

# ***Economic and Market Outlook***

***April 2020***



# International economy

## Part 1: Overview

As the SARS-Cov-2 virus responsible for COVID-19 sweeps across the world with exponential speed and indiscriminate fury, what started out as a public health emergency has morphed into an economic crisis of historic proportions. As containment measures make it virtually impossible for commerce to function, businesses are closing with unprecedented speed, leaving an unintentional trail of destruction and despair. Suppliers that are left unpaid may too be forced to close, their staff joining ever lengthening unemployment queues snaking down otherwise deserted streets.

In the absence of sufficient welfare payments, the displaced that have little savings will soon be unable to afford their rent or mortgages, let alone the basic necessities. Without discretionary incomes, the depressed environment for consumer spending will only get worse. As renters abandon properties they can no longer afford, landlords are left without an income they may have relied upon to pay their own mortgages.

Without any reprieve from banks, mortgage holders in time could be forced to sell, flooding the market with commercial and residential properties that may need to be discounted heavily to find a buyer. If sold at a loss, the bank will seek recovery through personal guarantees, forcing many into bankruptcy. Where there is no equity, the bank too will face mounting losses that may pressure their own balance sheets.

In turn, banks will tighten their own lending criteria to avoid further losses, making it difficult for businesses to refinance maturing loans. Rejected borrowers that turn to bond markets for funding are likely to be disappointed as investors are simply unprepared to lend to companies with little to no earnings certainty, and those that do, only at exorbitant rates. Companies that try and access funding via shareholders in a depressed market will likely only be able to do so at heavy discounts, leading to further value diminution.

In a worst-case scenario, where containment fails, no vaccine is found and rolling shutdowns continue for more than 12 months, the escalation of bad debts from corporate and personal insolvencies has the potential to threaten the viability of the highly leveraged banking system.

Indeed, it is not hard to see why some economists are suggesting that the economic impacts, if not managed appropriately, may well be much worse than the Great Recession of 2008/09. Fortunately, policymakers in Europe, the US, China and elsewhere, are aware of the gravity of the situation and have begun to implement unprecedented monetary and fiscal stimulus packages to cushion the global economy from the collapse in activity.

The intention of the packages is three-fold. First, central banks are ensuring the banking system has sufficient liquidity to enable banks to continue to lend to companies and individuals, including those experiencing financial difficulties. Second, quantitative easing measures are helping keep the cost of money low to avoid a sharp rise in interest rates that could threaten to destabilise the recovery when businesses reopen. Third, fiscal stimulus has been designed to provide additional support to help businesses retain staff, or where that has not been possible, provide enhanced welfare payments to displaced workers to help them pay their bills, at least over the next few months to help prevent a deeper contraction.

It must be said that the size, scale and speed of the policy response from Central Banks has been impressive. The European Central Bank and Federal Reserve have signalled that they will do as much as necessary and for as long as needed. In contrast, the fiscal response to date has by and large been lower and of insufficient magnitude to prevent mass insolvencies and huge private sector job losses. Indeed, even US treasury secretary Steve Mnuchin has warned that the unemployment rate in the US could reach 20%. We suspect much more will be done in coming weeks and months to subsidise lost wages to avoid a more severe contraction.

Ultimately though, these stimulus measures will not get people back to work, all they will do is buy time for the virus to be contained. The exit strategy remains unclear but there is a view that once the virus is sufficiently contained (potentially within 6 months), people will gradually return to work under strict social distancing rules with the hope that there will be a clinical treatment available by then (such as Remdesivir) to provide a safety net if infections re-emerge. The ultimate goal is a commercially available vaccine (potentially Moderna's mRNA-1273 vaccine) within 12-18 months.

### Conclusion

The global economy is in the midst of its greatest challenge since the Great Recession. At the time of writing, economists are scrambling to provide forecasts in this environment of very high uncertainty. Some more nimble private sector forecasts that have begun to filter through over the last week appear cataclysmic.

The global investment behemoth, Goldman Sachs, expects the annualised rate of GDP to fall in the second quarter by a staggering 24% in the US and 38% in Europe. Overall, Goldman's expect global growth to decline by 1% over the calendar year. Yet this forecast is highly uncertain and premised on a presumption of a gradual return to normality over the second half of the year.



In truth, even if the virus can be contained within six months, the current market expectation of a V-shaped recovery now looks very unlikely for a multitude of reasons. First, although most businesses (that haven't already failed) will re-open, it will take a long time before the millions of displaced workers find new employment. Second, the lifelines provided by banks to defer repayments will only increase the indebtedness of households and businesses, meaning that they will be more inclined to save and repay debt rather than spend. Third, the fear of a repeat incident will further discourage discretionary spending. Fourth, governments will be constrained from initiating new public works initiatives by the massive fiscal deficits they will need to run over the time it will take to normalise employment. Overall, we expect that it may take a number of years before aggregate demand returns to pre-crisis levels.

Economic growth forecasts (GPD growth%)	2020 Goldman Sachs	2020 Consensus	2021 Goldman Sachs	2021 Consensus
<i>Global</i>	-1.0%	2.6%	6.1%	3.1%
<i>United States</i>	-3.8%	1.3%	5.3%	1.9%
<i>China</i>	3.0%	5.3%	8.5%	5.8%
<i>Euro area</i>	-9.0%	0.4%	7.8%	1.4%

Source: Goldman Sachs Global Investment Research, Bloomberg. Calendar year estimates

## Part 2: Key economic indicators

### United States

Economic snapshot	Last reported result	Comments
<b>Growth (GDP)</b>	2.1% (annualised) Q4'19	Growth in the December quarter was a sound 2.1% (on an annualised basis), supported by growth in real Personal Consumption Expenditure (PCE), whilst non-residential fixed investment was weak.
<b>Unemployment</b>	3.5% Feb'20	The unemployment rate was little changed in February at levels not seen in half a century. Unfortunately, this is now set to rise to double digits by year end.
<b>Industrial Production</b>	0.6% m/m Feb'20 0.0% y/y Feb'20	Industrial production was supported in February by rising utility output.
<b>ISM Manufacturing</b>	49.1 Feb'20 48.1 Nov'19	The PMI reading of 50.1 was driven by increased production, whilst new orders and employment in the manufacturing sector contracted.
<b>Retail sales</b>	-0.5% m/m Feb'20 4.3% y/y Feb'20	Retail sales posted its largest decline in fourteen months as a result of a fall in auto sales and lower sales at gasoline stations, the latter a by-product of lower gas prices.
<b>Credit growth</b>	3.4% y/y Jan'20	Credit increased by 3.4% year-on-year and stands at \$4.21 trillion.
<b>Outlook</b>	As a result of COVID-19, we expect the US economy to plunge into a severe, but short-lived, recession. A very sharp contraction in the second and third quarters should be followed by a gradual return to growth in the final quarter should the pandemic be contained. Monetary stimulus from the Federal Reserve has been both significant and targeted, and along with the government's own stimulus will help cushion the massive blow to GDP.	

### Eurozone

Economic snapshot	Last reported result	Comments
<b>Growth (GDP)</b>	0.1% q/q Q4'19 1.2% y/y Q4'19	Growth in the fourth quarter was the lowest since 2014 as the manufacturing sector remains in recession.
<b>Unemployment</b>	7.4% Jan'20	The unemployment rate remains at the lowest level in over a decade.
<b>Industrial Production</b>	2.3% m/m Jan'20 1.9% y/y Jan'20	Industrial production was strong in January, supported by the production of intermediate, capital, durable consumer and non-durable consumer goods.
<b>Manufacturing PMI</b>	44.8 Mar'20 49.2 Feb'20	The PMI collapsed in March from the one-year high recorded in February as much of Europe entered a shutdown. The reading was the lowest since 2012.
<b>Retail sales</b>	0.6% m/m Jan'20 1.7% y/y Jan'20	Retail sales started the year strongly as glimpses of confidence were seen returning to the European consumer.
<b>Credit growth</b>	2.0% y/y Feb'20	The annual growth rate of total credit to euro area residents remained unchanged at 2.0% in February. The annual growth rate of credit to general government stood at 2.0% in February, after declining 1.9% in January, while the annual growth rate of credit to the private sector remained at 3.4% in February.
<b>Outlook</b>	The Eurozone headed into the COVID-19 crisis in a weak state. The increasing severity of the crisis in Europe has led to a near-shutdown in economic activity and border closures across the continent. This will lead to increasing damage across most sectors of the economy, namely trade, travel and tourism. Although the significant and rapid deployment of monetary stimulus by the ECB should help stabilise the financial system, the recession could be particularly severe given the limited fiscal tools available to member states.	

Unless otherwise stated, Refinitiv has been used as the source of all displayed figures.

## Part 2: Key economic indicators (cont.)

### China

Economic snapshot	Last reported result	Comments
<b>Growth (GDP)</b>	1.5% q/q Q4'19 6.1% y/y Q4'19	China's growth remains at levels not seen in three decades.
<b>Unemployment</b>	6.2% Feb'20	The urban surveyed unemployment rate jumped to the highest on record, as COVID-19 led to shops and factories closing throughout China.
<b>Industrial Production</b>	-13.5% y/y Jan & Feb'20 6.2% y/y Nov'19	Industrial production plunged as China responded to the escalation of COVID-19 cases by closing factories throughout the country.
<b>Manufacturing PMI</b>	35.7 Feb'20 50.2 Nov'19	The latest reading of 35.7 was the lowest since the survey began in 2004, amid the COVID-19 outbreak.
<b>Retail sales</b>	-20.5% y/y Jan & Feb'20 8.0% y/y Nov'19	Retail sales plummeted as COVID-19 closed shops throughout the country and containment measures prevented many citizens from visiting open stores.
<b>Fixed asset (urban) investment</b>	-20.5% calendar y/y Feb'19	Fixed asset investment (FAI) collapsed as many factories closed throughout the country.
<b>Outlook</b>	China's growth over 2020 is likely to almost halve from last year as the fallout from Covid-19 continues and factories struggle to get back to full capacity. External demand for goods and services is likely to remain weak as overseas customers face an indefinite lockdown.	

NB: The Manufacturing PMI data is compiled by the China Federation of Logistics & Purchasing (CFLP) and the China Logistics Information Centre (CLIC), based on data collected by the National Bureau of Statistics (NBS).

The Manufacturing PMI data is NOT the Caixin Manufacturing PMI.

### Japan

Economic snapshot	Last reported result	Comments
<b>Growth (GDP)</b>	-1.6% (annualised) Q4'19 -6.3% (annualised) Q4'19	Sound growth was underpinned by resilient domestic demand and business spending, offsetting a decline in exports.
<b>Unemployment</b>	2.4% Jan '20	The unemployment rate rose 0.2% over the month but remains at levels not seen for a quarter of a century.
<b>Industrial Production</b>	0.8% m/m Jan'20 -2.5% y/y Jan'20	Industrial production increased in January, supported by solid production of motor vehicles and transport equipment.
<b>Manufacturing PMI</b>	44.8 Mar'20 48.8 Dec'19	The latest reading of 44.8 marks the steepest contraction since April 2009.
<b>Retail sales</b>	0.6% m/m Feb'20 1.7% y/y Feb'20	A solid rise in Japanese retail sales was the result of panic buying of health and hygiene products as a result of COVID-19.
<b>Outlook</b>	Japan's export-dependent economy will be dragged into a sharp recession in 2020 due to the collapse in global demand and the postponement of the Olympics.	

Unless otherwise stated, Refinitiv has been used as the source of all displayed figures.



# Australian economy

## Part 1: Overview

The Australian economy is in the midst of the most challenging environment in post war history as the COVID-19 pandemic shuts down activity in all corners of the globe. Without doubt, the country is almost certain to be in the grip of a severe recession as spending levels dive\*. Hundreds of thousands of Australians have already lost their jobs or been stood down on leave without pay. Goldman Sachs believes that GDP in 2020 will fall by 6%, with a 10% slump occurring in the second quarter. This is premised by an increasing unemployment rate peaking at 8.6% in the third quarter. Even this forecast may prove to be overly optimistic considering the economy has suffered a “sudden stop”, the likes of which we have never witnessed.

Though individuals without incomes will benefit from existing government support payments as well as measures announced in the various stimulus packages released to date, these handouts may not be enough for the unemployed to meet their rent or mortgage repayments. As a result, many affected homeowners could either be forced to sell their property or default on their repayments and face foreclosure. The fact that many households are ahead in their rental repayments provides some support, as does the Government urging of lending institutions to provide relief for homeowners. Risks will escalate should this crisis become protracted as not many borrowers would be ahead in their mortgage payments by at least one year, so even this cohort could face the real possibility of default.

As a result of this evolving crisis, both the RBA and the Australian Government have moved to minimise the fallout on Australian businesses and households. The RBA for its part has cut rates twice in March, the second at an emergency meeting. This has brought down the cash rate to 0.25%. The traditional lever of monetary policy is now exhausted as the cash rate has effectively hit the RBA's lower bound. The RBA has also announced it would provide at least \$90 billion at the cash rate of 0.25% over three years to banks if these banks lend that cash to small and medium-sized businesses. Furthermore, the RBA commenced its inaugural Quantitative Easing (QE) program. In practice, this involves the central bank entering the financial markets to buy bonds that have been issued by the Federal and State governments with the aim of keeping the bond market functioning, as well as maintaining the benchmark three-year government bond yield (with which banks usually fund themselves in the bond market and which is the yield that banks use as a reference rate when lending to businesses) at around 0.25%. This will allow the few businesses who have the appetite to borrow at attractive interest rates.

The Government, for its part, has delivered three stimulus packages to combat the economic risks from COVID-19. Its measures are aimed at securing jobs,

incomes and keeping businesses operating. These currently total a combined \$320 billion, or 16.4% of GDP. The first round of stimulus focussed on cash payments to welfare recipients, lower deeming rates to the benefit of aged pensioners, investment incentives for businesses, wage subsidies for employers, amongst other benefits in the \$18 billion package. The second \$84 billion stimulus package will provide fortnightly payments over six months to benefit recipients, one-off payments to eligible concession cardholders, access to \$10,000 of superannuation in this and the next financial year, a reduction of 50% on superannuation drawdowns, up to \$100,000 in payments for small and medium businesses and a Government guarantee of 50% of the loan amount to small and medium businesses. The third and largest package to date is the \$130 billion JobKeeper Payment designed to encourage employers to retain their staff so that they are ready to re-open once the virus is contained. The latest package is the lifeline Australians needed.

A direct result of these mammoth Government stimulus measures may be a downgrade of Australia's AAA credit rating and the likelihood of a recovery levy (perhaps similar to the Flood levy) for many years to come. None of that really matters right now as these packages are absolutely essential to save potentially millions more from joining unemployment queues. It will provide the bridge to the other side that the Government has so desperately sought.

### Conclusion

Desperate times call for desperate measures and the Australian Government and RBA have launched their own version of “whatever it takes”. They have acted swiftly and with significant force. The stimulus measures won't get people back to work but they will buy time to allow the virus to be contained and prevent the economy from collapsing. This will leave the ‘lucky’ country battered and bruised, but not defeated.

\*Technically a recession requires two consecutive quarters of negative growth, so this won't officially be known until much later in the year, but that is semantics.

## Part 2: Key economic indicators

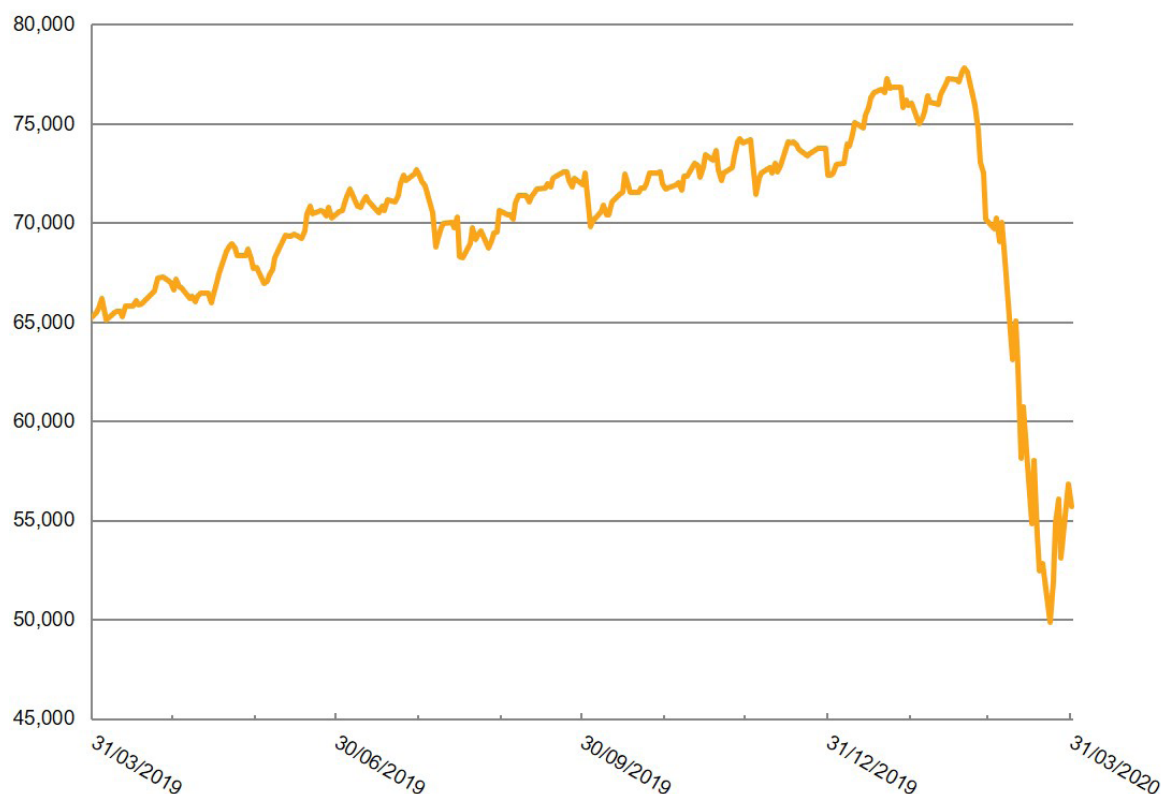
Economic snapshot	Last reported result	Comments
<b>Growth (GDP)</b>	0.5% q/q Q4'19 2.2% y/y Q4'19	The economy showed strength in the final quarter of 2019, supported by continued growth in government services.
	12 month Outlook	Notwithstanding the expansive fiscal policy responses to the COVID-19 crisis, growth will plummet in 2020, with a gradual recovery not expected at least until the last quarter.
<b>Retail trade</b>	-0.3% m/m Jan'20 2.3% y/y Jan'20	Retail trade fell in January, as bushfires across the country impacted the reading.
	12 month Outlook	Retail sales will decline significantly as the unemployment rate rises and retail shops face a possible prolonged period of closure, mitigated to a small degree by the fiscal stimulus packages rolled out by the Government.
<b>Manufacturing PMI</b>	44.3 Feb'20 48.1 Nov'19	The Australian Industry Group (AIG) stated that the Performance of Manufacturing Index (PMI) declined in February, and indicates the sector remains in a contraction phase.
	12 month Outlook	Manufacturing PMI is likely to decline as the economy enters recession and the country faces lockdown.
<b>Business investment (private new capital expenditure)</b>	-2.8% q/q Q4'19 -5.8% y/y Q4'19	Private new capital expenditure decreased over the quarter, impacted by sharp declines in capex on buildings and structures.
	12 month Outlook	The solid pipeline of infrastructure projects will offset, albeit to a very small degree, the large fall in business investment.
<b>Unemployment</b>	5.1% Feb'20 5.2% Nov'19	The unemployment rate remained steady in February as the economy added 13,300 full-time and 7,800 part-time jobs (on a seasonally-adjusted basis).
	12 month Outlook	The COVID-19 crisis could lead to unemployment levels more than doubling from current rates. As the economy reopens, employment levels will recover at a much slower pace.
<b>Inflation and interest rates</b>	<b>Inflation:</b> 0.6% q/q Q4'19 1.8% y/y Q4'19	The Consumer Price Index (CPI) increased solidly over the quarter but continues to remain below the lower end of the RBA's inflation target band of between 2% and 3%.
	<b>Interest rate:</b> 0.25% Cash Rate Mar'20	The RBA lowered the official cash rate twice in March (the second being an extraordinary meeting), noting that "the coronavirus outbreak overseas is having a significant effect on the Australian economy at present".
	12 month Outlook	The RBA has reached its lower bound for the cash rate of 0.25% and so this rate is expected to remain over the foreseeable future.
<b>Australian dollar</b>	AU\$1 = US\$0.62	The local currency has plunged over the past quarter as the COVID-19 crisis had led to a flight to safe-haven currencies such as the USD, whilst growth currencies like the AUD have been sold down.
	12 month Outlook	The AUD is likely to remain weak as the COVID-19 pandemic is still at least 6 weeks from peaking globally and this flight to safety will continue to underpin USD strength, to the detriment of the Australian Dollar.

# Australian equities

## Overview

The S&P/ASX 200 Total Return Index returned -23.1% over the three months and -20.7% over the nine months to 31 March 2020.

**S&P ASX200 Accumulation Index**



Source: S&P

## Outlook

Our outlook for some of the major sectors of the S&P/ASX 200 is as follows:

### Banks

The banking sector has felt the full force of the COVID-19 fallout. The deteriorating outlook of a steep rise in the unemployment level and likely bankruptcies will place further pressure on profitability within the sector. Banks face the increasing probability of loan defaults, both in mortgages as well as business and personal loans. At its emergency meeting in mid-March, the RBA announced that it will provide a lending facility to banks of at least \$90 billion at the RBA cash rate of 0.25%, over three years, provided the banks lend this cash to small and medium-sized businesses. Notwithstanding this measure, the significant job losses across the country will inevitably lead to unemployment levels not seen since Australia's last recession nearly three decades ago.

The recent RBA interest rate cuts have also impacted the banks, putting further pressure on Net Interest Margins (NIM's). Banks have traditionally mitigated the tightening of NIM's by repricing loans, however no such luxury exists in the current economic environment. It is expected that over the next year banks will have to contend with lower NIM's, higher bad debts and further dividend cuts. Capital positions are also likely to weaken, in line with the Australian Prudential Regulation Authority (APRA) announcement that it would be relaxing its expectations in regards to the capital requirement of the banks, noting that these banks "may need to utilise some of their current large buffers to facilitate ongoing lending to the economy".



# Australian equities (cont.)

## Resources

The resources sector performed strongly in 2019 in the face of the protracted Sino-American trade war and a slowdown in industrial production. Enter the COVID-19 pandemic, which has led to a steep increase in the volatility of commodity prices and strong downward movements in the prices for many commodities. Crude oil, in particular, has had the most brutal correction with prices tumbling as a result of a simultaneous demand shock (COVID-19) and supply shock (the Saudi Arabia – Russia standoff). The supply shock has been exacerbated by not only a breakdown in talks regarding production cuts, but subsequently a ramping up of output by the Saudis. In the midst of all this turmoil, gold has confirmed its safe-haven status as investors have flocked to the precious metal.

The broader spread of COVID-19 has increased the risk of further supply chain disruptions as operational risks begin to emerge at mining sites, as well as further weakening in global consumption, together impacting demand for commodities. This expected slumping of demand has been largely factored into the share prices of many companies in the resources sector. The possibility that the Chinese Authorities will unleash aggressive fiscal stimulus in the coming weeks could provide support for commodity prices in coming months.

## Retail

The woes of the retail sector have gotten worse over the past month. The COVID-19 crisis has resulted in mass layoffs within this sector. This is likely to push unemployment to levels not seen since the last recession in the early 1990's. The retail environment has been buffeted by a perfect storm and more retailers will fail.

Discretionary retailers have been the biggest casualties of the tightening distancing measures enforced by both the Federal and State Governments. Stores continue to close as foot traffic has dried up and many retailers have taken the pre-emptive step to shutter their operations so as to not expose their employees to the virus. Consumer staples such as Woolworths and Coles have been beneficiaries, with health and sanitary products, and food enjoying unprecedented demand. Many businesses who shutter their operations will come under pressure as their cash flow will dry up, leaving any debt they carry on their balance sheet exposed.

## Australian Real Estate Investment Trusts (AREITs)

The AREIT sector performed strongly in 2019, and continued this performance until the COVID-19 pandemic began to worsen around the globe in February this year. Since then the sector has fallen sharply, down by around one-third over the quarter.

Conditions in the struggling retail sub-sector have deteriorated at a much faster rate than other AREIT sub-sectors. The performance of retailers is correlated with consumer sentiment, which has been fragile for the past few years. Consumer sentiment is now damaged as many households are (or will be) affected by unemployment. Fiscal stimulus provided

by the government will do little to support consumer confidence as many recipients of the handouts in the Government's stimulus package will likely save the money in these times of economic calamity. In another ominous sign, many retailers have recently closed their doors for at least one month, citing the need to protect their workers who face heightened risks when dealing face-to-face with the public. These are bad outcomes for office landlords who will face increasing pressure to pass rental discounts to all tenants and not just those who are forced (or have decided) to temporarily shutter their doors.

Whilst the office sub-sector continues to benefit from the tight supply of properties, there are now expectations that many tenants will either ask for rental relief or simply fail to pay their rent. The end result of these potentially lower rents is reduced cashflows and, by extension, lower distributions to investors.

The residential sub-sector will also face headwinds over the next year. The lockdown enforced by the government will lower activity. Furthermore, mortgage defaults (and by extension, bad debt charges) are likely to rise as unemployment climbs significantly. Many of these defaults will ultimately lead to losses. Therefore, it is likely this will put downward pressure on residential prices.

The industrial sub-sector appears the one that will be less affected on a relative basis from the health crisis. Growth in online sales could be higher than anticipated as consumers become almost constrained to purchasing non-essential items via these channels, thus providing solid demand for industrial properties within close proximity to transport hubs. The headwind within the industrial sub-sector is the continued disruption to global supply chains, which could temper demand for industrial properties until such supply chains are restored.

We upgrade our recommendation from modest underweight to neutral for AREITs. The steep decline in prices across the sector has made valuations attractive on a through-the-cycle basis, albeit with the heightened possibility of more steep declines over the short term. The sector's moderate gearing levels will enable the companies in the sector to survive in the current climate and thrive when the crisis finally subsides.

## Conclusion

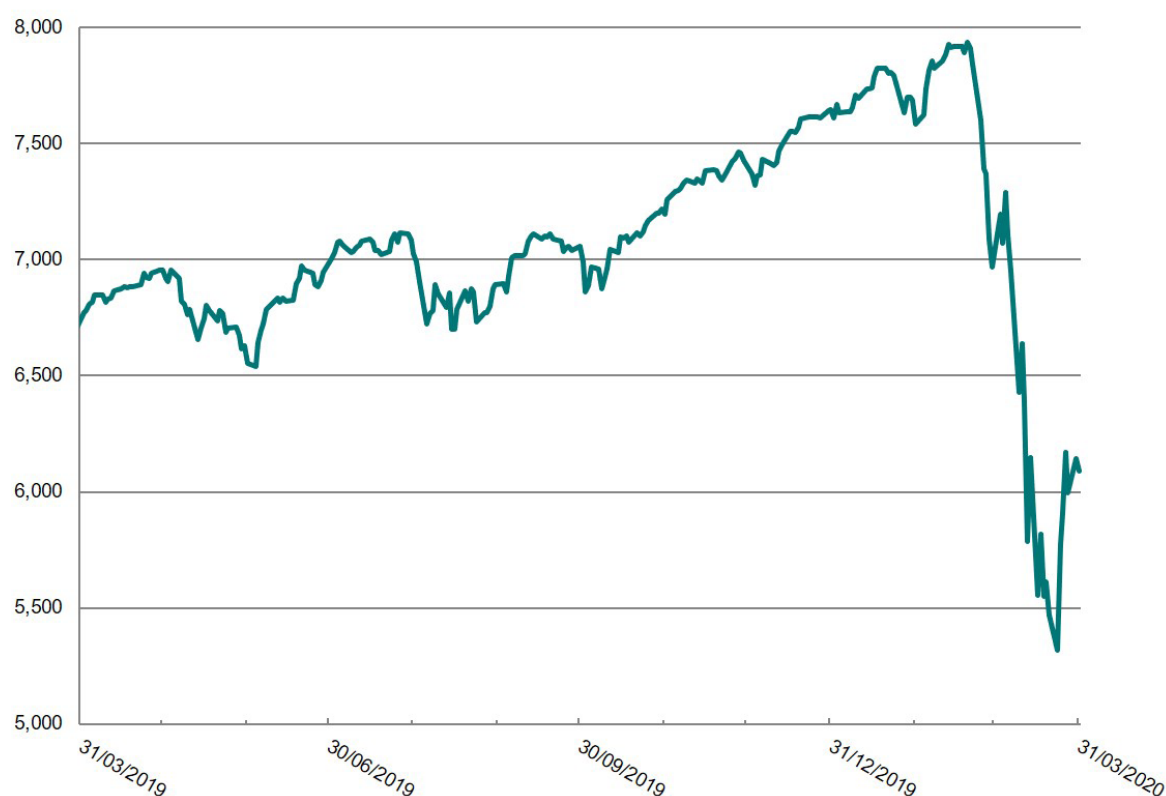
The domestic equity market performed strongly in 2019, supported by an improving global growth outlook and investors cycling out of investments with low returns into investments with a higher risk profile, namely shares. However, the COVID-19 pandemic has now developed into a fully-fledged health and economic crisis and global equities have borne the full brunt of the sell-off of riskier assets. Investor confidence has been battered as the Australian sharemarket has lost one-quarter of its value since its peak in February. Whilst massive earnings downgrades over FY20 and FY21 will continue across the ASX, value on a through-the-cycle basis can be seen across most sectors of the market. We therefore upgrade our recommendation from modest underweight to neutral.

# International equities

## Overview

The MSCI World (ex-Australia) Accumulation Index (local currency) returned -20.3% over the three months and -12.3% over the nine months to 31 March 2020.

**MSCI World ex-Australia Accumulation (Gross) Index (Local Currency)**



Source: MSCI

After a strong start to the quarter following the phase one trade deal between the US and China, sharemarkets around the world began to slide in late February as it became clear that the novel coronavirus that emerged out of central Wuhan was unlikely to be contained. That slide quickly became a freefall as containment measures across the world rapidly extended from travel bans, to border closures, to complete public lockdowns, making it nigh impossible for most businesses to continue to trade and people to go to work. The complete shutdown in economic activity was reflected in the swiftest sell-off in history. The first 20% decline took just 16 trading days, faster than the crash of 1929 which took 42 days. On 21 March the S&P 500 fell to an intra-day low of 2,191, down 35% from a record high of 3,393 on 19 February. At the time of writing, most equity markets have fallen between 25%-30%.

## Outlook

The unprecedented nature of the shock and the difficulty in predicting the depth and duration has made forecasting near term earnings challenging. In the United States, operating earnings for S&P 500 companies are currently expected to fall by less than 1% in 2020 and grow by 19% in 2021. It should be noted that there is a huge variability in earning expectations for 2020, the lowest being \$110, but all analysts are expecting a recovery in the second half of the year.

# Valuations

In our view the 2020 consensus expectations are overly optimistic and are likely to be subject to significant downward revision, potentially 20% or more in coming months.

2020 Calendar year forecast	EPS earnings estimates	S&P 500 fair value estimate	Upside/(downside) S&P 500 = 2584
<b>Consensus</b>	\$162.51	2,600	+1%
<b>If 10% below</b>	\$146.26	2,340	-9%
<b>If 20% below</b>	\$130.00	2,080	-20%
2021 Calendar year forecast	EPS earnings estimates	S&P 500 fair value estimate	Upside/(downside) S&P 500 = 2584
<b>Consensus</b>	\$193.72	3,099	+20%
<b>If 10% below</b>	\$174.35	2,790	+8%
<b>If 20% below</b>	\$154.98	2,480	-4%

Source: S&P and Bloomberg, Refinitiv

## Conclusion

Despite heavy falls to date, global markets are vulnerable to further downside in the short run, particularly if fiscal stimulus falls short of expectations, or the duration of the pandemic extends well beyond another six months. Nevertheless, this pandemic will not last forever. A clinical treatment to COVID-19 is expected within six months and a vaccine to provide broad immunity is likely within 12-18 months. As markets are forward looking, a modest recovery (but not V shaped) may well emerge well before then, possibly when it becomes clear that infection rates in the US and Europe are in decline. At this time quality companies with strong balance sheets are likely to attract renewed interest. For these reasons, we recommend gradually increasing exposure from moderate underweight to neutral on any renewed weakness. Given the devaluation of the Australian dollar, we believe exposure to international assets at the present time is best obtained on a currency hedged basis.

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