Markets Summary – June 2020

Taken from the CBA Global Markets Research report, 'June Month in Review', and 'CoreLogic Dwelling prices – June 2020)', all first published on 1 July 2020.

Highlights in June

- There was no change to the RBA cash rate in June
- Government bond yields were little changed
- Aussie credit spreads continued to tighten
- The Australian dollar rose 2% on a trade weighted index basis
- Australian equities rose again but the 2019-20 financial year numbers finished poorly
- Oil prices rose but thermal coal prices fell
- Dwelling prices fell by 0.8% across Australia's eight capital cities in June.

Summary

Volatility was sharply reduced in the core fixed income markets over the month of June, as central bank actions have dampened trading ranges. Credit spreads and equity markets performed well, helped by generally better data flow.

The ASX 200 accumulation index rose 2.61% while there were significant tightening in corporate credit spreads. Government bond yields were little changed. With the cash rate so low there were only modest returns in the cash allocations.

The Australian dollar (AUD) rose 2% against the US dollar (USD) on a trade weighted index basis as risk appetites returned and the global environment became more positive.

Cash

There was, naturally, no change to Reserve Bank of Australia (RBA) cash rates over June and the rate at which cash traded remained around 0.13%. The RBA left the 0.25% target cash rate on hold in June and also left the target yield for three-year government bond yields at 0.25%. The RBA has also been largely inactive in its quantitative easing program with no purchases since the 6 May. The RBA currently holds close to $A60 billion of Australian federal and state government bonds.

Australian and global fixed interest

Government bond yields remained stable in June and confined to fairly tight ranges. Despite no purchases of Australian Commonwealth Government Bonds (ACGB) or Semis from the RBA during the month, the 3-year ACGB held its yield curve control (YCC) level of around 0.25% while the 10-year broadly fell. It started the month at 1%, selling off to 1.1%, before enjoying a fairly solid drop to a low of 0.85%. They closed the month selling off, trading at 0.91% as data became more positive. The 3-year traded at a low of around 0.24% to a high of 0.28%.

Comments from the RBA over the month noted the increase in yield in short dated ACGBs, related to the illiquidity in that sector. At the end of June, RBA Deputy Governor Dr Guy Debelle delivered a speech on the RBA's policy actions and its balance sheet in which he discussed a number of factors at play for the RBA, but once again made the clear point that market dysfucntion was a major driver of YCC.

Chart 1 – Australian bond yields

Source: Bloomberg, CBA

Global credit

Australian credit spreads continued to tighten in June. So far non-financial spreads have retraced 17% from recent wides while financial spreads have retraced 25%. Corporate issuance picked up in June. Year-to-date non-financial issuance is now at $A4.9 billion, up $A1.9 billion from last month, and tracking close to last year's volume and long-term average.

Global and Australian equities – June quarter summary

Global sharemarkets posted solid gains in June, bolstering investor returns over the second quarter as global economies reopened and stimulus measures flooded markets.

- The US Dow Jones (+17.8%) and S&P500 (+20%) indexes posted their biggest quarterly gains since 1987 and 1998 respectively.
- The tech heavy Nasdaq soared 30.6% – its best quarter since 1999.
- The Australian S&P/ASX200 index gained 16.2% – the biggest lift since the September quarter 2009.
- The German Dax lifted 23.9%
- Japan's Nikkei rose 17.8%
- the UK FTSE increased 8.8%

Global and Australian equities – month of June

Global sharemarkets began June positively. Investors focused on signs of an economic recovery and the roll out of additional government stimulus measures, despite civil unrest across the US and the re-emergence of US-China trade tensions. A better than expected US jobs report for May also boosted risk sentiment.

Over the second week (June 8-12) investors worried about stretched share valuations. The World Bank predicted that the global economy (GDP) will probably contract by 5.2% in 2020 due to COVID-19 shutdowns - the fourth deepest recession of the past 150 years. Cautious comments from US Federal Reserve Chairman Jerome Powell and jitters about growing numbers of US Coronavirus cases reduced risk appetites.

In the third week of the month (June 15-19), shares posted modest gains as concerns over a second wave of the virus capped returns. The US Federal Reserve announced the direct purchase of corporate bonds, the Bank of Japan increased its estimate of low cost bank funding, the Bank of England boosted its bond buying program by £100 billion and the European Central Bank saw a record take-up of €1.3 trillion in funding for banks at a sub-zero interest rate. US President Trump also talked up a potential US$1 trillion infrastructure spending plan.

In the final week of June (June 22-26) investors were on edge due to confusing White House communication on the Phase 1 China trade deal, reports of US tariffs on EU imports and record US virus cases in Sunbelt states. The International Monetary Fund (IMF) provided another downbeat assessment of the global economy, but Australia was one of the few economies to see an upgrade in GDP forecasts to -4.5% in 2020 (previously -6.7%).

For June overall, the US Dow Jones was up by 1.7%, the S&P 500 increased by 1.8% and the Nasdaq finished up by 6%. In Europe, the German Dax rose by 6.2% and the UK FTSE rose by 1.5%. And in Asia, Japan's Nikkei rose by 1.9% and the ASX 200 lifted by 2.5%.

Chart 2 – Aussie sharemarket rebounds

Global and Australian equities – financial year summary

The ASX200 index hit a record high of 7,162.5 points on February 20 only to fall by 10.9% over the financial year – the worst performance since the 2011-12 financial year. US sharemarkets outperformed with the Dow Jones down 3%, the S&P500 up 5.4% and the Nasdaq up by 25.6%. Elsewhere, the Nikkei rose 4.8%, the UK FTSE was down 16.9% and the German Dax fell 0.7%.

Over the financial year, seven of Australia's 22 sub-industry sectors posted gains. Leading the gains was Consumer durables and apparel (up by 39.1%), followed by Pharmaceutical and Biotech (up 31.2%). Energy fell the most (down 31.2%) from Banks (down 28.3%). Of the size categories, the MidCap50 out-performed (down 2.3%) from the Small Ordinaries (down 8.3%), the ASX100 (down 11.1%) and the ASX50 (down 12.5%).

Australian dollar

The AUD rose by 2.0% on a trade-weighted basis in June.

AUD/USD rose strongly over the first few weeks of June. AUD hit its month high of 0.7063 on 10 June, propped up by improving global prospects amid signs the global economy was beginning to recover. Strong

Chinese fiscal stimulus added further support for AUD early in the month. In contrast, the small contraction in Q1 2020 Australian GDP on 3 June did little to stop AUD's upward trend.

AUD consolidated over the remainder of the month and traded in a reasonably tight 0.68-0.70 US cent range. AUD was caught in the cross-currents of improving global economic data and concerns about a resurgence in coronavirus cases offshore. In particular, surging coronavirus cases in southern and western US states weighed on AUD/USD. Heightened US-China tensions and intermittent spikes in Australia-China tensions also provided some offset to the ongoing recovery in Australian (and global) economic data.

Chart 3 – Australian dollar June performance

AUSTRALIAN DOLLAR			
	End May	**End Jun**	**M/M %**
	29-May-20	**30-Jun-20**	**Change**
AUD-USD	0.6667	0.6903	3.5
AUD-JPY	71.92	74.51	3.6
AUD-EUR	0.6007	0.6145	2.3
AUD-GBP	0.5398	0.5567	3.1
AUD-CHF	0.6413	0.6539	2.0
AUD-CAD	0.9184	0.9372	2.0
AUD-NZD	1.0748	1.0695	-0.5
TWI	58.8	60.0	2.0
Month High		0.7063	10-Jun-20
Month Low		0.6646	1-Jun-20

Source: Bloomberg, CBA

Commodities

Commodity prices finished mostly higher in June. Demand prospects improved as COVID-19 lockdowns eased, but a rise in COVID-19 cases, particularly in the US, India and Latin America kept demand concerns in the picture. Oil and copper saw the strongest gains, while thermal coal fell.

Oil prices lifted during June on signs that global oversupply concerns are easing. Easing lockdown measures support transportation, which accounts for two thirds of global oil consumption. However, the demand recovery story faced headwinds due to the ongoing increase in COVID 19 infections. Supply curtailments helped lift oil prices too. OPEC+ extended deeper production cuts until the end of July (committed to cut ~9.7% of global supply in July, up from 7.7% previously).

Copper rose in June on resilient demand in China and supply concerns in Chile. China accounts for just over 50% of global copper demand, and its industrial sector has rebounded strongly from COVID 19 lockdowns earlier this year on policy support. Codelco, the world's largest copper producer, halted mining at its Chuquicamata mine in Chile late last month after a third worker died from COVID 19.

Iron ore prices started June strongly, but eased by the end of the month. The initial price gain reflected resilient demand in China and supply concerns in Brazil.

Australian property prices

Nationally, property moved lower in June according to CoreLogic data. Given the huge negative shock to the economy caused by the COVID-19 pandemic it is hardly surprising that prices have eased. Indeed what has surprised us is that prices have only contracted nationally by ~1.0% since March.

The expectation at CBA's Global Economic and Markets Research team has been that dwelling prices nationally would fall by around 10% as a result of the COVID-19 pandemic. The increase in unemployment, falling rents and lower net overseas migration were the primary reasons behind our forecast. But in our detailed note of 17 April we pointed out that there were clear upside risks to the forecasts:

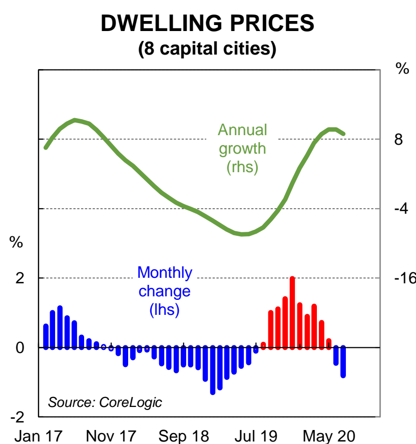
"*There are both downside and upside risks to our dwelling price forecasts. The risks both hinge on the length of the enforced shutdown and restrictions placed on economic activity. In a best case scenario government restrictions on economic activity could start to be lifted by the end of May. For that to occur, it would probably take several days of zero or very low community transmission of new COVID-19 cases. That is a possible scenario given the current trend in new COVID-19 cases. If that were to occur the plunge in economic activity that we expect would not be as large and the impact on the property market would not be as severe. Indeed the fall in property prices would be significantly smaller than our central scenario, particularly given the extraordinary low borrowing rates currently on offer*."

That upside risk has to date materialised. The result is that dwelling prices have not fallen all that much so far, which means that there is no material negative wealth effect to date coming via house prices. This is very important for the outlook for household consumption and consumer sentiment as falling property prices weigh on overall expenditure.

Corelogic reports that over June prices fell the most in Melbourne (-1.1%) and Perth (-1.1%) followed by Sydney (-0.8%). Price falls were more modest in Brisbane and Adelaide while prices *rose* in Hobart, Canberra and Darwin. Price declines since the pandemic struck have been most pronounced in Melbourne, Perth and Sydney. It's important to note, however, that our two largest cities also had the biggest prices rises in the year to March so the retracement needs to be put in context.

Whilst property prices are still likely to ease over coming months, it looks more likely that the falls will be more modest than initially anticipated. Auction clearance rates have rebounded to reasonable levels at around ~65% nationally. And it looks like the impact of significantly lower mortgage rates is largely offsetting the other forces weighing on dwelling prices. For the record, there has been no revision to CBA's Global Economic and Markets Research team's expectation of a 10% fall in dwelling prices nationally. There are a number of dynamics that are still playing out and it's still early days in terms of the big shock to the economy. In addition, the house price expectations index from Westpac/Melbourne Institute remains in pessimistic territory. Notwithstanding, it looks more likely that there will be an undershoot rather than overshoot on the team's central scenario centred on a 10% fall.

Chart 3 – Dwelling prices – month and annual change



This document has been prepared by AFD Financial Solutions, ABN: 36 125 417 076, AFS Licence: 234951, Filippo Battisti.

The information, opinions, and commentary contained in this document have been sourced from Global Markets Research, a division of Commonwealth Bank of Australia ABN 48 123 123 124 AFSL 234945. Global Markets Research has given Colonial First State Investments Limited ABN 98 002 348 352, AFS Licence 232468 (Colonial First State) its permission to reproduce its information, opinions, and commentary contained in this document and for Colonial First State to authorise third parties to reproduce this document.

This information was first made available to CBA clients on 1 August 2018 in a CBA Global Markets Research report publication titled, 'July Month in Review'.

This document has been prepared for general information purposes only and is intended to provide a summary of the subject matter covered. It does not purport to be comprehensive or to give advice. The views expressed are the views of Colonial First State at the time of writing and may change over time. This document does not constitute an offer, invitation, investment recommendation or inducement to acquire, hold, vary, or dispose of any financial products.

Colonial First State is a wholly owned subsidiary of the Commonwealth Bank of Australia ABN 48 123 123 124, AFS Licence 234945 (the Bank). Colonial First State is the issuer of super, pension and investment products. The Bank and its subsidiaries do not guarantee the performance of Colonial First State's products or the repayment of capital for investments.

Colonial First State has given Filippo Battisti its permission to reproduce the information, opinions, and commentary contained in this document.

This document may include general advice but does not take into account your individual objectives, financial situation or needs. You should read the relevant Product Disclosure Statement (PDS) carefully and assess whether the information is appropriate for you and consider talking to a financial adviser before making an investment decision. PDSs can be obtained from colonialfirststate.com.au or by calling us on 13 13 36.

Past performance is no indication of future performance. Stocks mentioned are for illustrative purposes only and are not recommendations to you to buy sell or hold these stocks.

This document cannot be used or copied in whole or part without Colonial First State's express written consent. Copyright © Commonwealth Bank of Australia 2018.