MARKET PERFORMANCE AND ECONOMIC COMMENTARY – APRIL 2020

MARKET PERFORMANCE

Financial market behaviour over the past year is summarised in the table below:

Index	1 Month %	3 Months %	1 Year %
Global Equities			
MSCI Emerging Markets	8.8	-8.9	-7.7
S&P 500 (US)	12.7	-9.7	-1.1
Nikkei 225 (Japan)	6.7	-13.0	-9.3
FTSE 100 (UK)	4.0	-19.0	-20.4
DAX (Germany)	9.3	-16.3	-12.0
CAC 40 (France)	4.0	-21.3	-18.2
Trans-Tasman Equities			
S&P/NZX 50	7.5	-10.1	5.2
S&P/ASX 300	9.0	-20.4	-9.1
Bonds			
S&P/NZX NZ Government Stock	2.7	4.2	8.5
S&P/NZX A Grade Corporate Bonds	2.5	2.7	6.8
Barclays Global Aggregate Bonds (Hedged to NZD)	1.6	1.1	7.7
FTSE World Government Bonds (Hedged to NZD)	0.9	2.6	9.7
Oil			
West Texas Intermediate Crude Oil	-8.0	-63.5	-70.5
Brent Crude Oil	10.4	-57.9	-67.0
NZD Foreign Exchange			
AUD	-2.7	-2.5	-0.5
EUR	4.3	-3.5	-5.3
GBP	2.3	-0.4	-4.4
JPY	3.1	-5.9	-11.2
CNY	3.6	-3.9	-3.1
USD	4.1	-4.7	-7.5

Source: Nikko Asset Management

We make the following key observations:

- A bounce in equity markets in April following fiscal and monetary support, though red ink prevalent for longer time horizons.
- NZ equity market the only positive market over 1 year. Is this sustainable?
- Fall in West Texas crude oil futures in April due to lack of storage on the delivery of the May contracts. This forced prices into negative territory, but the price has risen back to over $20 a barrel since then.
- A bounce back in the NZD except against the AUD. The weakening against the AUD perhaps a reflection of improvement in oil prices in relation to Australia's energy sector, but also more aggressive asset purchases by the RBNZ relative to the RBA.

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ECONOMIC COMMENTARY

Market liquidity improved as monetary and fiscal stimulus was pumped into the economy through April. Several capital raisings took place across Australia and less so in New Zealand. The market reacted positively to this stimulus, but also to the health response in most places and prospect of opening up economies again.

Figures 1 and 2 show the bounce in returns between different equity markets and asset classes.

Figure 1: Bounce in equity markets

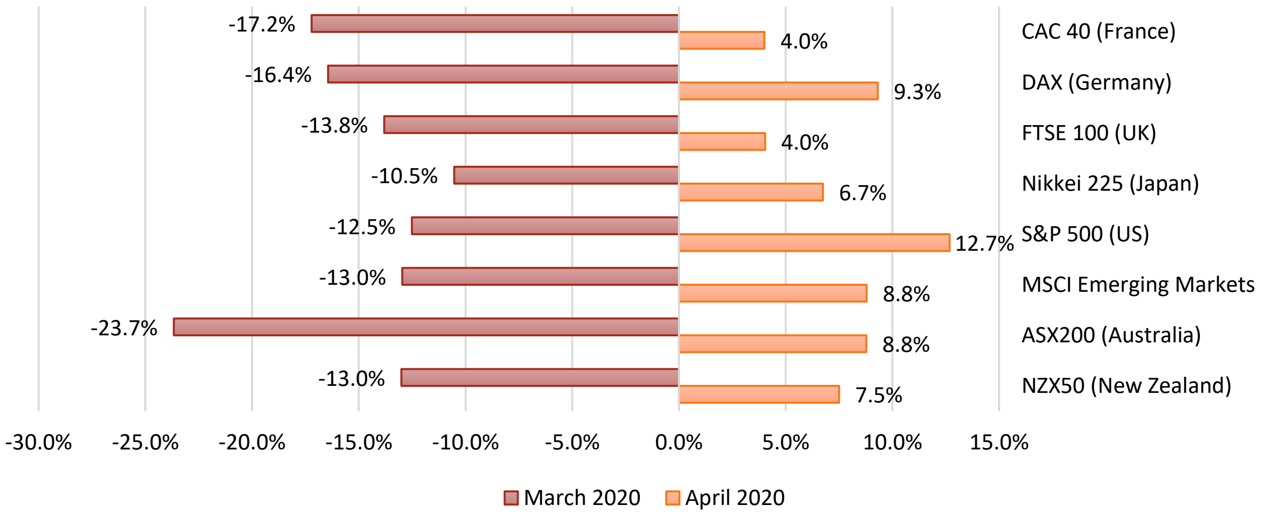
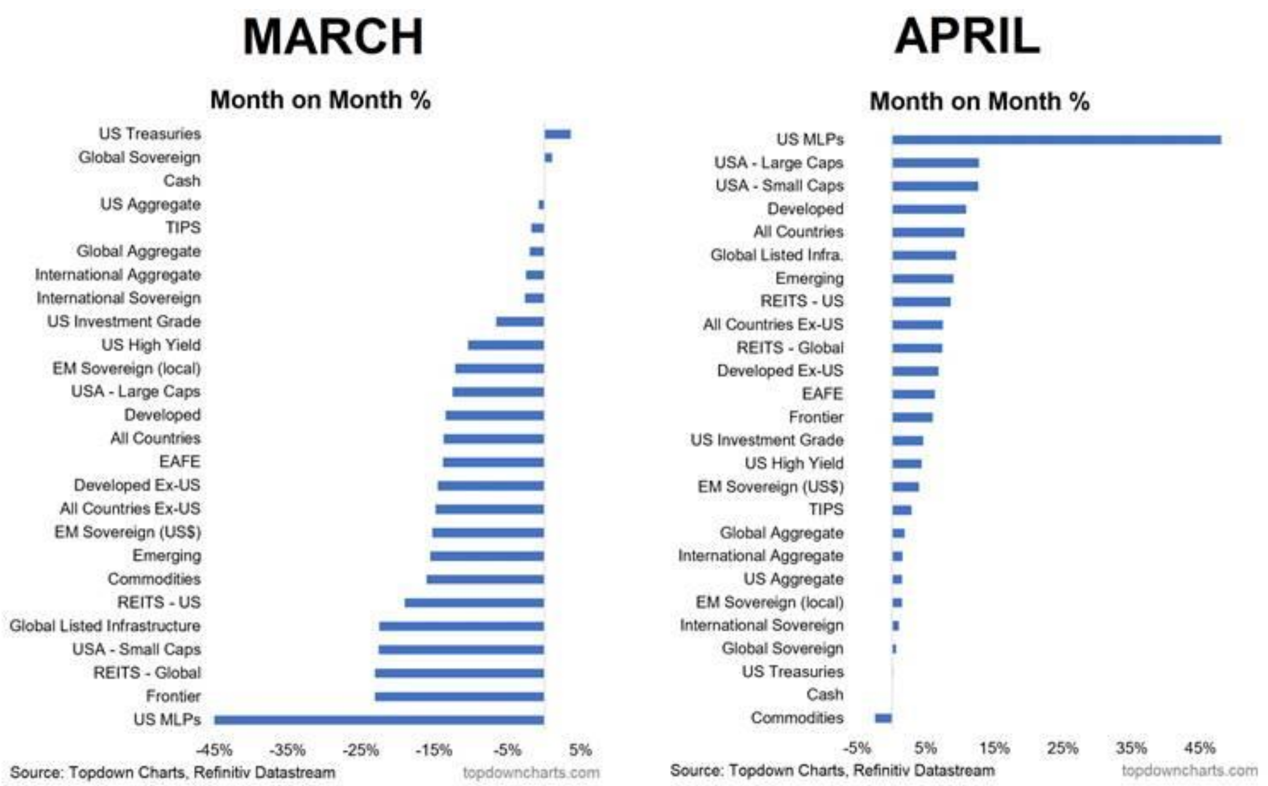


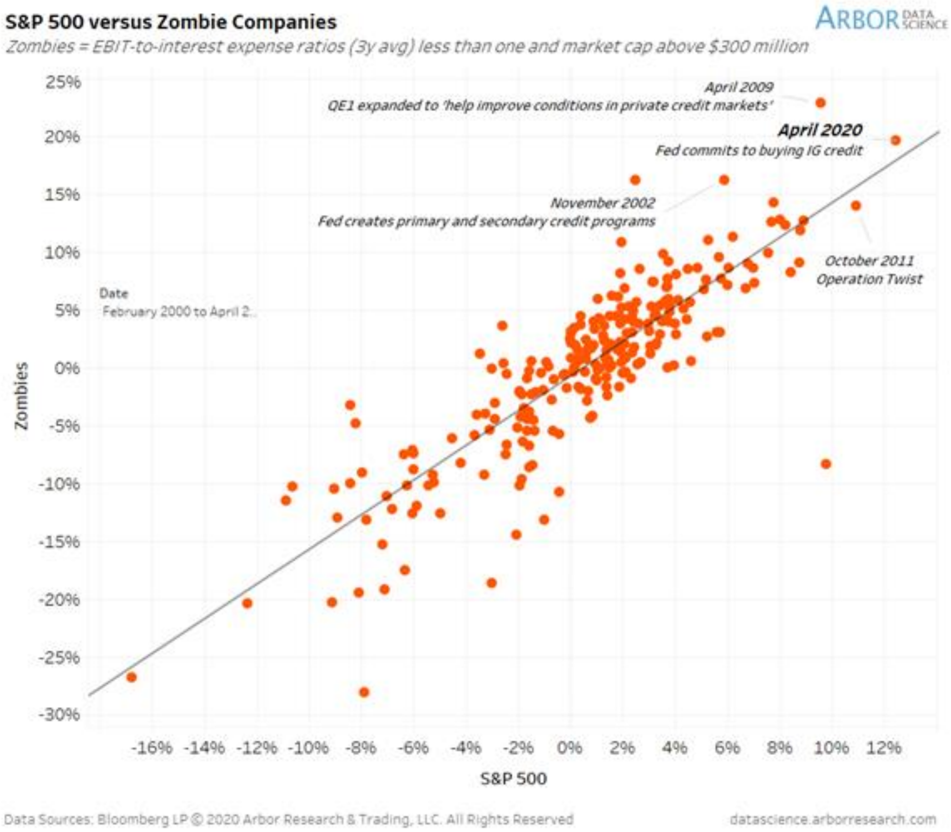
Figure 2: March vs April return breakdown across different assets



Source: Topdown Charts, Refinitiv Datastream, Schroders

However, attention should be paid to the solvency of businesses across all sectors as the reality of the lockdown flows through the economy. Fiscal and monetary stimulus, along with capital raisings, are helping to keep companies afloat. Ultimately though, earnings need to recover to keep the businesses operating over the longer term. Figure 3 shows the monthly return of companies that have EBIT/interest expense ratios below one. These "zombie companies" are not able to earn enough to cover the interest they need to pay on their debt. In April the US Federal Reserve announced they would start a corporate debt-buying program, hence the ~20% return of these companies through April at the top right of Figure 3.

Figure 3: Monthly return of "Zombie Companies" versus the S&P 500



Source: Arbour data science, Schroders

Estimates from the Reserve Bank of New Zealand show how devastating the lockdown at different alert levels might be. Figure 2 below shows that if the economy was at alert level 4 for three straight months, then GDP would contract by 37%.

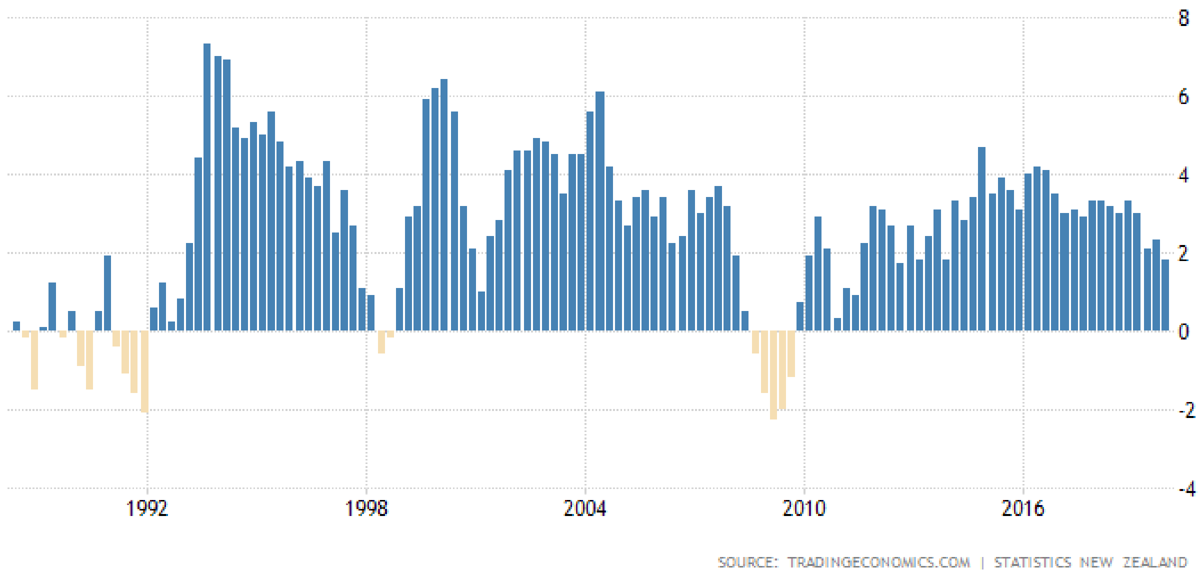
Figure 4: Estimates of GDP reduction when COVID-19 alert levels are in place for one quarter

Alert Level	GDP Reduction %
1	-3.8
2	-8.8
3	-19
4	-37

Source: RBNZ

To put this into context, Figure 5 shows the annual GDP growth rates for New Zealand over the past thirty odd years. Even in the depths of the GFC the growth rate of GDP only contracted around 2% on an annual basis.

Figure 5: New Zealand GDP Annual Growth Rate



Despite the economic data that is slowly being released, the NZX 50 still managed a return of 7.5% in April. Small cap stocks, consumer discretionary and information technology were the most volatile as investors looked to buy oversold companies that had fallen steeply in March.

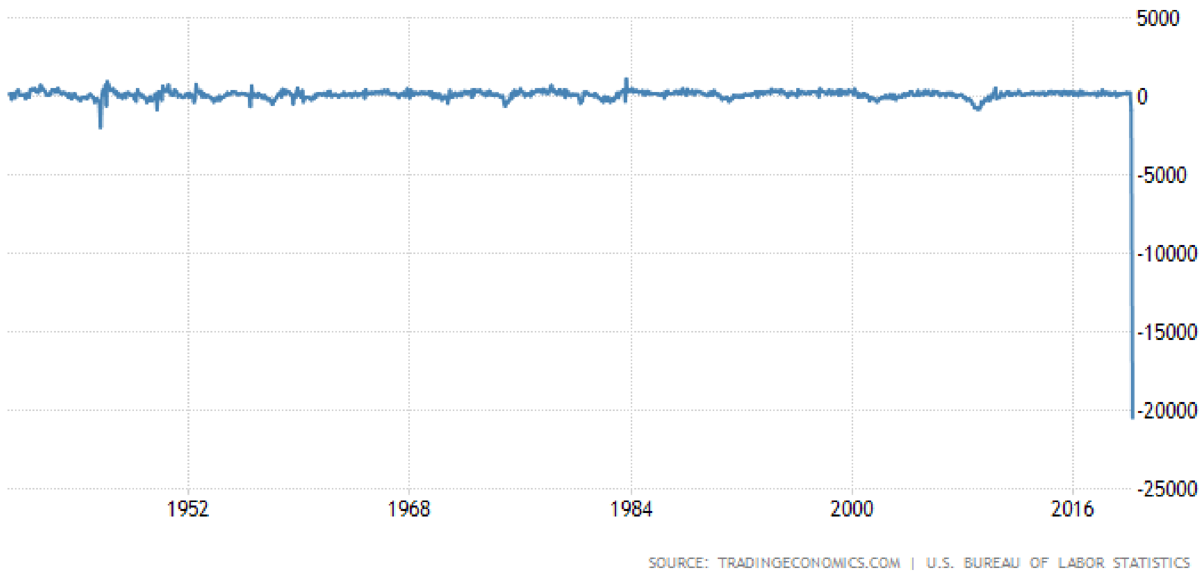
Figure 6: NZ equity market return breakdown for March vs April

	March Return %	April Return %
NZ Large Cap	-11.8	7.5
NZ Mid Cap	-17.9	8.7
NZ Small Cap	-24.5	17.5
Energy	-28.7	8.4
Materials	-32.2	6.4
Industrials	-24.5	16.9
Consumer Discretionary	-40.5	29.3
Consumer Staples	4.8	13.6
Health Care	-3.1	-2.2
Financials	-26.6	10.8
Information Technology	-34.8	26.1
Communication Services	-6.9	7.1
Utilities	-10.8	10.9
Real Estate	-19.3	3.7

The same comparison can be made with US stocks. Despite the initial job loss figures cumulatively rising to over 30 million through March and April, the S&P500 posted its strongest monthly return since 1987

(12.7%). The latest data on employment in the US released in early May showed a total of 20.5 million jobs were lost in April due to the closure of the economy (Figure 7). This takes the level of employment in the US back to what it was in 2011. The vast majority of the job losses were in the leisure and hospitality sectors (7.7 million), of which most jobs lost were in food services or drinking venues (5.5 million). The arts, entertainment and recreation sector also suffered with a decline of 1.3 million jobs.

Figure 7: United States Non-Farm Payrolls



The world is putting so much resource and effort into finding a solution to this pandemic that you wouldn't exactly want to bet against it. Perhaps this is what ultimately underlines the bounce in markets through April?