Retirewell Wealth Management Solutions

eNewsletter

Exclusive Client Email Newsletter
9 April 2020

To Clients and Friends of Retirewell,

SIGNPOSTS FOR A SHAREMARKET BOTTOM

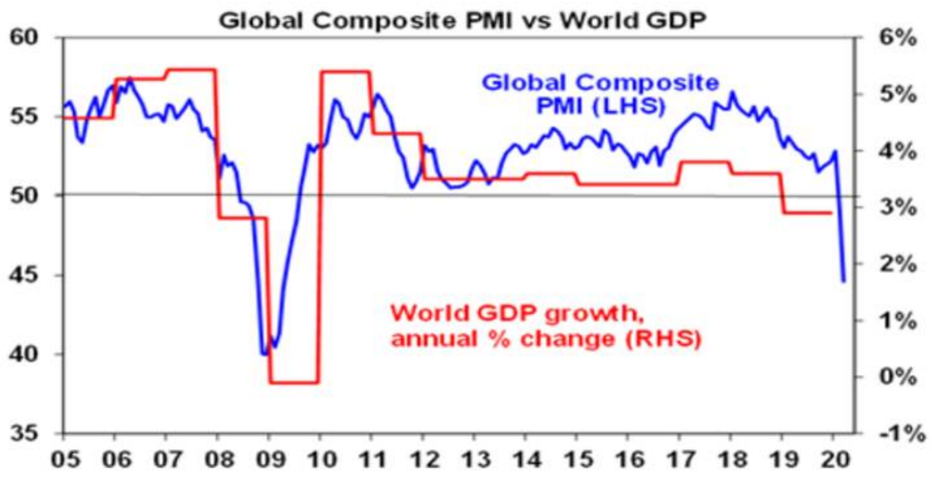
Summary

* While shares have rallied 15-20% from their March low and may have started a bottoming process, it's still too early to say with confidence we have seen the low for this bear market.

* Key signposts to watch for are: signs that the virus can soon be contained (here the evidence is starting to look better); monetary & fiscal stimulus to minimise collateral damage to economies (this gets a tick); signs that collateral damage is being kept to a minimum and growth momentum is bottoming (it's too early for this one – albeit this may partly be a lagging indicator); and technical signs of a market bottom (some tick this off).

Introduction

After a roughly 35% plunge from their February high point to their lows around 23 March, global and Australian shares have had a 15-20% rally. What's more, this rally has occurred despite increasingly bleak economic data ranging from plunges in business conditions surveys or Purchasing Managers' Index (PMIs) - see chart below - to a record 10 million surge over two weeks in claims for unemployment payments in the US. Volatility remains very high, but at least we are seeing up and down volatility rather than all down as was the case into mid-March.



Source: Bloomberg, AMP Capital

Markets usually lead and so may have already factored in the worst. And we have seen massive fiscal and monetary stimulus over the last few weeks to match the coronavirus threat to economies. So maybe we have already seen the low for shares? Or maybe not?

There is still a lot of bad news ahead regarding the virus and the economic hit and we still don't know how long the shutdown will be for and hence it's hard to gauge the size and duration of the economic hit, when the recovery will come and what it will be like.

What's more, past bear markets have often been interrupted by strong rallies, eg, October/November 2008 saw two 19% rallies in US shares followed by the ultimate low in March 2009. This could be the case here even if we have entered into a bottoming process.

So, what should investors look for in terms of when we can expect a bottom or be at least somewhat confident that the bottom has been reached? Not that anyone will ring a bell at the bottom or that investors will be bullish at the bottom.

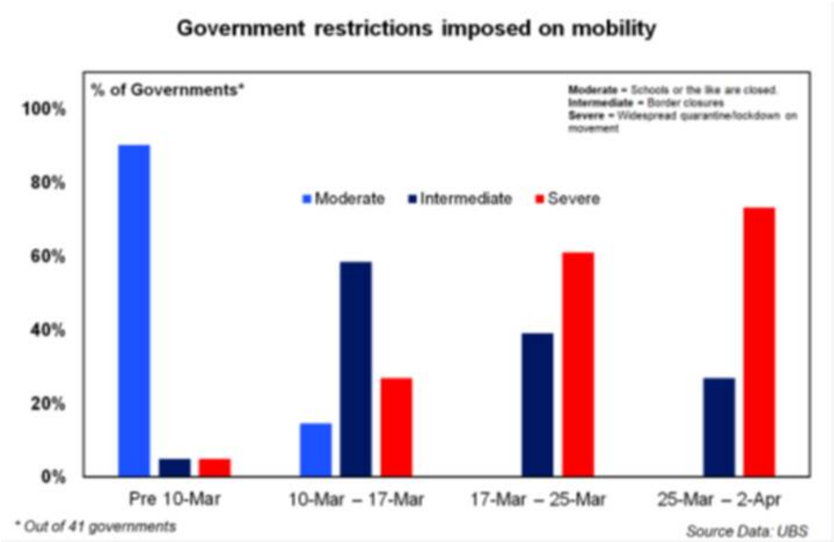
The following are what we are looking for:

- confidence the coronavirus can soon be contained;
- measures to minimise collateral damage to the economy;
- confidence collateral damage is being kept to a minimum and signs that growth momentum is bottoming; and
- technical signs of a market bottom.

Confidence the Coronavirus Will Soon be Contained

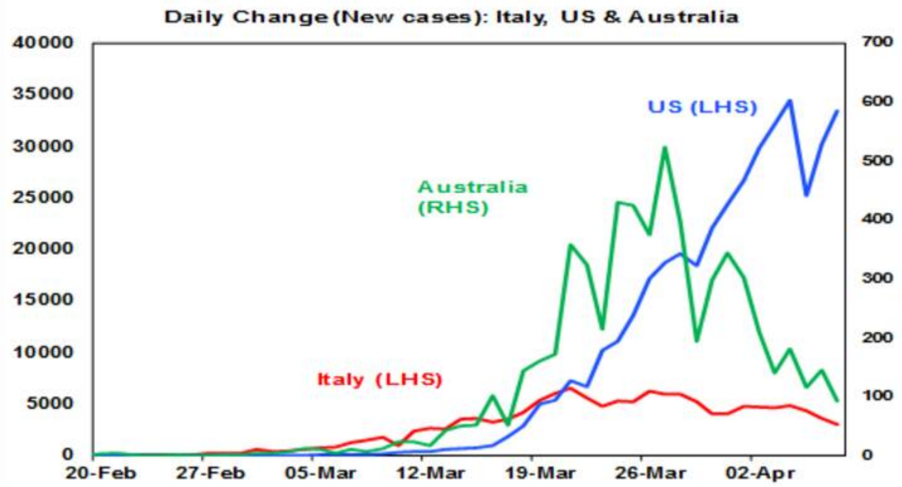
This is important as it will give guidance as to the duration of the shutdowns and their severity and hence the first round hit to the economy. There are several key things to watch:

- **The severity of suppression measures.** After containment policies (quarantining and contact follow-up) failed to control the virus (South Korea may be an exception), most countries have moved on to suppression, i.e. social distancing. This has been made necessary to allow hospital systems to cope without a blow-out in deaths as in Italy. The question is: Are they being applied rigorously? The evidence suggests that they are. Of 41 major countries, nearly 80% now have severe restrictions in place, including Australia.



Source: UBS, AMP Capital

- **Is suppression working?** The best thing to watch for is a turndown in the number of new cases. Italy is a good one to watch as it went into national lockdown around 9 March and if they get it under control it gives other countries hope. And there are some positive signs here with a downtrend in new cases evident in Italy, Spain, Germany, the EU generally and Australia. In the US it's too early to tell, but its New York epicentre is showing a decline in new cases.



Source: Worldometer, Bloomberg, AMP Capital

- Based on China's experience: 11-21 days after the lockdown new cases peak, and a month or so after that, the shutdown can start to be relaxed, which is why Chinese economic indicators started to improve in March. (While some question the reliability of China's Covid19 case data, directionally it looks right and lines up with President Xi's March 10 Wuhan visit & the restart of its economy.)
- This would suggest that the lockdown in Italy and maybe even Australia may be able to be relaxed later this month or in May, if the number of new cases continues to trend down.
- Of course, if the lockdown is eased too quickly this may risk a second wave of cases (as occurred in relation to the 1918 Spanish flu pandemic). To guard against this, quarantining of new cases and contact follow-up will have to be aggressive and international travel bans would likely have to remain in place to prevent imported new cases (as China has found). There are two things that could get around this:

  Antibody tests. It's likely the actual number of coronavirus cases is being significantly underestimated because those with mild or no symptoms are not showing up for testing, but mass testing for antibodies to Covid19 would reveal what proportion of the population have already been infected and recovered. They will likely no longer be transmitters of the virus and should be able to return to work. Some estimates suggest that it's already 40-60% of the Italian and UK populations. If so, there would already be a degree of "herd immunity" making it easier to safely relax the shutdowns. Such testing may still be several months away though.

  Anti-virals or a vaccine. A vaccine may still be 12 months away, but anti-virals are being rapidly tested (mostly drugs already approved for other conditions which may be able to be repurposed).

The bottom line on this is that there are a lot of balls in the air, but the decline in the number of new cases in several countries including Australia indicates that shutdowns are working - which in turn holds out the hope that restrictions can be relaxed in a month or so (providing containment measures are rigorous). International travel will likely be the last restriction to be lifted.

Policy Measures to Support the Economy

The past month has seen a massive ramp-up in monetary and fiscal measures globally and in Australia to support businesses, jobs and incomes through the shutdown period and to keep financial markets functioning properly. Some (e.g. in Australia) are better than others (e.g. in the US), but with policy makers committed to doing whatever it takes, they provide confidence that second round damage from the shutdowns will be kept to a minimum, which will enable economies to recover once the virus is under control. We rate this as positive, although more may still need to be done.

Collateral Damage Being Kept to a Minimum/Growth Indicators Bottoming

There are a range of indicators to track on this front, including:

- **Credit spreads**. Corporate and government bond yield gaps need to narrow. They are off their highs, but above normal.
- **Money market funding costs.** As measured by the gap between 3 month borrowing rates and expected official rates, these have narrowed in Australia but remain high in the US
- **Default rates up only slightly.** This is important in terms of assessing whether public support and debt/rent payment holidays are working. It's too early to tell in most countries.
- **Daily activity indicators (e.g., for energy production and traffic congestion) stabilising.** This has been a good indicator in China, but it's too early in developed countries.
- **Business conditions PMIs stabilising/improving.** They've improved in China but are still falling elsewhere.

Technical Signs of a Market Bottom

Bear market bottoms usually come with a bunch of signs.

- **Extreme oversold conditions.** This got a tick in March.
- **Apocalyptic investor sentiment.** It's very negative but maybe not apocalyptic yet.
- **Signs of falling downwards momentum.** This may only become apparent on a re-test of the March low.

Signpost Table

The following provides a summary. The key ones are in blue.

SIGNPOST	WHY	CURRENT STATUS
Control of the Virus		
Suppression	Is social distancing stringent?	Yes, in most major countries
Curve flattening	**Our restrictions slowing new cases?**	**Yes, in China, Italy, Spain, Australia. Not yet in US, UK**
Containment/quarantine	Our new cases being quarantined successfully?	Successful in China, Korea. Insufficient in most countries
Antibody test	Guide to "herd immunity"	May be a few months away
Anti-virals /vaccine	Could end the virus threat quickly	Lots of activity but still some way off
Government Support for the Economy		
Fiscal support	**To limit collateral damage & boost the economy**	**Positive**
Monetary support	**Ditto**	**Positive**
Collateral Damage Minimised/Signs Growth Momentum is Bottoming		
Credit spreads narrowing	Sign of functioning financial markets	Some narrowing but mixed
Default rates up only slightly	Is public support working?	Too early to tell
Daily activity indicators stabilise	They are timely	Up in China, still falling elsewhere
Purchasing Manager Indexes stabilise/improve	**Sign of economic momentum**	**Improved in China, falling elsewhere**
Market Technical Signs of a Bottom		
Extremely oversold conditions		Yes in March
Ultra-negative investor sentiment	**Bottoms have maximum bearishness**	**Yes but it could get more negative**
Less stocks making a new low		**May need to see a re-test of the low though**

Concluding Comment

Many of these signposts tick off positively, so we may have seen the low. But given the uncertainty around the length of the shutdown, risks of a second wave and very poor economic data to come, it's still too early to say that with confidence. Trying to time market bottoms is always very hard. For investors with cash to invest, a good strategy for long term investors is to 'average in' over several months.

Acknowledgement: *Sourced from AMP Capital Investment Insight Report 8 April 2020 (Dr Shane Oliver, Head of Investment Strategy and Chief Economist at AMP Capital).*

If you have any queries or concerns regarding the recent falls in Australian and global share markets, particularly in relation to your own financial situation, please contact us on (07) 3221 1122.