developed economies.
- **Investment sentiment**: New stimulus by China improved risk appetite after supporting a rise in iron ore prices.

8. Australian economic surprise outperformance (May-19 to Jun-20)



We note weakness in coal and LNG prices may pose some near-term risks to the Australian dollar. Another risk factor has been heightened rhetoric between Beijing and Canberra (initially triggered by Australian calls for an inquiry into the origins of the coronavirus) which saw punitive 80% tariffs enacted against Australian barley exports to China. To date, investors have been prepared to discount this risk.

Commodities

	Commodities	May-20 Price	1M return (%)	Feb-20 Price	3M return (%)
▲	Aluminium	1535	3.65	1700	-9.69
▲	Copper	243	3.48	254	-4.68
▲	Nickel	12271	0.91	12274	-0.03
▲	Zinc	1991	2.79	2021	-1.50
▲	Crude Oil – Brent	35.33	39.81	50.52	-30.07
▼	Natural Gas	1.85	-5.13	1.68	9.80
	Metallurgical Coal	143	--	149	-4.01
▲	Thermal Coal	55	10.37	67	-18.55
▲	Iron Ore	92.54	10.38	86.46	7.03
▲	Gold	1752	2.98	1576	11.13
▲	Silver	18	23.55	17	11.95

Source: Bloomberg, IOOF

Oil prices continued to recover from March lows. Continued reduction in supply by OPEC and non-OPEC members as well as rising demand with US inventory levels falling helped drive prices higher. Relaxation of lockdown measures in developed economies also added to oil demand.

Natural Gas (an important Australian export) saw prices struggle during the month on subdued demand from Asian trading partners.

Precious metals benefitted from a weaker real yield (bond yield after inflation) environment following continued bond purchases by central banks globally.

Aluminium prices rose on the back of stronger than a sharp decline in inventories and stronger expected demand from China.

Iron ore prices continue to be supported not only by the expectation of stronger stimulus in China following the plans for more deficit spending there but also the troubles besetting Brazil a major source for iron ore. Brazil is currently second in the most recorded coronavirus infections globally with over 580k and also over 32k dead. Over the past year, Brazilian exports are down 65mt for context, contributing to a supply deficit that has supported prices to date.

Coal prices benefitted from disruption by heavy swell near Newcastle that saw 5 days of exports lost to the market. There were other supply disruptions within the Australian market by producers such as Peabody and New Hope that further constrained supply offsetting demand weakness during the month.

Australia

Fiscal and monetary policy moves will help soften the blow sparked by coronavirus shutdowns but a negative result for March GDP suggests Australia's 30-year trend of avoiding recession has ended. Earlier relaxation of lockdown rules will assist the economic recovery with consumer confidence also recovering.

Policy

The RBA signalled keeping the cash rate at current levels of 0.25% for a prolonged period (FactSet consensus suggests at least the next 2 years). Absent a much faster-than-expected economic recovery it is likely to stay near these levels for the next three years. This is also because of the yield curve targeting it has implemented to keep the 3-year government bond yield at 0.25%. Any departure from that target will need to be gradual to avoid a potentially damaging hike in borrowing costs.

There has been increased discussion during May and subsequently over an upcoming “fiscal cliff”. This refers to the expected negative economic impact of many stimulus measures ending in September this year. Some of this discussion has crystallised into new stimulus measures such as the Homebuilder grant. This is designed primarily to encourage new housing construction particularly on urban fringes given the allowance is both practical and generously designed to encourage new housing builds. The arm of the grant for existing housing is less generous with most use cases excluded by the terms or income thresholds. Other proposals include keeping Jobseeker (unemployment benefits) at current elevated levels past September.

We saw further progress towards relaxing lockdown measures within States in recent weeks. At the time of writing, relaxation of State border restrictions is being anticipated during July. In addition, some States are already moving further in relaxing restrictions on hospitality establishments such as bars or sporting venues. More concerted efforts along these lines should support job creation and help reduce the unemployment rate.

Business sector

Inflection in business sentiment and activity during May as lockdown restrictions were relaxed. The CBA Composite PMI rose slightly to 28.1, up from 21.7. This reading suggests economic activity is still contracting but a slower pace i.e. we are arguably at or closer to the bottom of this economic contraction.

The NAB Monthly Business Survey also highlighted improvement with business confidence at -20, (a similar level to the trough seen in the last Australian recession of the early 90s) but business conditions also improved to -24. Weakness in capacity utilisation suggest limited need for new investment which will pose an additional drag to economic growth as even with incentives such as new tax breaks will struggle for usage if businesses cannot find clear use cases for this spending.

Consumer sector

The Westpac-Melbourne Institute Index of Consumer Sentiment improved to 88.1 in May, up from a very weak level of 75.6 in April which was itself worse than readings during the global financial crisis. An important driver of this continued improvement relative to what we saw during the 90s recession was increased anticipation of better long-term prospects. It appears today that consumers are more willing to look past this weakness with the reading for medium-term economic prospects ~50% higher than the average recorded during that recession. Overall this improvement is welcome, and we will continue to see if and how it is confirmed by recovery in consumer spending.

Inflation

Alternate, more frequently reported inflation measures, namely the Melbourne Institute Inflation Gauge are flagging weaker inflation with only 0.55% growth year-on-year to May. Some recovery in oil prices from March lows will act as an offsetting factor but the move in the near term is consistent with inflation anchored below the RBA target band of 2-3%.

Economic growth

GDP growth surprised expectations at -0.3% for the quarter and +1.3% for the year to March. It marked the now highly likely prospect of Australian recession as starting during the March quarter. We saw net exports and government spending unable to offset private sector weakness which continued from 2019 into 2020.

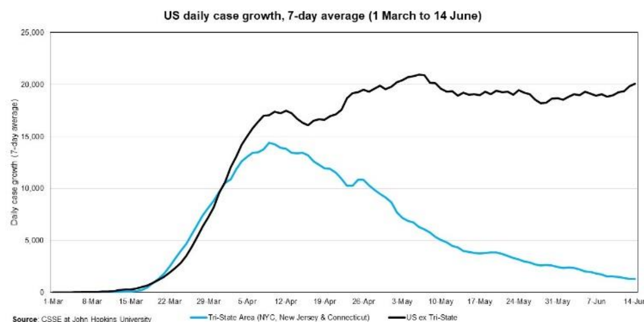
The Westpac-MI Leading Index slipped to -5.2% for April suggesting a sharper decline in growth over the next 3-9 months. This was driven by substantial weakness in US industrial production (falling 15.3% between February and April) and total hours worked nationally (which fell 9.2% in April). However, we note that the relaxation of lockdown measures will improve the rate of recovery as seen in slower declines seen in PMI indicators.

United States

The National Bureau of Economic Research (NBER) has declared the US is in recession from February 2020. Government spending and monetary policy are supporting economic recovery while various indicators are suggesting a trough in growth has been reached during the June quarter though coronavirus concerns linger.

Coronavirus outbreak and policy response

9. Total US cases vs 7-day change (Mar-20 to Jun-20)



In the US we saw substantial growth in coronavirus cases continue to over 2.1m confirmed and over 116,000 deaths as at 15 June. While there has been declining growth in new cases, this is mainly attributable to success in States that experienced the brunt of the initial impact such as New York or New Jersey. Case growth has been declining in these areas at a rapid pace but elsewhere in the US has remained at elevated levels. This latter point is a concern not just for the human impact (more deaths) but also its economic one. The failure of getting the virus under control across the country could see the need for more public health interventions e.g. new lockdowns as well as deferred consumption which may delay further economic improvement. The US has arguably been the only developed country to come out of lockdown without getting the virus under control. That carries its own set of risks and we will continue observing closely to see if the recovery begins to be derailed. We have already seen threats of lockdowns being resumed in New York for example.

The Federal Reserve has continued its bond purchasing program supporting US financial conditions. The Chicago Fed Financial conditions index is now at -58 (readings below 0 point to looser financial conditions), suggesting a more supportive environment for US businesses to raise capital. Chairman Powell also rejected the prospect of negative interest rates in the US as a policy tool suggesting 0-0.25% will be the floor for the current rate cutting cycle. Additional fiscal stimulus continues to be debated but not enacted. It remains unclear whether this will occur.

Politics update

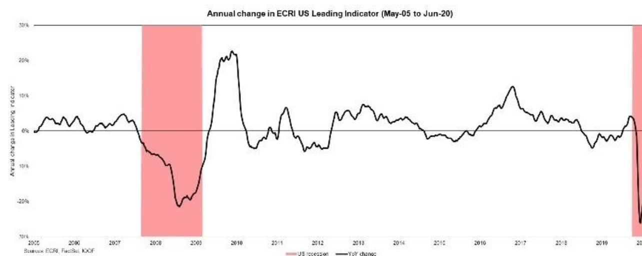
We remain several months away from the November Presidential Election. Current polling suggests an uphill battle for President Trump to be re-elected, but it is too early to call at this juncture. As we near the election we may see more market volatility depending on which outcomes are being expected. Joe Biden for example has a tax reform agenda that could be harmful to US corporate profits.

“Black Lives Matter” protests began across the country following the death of African American George Floyd at the hands of police officers in Minneapolis. These may have longer term social implications for the US, but their economic impact is not expected to be material unless further, more severe escalation occurs.

Economic growth and business sentiment

The Markit Composite PMI which rose to 37 in May, up from its record low of 27 in April. Weakness in new business orders and employment intentions remain a concern in terms of achieving a “V-shaped” economic recovery of the speed some observers are hoping for. The reading below 50 still points to a contraction in economic activity, albeit at a slower rate which usually occurs at or near the bottom of a down cycle in PMI surveys. When we combine this with other measures it suggests we are nearing or past the bottom of this trough in economic activity. The NBER which has historically tracked US business cycles declared the start of the recession as of February this year, confirming our statements in earlier reports.

10. US Leading Indicator YoY vs US recessions (Jun-04 to Jun-20)



In chart 10 we track the annual change of the ECRI Leading Economic Index. The latest reading of -12.8% is consistent with recessionary level but its bottoming has been confirmed in subsequent weeks suggesting we are past the cycle trough barring further economic shocks.

Inflation

Inflationary pressures remain subdued within the US. Producer price indices (a measure of input costs for final goods and services) fell -1.2% for the year to April. This suggests downward pressure on inflation in the near term.

China

A continuation of the recovery from February lows into May with measured fiscal stimulus in place. While domestic activity is getting back to normality, the weaker global economy is posing challenges for China’s exporting industries with employment prospects still challenged given weak global demand.

Coronavirus and Policy

The coronavirus outbreak appears to be almost concluded within China. However, there have been periodic case clusters with the latest such prompting a lockdown within the capital Beijing after dozens of new cases at a food market. The original centre of the outbreak Hubei province and its

capital Wuhan has seen travel restrictions with the rest of China relaxed. This is an important development given Wuhan's importance as a logistical hub and as a sign that Chinese authorities are confident enough to let travel within China become less restricted.

Chinese authorities are planning a sizeable package of cost cuts for businesses and households. A large portion of this has come in the form of reduced borrowing costs via lower bank interest rates. There are also tax exemptions, reduced utility prices as well as other fiscal spending initiatives that will see the central government deficit rise to 3.6% of GDP. This package is smaller than past stimulus packages such as the GFC variant at approximately 5% of GDP as authorities continue to maintain reluctance to encumber the national government with excessive debt levels given the potential for more capital misallocation. In some ways it still appears to be a missed opportunity to reform taxation within China that would allow for more balanced growth drivers. In overall terms though, this suggests the stimulus impulse will not be as pronounced as during the GFC which is a net negative for global growth (less demand from China).

Business activity and sentiment

The Caixin China Services PMI rose to 55 in May, up from 44.4 in April, a sign of continued recovery from the record low February result of 26.5, the first recorded contraction for services activity since the survey began 14 years ago. This signalled the first expansion in business activity for several months with strong domestic demand seeing overall new orders rise even though new export orders continued to decline. The Caixin China Manufacturing PMI returned to expansionary territory, rising from 49.4 in April to 50.7 in May. Improving business confidence was an important driver but we also saw weaker new orders (driven by weak export demand) as well as challenged employment conditions with the employment subindex remaining in contractionary territory for a fifth consecutive month.

The combination of results saw the Chinese Composite PMI rise to 54.5 in May, up from 47.6 in April. This was driven by positive new orders on an overall basis, but concerns persist on both weak export demand as well as a weak employment outlook.

Economic growth

Chinese authorities have shifted away from their annual GDP target. This has been abandoned given the uncertainty in the outlook for this year in the wake of the coronavirus pandemic.

Intra-quarter results for the period until May disappointed expectations slightly. Industrial production grew 4.4% in the year to May (consensus: 5%) while retail sales fell -2.8% over the same period (consensus: -2%) and fixed asset investment also declined over the January to May period by -9.6% (consensus: -5.9%).

US tensions

Lastly, we note that the relationship between the US and China has worsened since a "phase one" trade deal was signed at the start of the year. We discussed the increase in sharper rhetoric last month. Subsequently we have seen President Trump announce that Hong Kong will have its preferential trade and commercial status with the US removed as the region is no longer recognised as autonomous following increased controls by China including new legislation requiring Hong Kong implement national security legislation.

There have been mixed reports of Chinese officials suggesting new efforts to improve relations as well as comply with Chinese obligations under the phase one deal. US Secretary of State Pompeo is reportedly planning to hold talks for the first time in January as well. While promising at face value it appears there is valid concern over Chinese compliance with the deal's terms. This includes a failure to meet (admittedly ambitious) targets for purchasing of US goods including commodities and energy exports. This may form the grounds for a renewal of the "trade war" saga with China or at least more unfriendly relations between the two countries. The proximity of presidential elections may stay the Trump Administration's hand in the near term to avoid further economic damage after the coronavirus shock. However, the issue remains unresolved and bears ongoing scrutiny.

Europe

The coronavirus outbreak appears to be contained with limited growth as even economies come out of lockdown. We have seen renewed monetary policy responses but still inconclusive news on the fiscal front.

United Kingdom

The British economy shrank 20.4% month-on-month during April following on from a -5.8% fall in March as the country was in full lockdown over the entire month. The Bank of England's latest estimates suggest a 25% contraction in GDP quarter-on-quarter with unemployment expected to also double. These results should mark the trough of the cycle but also lay out how much work and time will be required to recover the lost jobs and economic activity.

The UK has increasingly come out of lockdown without a material uptick in coronavirus case growth which has been gradually declining to a daily average of ~1,400 cases as of mid-June. We have seen an increased willingness by the

Johnson government to exercise fiscal policy under Chancellor Sunak and are likely to see further calls given the depth of the downturn and the sluggish recovery in demand to date particularly for the services sector. As of late May, government loans and guarantees to business had already reached £32bn.

On the monetary policy front the Bank of England has reportedly been grappling with imposing negative interest rates after cutting rates to a low of 0.1% during the March quarter. This move would, in theory, be supportive of a weaker pound and help support British export industries but would have additional punitive consequences for savers. In addition, it is expected to announce further increases in its bond purchasing program of up to £745bn. This would suppress government borrowing rates and implicitly allow for cheaper financing of a larger budget deficit which the UK government is expected to generate with its broader use of fiscal policy.

Finally, the UK has signalled its intention to finalise exit from the EU by the end of this year when its existing transition period is due to complete. The notional plan would be to have a formal trade agreement with the EU established otherwise relations would revert to harsher WTO agreements (a punitive setup for both UK and European firms). We are several months away from this scenario becoming reality and in the past the Johnson government has shown itself to be pragmatic in requesting extensions (albeit at the eleventh hour). This is not a situation likely to become materially worse in the short term so is unlikely to materially hinder markets or economic activity but as we near the deadline without a deal it may start to see adverse business decisions on investment spending and the like. We will continue to follow closely on how the situation unfolds.

Policy

The European Central Bank (ECB) left its interest rate settings unchanged as expected during May. It also increased its emergency bond purchasing program from a total of €750bn to €1,350bn with the horizon for the program also extended to June 2021 for new purchases and June 2022 for the maturity of any principal payments received. This will be important in offsetting expected increases in government debt in the months ahead. We have also seen novel bond issuance in Italy with GDP-linked bonds designed to reward investors a bonus provided economic growth reaches a target level over the bond's life.

Talks for an EU Recovery Fund remain underway. Delaying factors include concerns over the size as well as distribution of the stimulus and any conditions attached to it. Given these factors it may be delayed beyond July given the need to reach unanimity across the leaders of all 27 EU member states.

Business Activity and Economic growth

European PMI surveys echoed results elsewhere as the ending of lockdown measures allowed for resumption of trading for many businesses. The IHS Markit Eurozone Composite rose to 31.9 in May, up from 13.6 in April, while the Manufacturing PMI improved to 39.4, up from 33.4. As noted elsewhere this result is still consistent with weaker activity than April (lockdown restrictions were still biting), but at a less severe pace. In addition, PMIs are aggregated indices with stronger results in some subindices hiding weakness elsewhere. For this month for instance although conditions improved, we did also see a fall in in the level of new orders supporting prolonged economic weakness given the state of demand for business goods and services.

Sentiment

Finally, the European Area Economic Sentiment and Employment Expectations indices both bounced higher from April lows to 67.5 and 70.2 respectively. Both results are well below the long-term average (100 for these series) but reflect improvement in industry and consumer confidence with consumers recording greater willingness to spend on "big ticket" items and general economic expectations while employment expectations were boosted by stronger hiring intentions.

Company news (best and worst performers during the month of May 2020)

Southern Cross Media Group (+67.9%)

Southern Cross Media Group (SXL) enjoyed a strong rally as a rebound in traffic numbers showed that people are choosing to drive rather than use public transport, resulting in a faster recovery of SXLs radio network audience than previously expected. SXL also announced the completion of their $169m capital raise and provided a positive trading update stating that EBITDA for the month of April was positive, with declines in revenue partially offset by operating cost reductions. Receivables collections were also in line with expectations with limited payment deferral requests and no changes to the bad and doubtful debts provision for FY20 ($5m). Net debt stood at $161.8m inclusive of the receipt of net proceeds from the equity raise.

Afterpay Ltd (+52%)

Afterpay (APT) surged in May after Tencent revealed it had taken a minority 5% stake in the company, purchasing $300m worth of Afterpay shares at an average price of $22.63 per share. It signalled a strong endorsement of the Afterpay operating model and allowed APT to tap into Tencent's "vast experience and network, with potential to collaborate in areas such as technology, geographic expansion and future payment options on the Afterpay platform". The stake was rumoured to be in response to Ant Financial, a competitor to Tencent, which bought a minority stake in Klarna, a European buy-now-pay-later platform. Afterpay currently has 3x the search traffic of Klarna.

Nearmap Ltd (+50.2%)

Nearmap (NEA) released a positive trading update, announcing that Annualised Contract Value (ACV) now exceeded $102m, with a churn rate below 10% (compared to a spike to 11.5% in December 2019), and a new AI dataset package for subscribers (Nearmap AI). Although NEA reaffirmed the resilience of its business, as most of its customers are not impacted by cyclicality (insurance, government, infrastructure), it nevertheless implemented a large cost-cutting program designed to help the company hit cashflow breakeven by the end of FY20. These include a 25% cut to CEO and board member remuneration, a 30% reduction in operating and capital costs, and a 20% reduction in salaries of employees over the same period.

Incitec Pivot Ltd (-15.9%)

Incitec Pivot (IPL) retraced some of its April gains after the company abandoned plans to spin-off its underperforming fertilisers business and announced a $675m capital raising ($600m institutional placement, $75m retail SPP). Half-year results ending 31 March 2020 revealed IPL had achieved a 54% increase in 1H NPAT to $65m, however the fertiliser business continued to underperform, reporting a 1H loss of $9.9m. The capital raise was priced at $2.00 per share and intended to pay down existing debt, while providing financial flexibility to "pursue disciplined organic growth opportunities". Post-raising, IPL will have a pro-forma net debt of $1.3bn and a net debt/EBITDA ratio of 1.9x.

Alumina Ltd (-14.4%)

Alumina (AWC) faced renewed scepticism over the operation of its loss-making Portland (Victoria) aluminium smelter as it struggles with high electricity prices and a slump in alumina prices. The alumina price has seen a steady decline from $US2,110 per tonne in 2018 to ~$US1,480 in May, and at current energy prices, the Portland smelter remains economically unviable. In the 3 years to 31 December 2019, the smelter lost a combined total of $US136.9m EBITDA, only staying afloat due to a $200m rescue package from the Victorian government which is expiring in 2021.

Unibail-Rodamco-Westfield (-14.3%)

Unibail-Rodamco-Westfield (URW) is set to have net rental income from its European and North American shopping malls plunge, by some estimates by greater than 25% (pcp), as a result of missed rental payments, potential tenant bankruptcies, and reduced footfall from social distancing measures. Europe is only just remerging from 2 months of economic shutdown, and investors are increasingly sceptical about the recovery of physical foot traffic as the shutdown showed a clear trend towards online shopping. However, there are some encouraging signs that acted as mitigating factors, with Germany and Austria showing footfall now averaging 80% of prior corresponding period levels, while France is only averaging 60%.

Sources: ASX company announcements, Bloomberg, Fund manager disclosures, *Australian Financial Review*, *Sydney Morning Herald*

Movers and Shakers for month of May 2020

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month Δ (%)	Quarter ago close ($)	Quarter Δ (%)	Year ago, close ($)	Year Δ (%)
SXL	Southern Cross Media Grp Ltd	0.24	0.14	67.9	0.49	-51.7	0.88	-73.4
APT	Afterpay Ltd	47.41	31.20	52.0	33.17	42.9	24.15	96.3
NEA	Nearmap Ltd	2.29	1.53	50.2	1.65	39.2	3.39	-32.4
WEB	Webjet Ltd	4.14	3.06	35.3	6.94	-40.4	10.78	-61.6
JHG	Janus Henderson Group CDI	32.73	24.59	33.1	32.40	1.0	30.18	8.4
SUL	Super Retail Group Ltd	8.37	6.35	31.8	8.11	3.2	9.25	-9.5
PRN	Perenti Global Ltd	1.19	0.91	30.8	1.35	-11.9	1.47	-18.8
EML	EML Payments Ltd	3.64	2.81	29.5	3.62	0.6	2.59	40.6
MMS	Mcmillan Shakespeare Ltd	8.64	6.67	29.5	10.83	-20.2	12.93	-33.2
BRG	Breville Group Ltd	22.36	17.56	27.3	19.45	15.0	16.88	32.5

Source: Bloomberg, IOOF

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month Δ (%)	Quarter ago close ($)	Quarter Δ (%)	Year ago close ($)	Year Δ (%)
IPL	Incitec Pivot Ltd	2.01	2.39	-15.9	2.73	-26.4	3.28	-38.7
AWC	Alumina Ltd	1.49	1.74	-14.4	1.94	-23.5	2.39	-37.9
URW	Unibail-Rodamco-Westfield CDI	4.14	4.83	-14.3	9.14	-54.7	10.84	-61.8
NHC	New Hope Corp Ltd	1.35	1.55	-12.6	1.45	-6.6	2.63	-48.7
CSL	CSL Ltd	276.22	309.44	-10.7	309.44	-10.7	205.49	34.4
SYD	Sydney Airport	5.85	6.30	-7.1	7.77	-24.7	7.41	-21.1
WOR	Worley Ltd	8.40	9.00	-6.7	12.52	-32.9	13.18	-36.3
AST	Ausnet Services	1.76	1.88	-6.4	1.70	3.5	1.78	-1.4
HLS	Healius Ltd	2.43	2.59	-6.2	3.04	-20.1	3.16	-23.1
BEN	Bendigo and Adelaide Bank	6.15	6.54	-6.0	9.19	-33.1	11.23	-45.2

Source: Bloomberg, IOOF

Long-term asset class performance to May 2020 (Total returns in AUD)

				Annualised						
Asset class	**1-mth**	**3-mth**	**6-mth**	**1-yr**	**3-yr**	**5-yr**	**7-yr**	**10-yr**	**15-yr**	**20-yr**
Australian equities (S&P/ASX 200)	4.4%	-9.9%	-14.6%	-6.7%	4.3%	4.3%	6.7%	7.2%	6.8%	7.7%
Australian equities - Mid caps	7.7%	-3.4%	-10.0%	-1.1%	5.2%	7.8%	10.7%	8.9%	7.4%	10.0%
Australian equities - Small caps	10.6%	-1.9%	-7.7%	-2.9%	7.5%	6.6%	6.7%	4.4%	4.5%	5.9%
Australian equities - Micro caps	13.6%	-1.0%	-13.7%	-3.6%	5.8%	6.7%	5.5%	1.6%	4.2%	#N/A
International equities	3.4%	-1.8%	-3.3%	12.0%	10.2%	9.0%	13.6%	12.0%	7.4%	3.5%
International equities (Hedged)	4.7%	-0.3%	-7.0%	4.9%	5.5%	6.3%	9.4%	11.4%	8.0%	#N/A
International equities - Small caps	5.2%	-6.0%	-10.5%	2.1%	5.5%	6.5%	11.9%	11.3%	7.8%	6.9%
Emerging Markets equities	-0.6%	-9.6%	-8.0%	-0.2%	3.7%	3.8%	6.7%	4.9%	7.0%	#N/A
Australian REITs	7.0%	-21.1%	-23.7%	-16.8%	0.8%	3.8%	7.6%	9.3%	3.6%	6.2%
Global REITs	-1.1%	-19.5%	-21.5%	-13.4%	1.6%	2.8%	7.4%	8.3%	5.1%	#N/A
Global REITs (Hedged)	0.1%	-18.5%	-24.3%	-18.7%	-2.4%	0.3%	3.7%	7.7%	5.2%	#N/A
Global Infrastructure	2.8%	-7.6%	-6.0%	2.1%	7.5%	8.1%	12.1%	11.8%	#N/A	#N/A
Global Infrastructure (Hedged)	3.8%	-5.3%	-7.9%	-2.5%	3.8%	5.9%	8.6%	11.6%	#N/A	#N/A
Trend following	-3.7%	-0.8%	4.3%	7.9%	4.1%	0.4%	7.6%	3.6%	4.6%	4.9%
Australian bonds	0.3%	0.0%	1.5%	4.9%	5.1%	4.5%	4.9%	5.7%	5.8%	6.0%
Australian bonds - government	0.2%	0.0%	1.6%	5.2%	5.4%	4.6%	4.9%	5.7%	5.8%	6.0%
Australian bonds – corporate	0.7%	-0.6%	0.7%	3.9%	4.7%	4.5%	4.9%	5.9%	6.0%	6.2%
Australian bonds - floating rate	0.3%	0.2%	0.6%	1.7%	2.5%	2.7%	3.0%	3.9%	4.4%	4.8%
Global bonds (Hedged)	0.3%	0.0%	2.8%	6.0%	4.5%	4.4%	5.0%	6.1%	6.4%	7.2%
Global bonds - government (Hedged)	-0.1%	0.5%	3.5%	6.5%	4.8%	4.6%	5.2%	6.1%	6.4%	#N/A
Global bonds - corporate (Hedged)	1.2%	-2.0%	1.0%	5.9%	4.5%	4.8%	5.3%	6.9%	6.7%	#N/A
Global bonds - High Yield (Hedged)	4.8%	-6.4%	-5.8%	-2.9%	1.1%	4.0%	5.0%	8.3%	8.4%	#N/A
Emerging Market bonds (Hedged)	6.5%	-7.3%	-5.1%	-0.8%	1.6%	4.2%	4.7%	7.3%	7.9%	10.1%
Cash (AUD)	0.0%	0.2%	0.4%	1.0%	1.6%	1.8%	2.0%	2.7%	3.7%	4.1%

Sources: Bloomberg, IOOF calculations

* AUD total returns as at May-20 assuming reinvestment of dividends
** Returns reflect index performance excluding any fees; Actual ETF/managed fund performance will vary due to both fees and tracking error.

Appendix – Index sources

Asset class	Index
Australian equities (S&P/ASX 200)	S&P/ASX 200 Accumulation Index
Australian equities - Mid caps	S&P/ASX Accumulation Midcap 50 Index
Australian equities - Small caps	S&P/ASX Accumulation Small Cap Ordinaries Index
Australian equities - Micro caps	S&P/ASX Emerging Companies Total Return Index
International equities	MSCI World ex Australia Net Total Return (in AUD)
International equities (Hedged)	MSCI World ex Australia Hedged AUD Net Total Return Index
International equities - Small caps	MSCI World Small Cap Net Total Return USD Index (in AUD)
Emerging Markets equities	MSCI Emerging Markets EM Net Total Return AUD Index
Australian REITs	S&P/ASX 200 A-REIT Accumulation Index
Global REITs	FTSE EPRA/NAREIT Developed Index Net Total Return (in AUD)
Global REITs (Hedged)	FTSE EPRA/NAREIT Developed Index Net Total Return (Hedged to AUD)
Global Infrastructure	FTSE Global Core Infrastructure 50/50 Net Total Return in AUD
Global Infrastructure (Hedged)	FTSE Global Core Infrastructure 50/50 100% Hedged to AUD Net Tax Index
Trend following	SGI Cross Asset Trend Following Index (AUD)
Australian bonds	Bloomberg AusBond Composite 0+ Yr Index
Australian bonds - government	Bloomberg AusBond Govt 0+ Yr Index
Australian bonds – corporate	Bloomberg AusBond Credit 0+ Yr Index
Australian bonds - floating rate	Bloomberg AusBond Credit FRN 0+ Yr Index
Global bonds (Hedged)	Bloomberg Barclays Global Aggregate Total Return Index Value Hedged AUD
Global bonds - government (Hedged)	Bloomberg Barclays Global Aggregate Treasuries Total Return Index Hedged AUD
Global bonds - corporate (Hedged)	Bloomberg Barclays Global Aggregate Corporate Total Return Index Hedged AUD
Global bonds - High Yield (Hedged)	Bloomberg Barclays Global High Yield Total Return Index Hedged AUD
Emerging Market bonds (Hedged)	J.P. Morgan EMBI Global Core Hedged Index Level AUD
Cash (AUD)	Bloomberg AusBond Bank Bill Index

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