OUTLOOK FOR FINANCIAL MARKETS as at 5/6/20

First some facts:

Negatives:

- COVID 19, Globally 7,015,128 confirmed cases and 402,852 deaths to date and still growing – the actual numbers are likely quite a bit higher than these, particularly in 3rd world countries. The virus and infections by themselves should not have much impact on economic growth but the shutdowns enacted to control the spread are what's causing a significant deleterious impact on economic growth. The spread of the virus is at different stages in each country. Some appear to have things under control. e.g. Australia, New Zealand, Taiwan, China, South Korea & Japan. Many European countries are close to having things under control. e.g. Spain, Italy, France & Germany. Some others are a little further behind. e.g. UK, USA & Russia. And some countries are of control. e.g. South and Central America, the subcontinent, the Middle East and Africa (*although low numbers are recorded here at this stage*) – also mostly low death rates though and who is to say that the "herd immunity" method of dealing with the virus is not a valid approach.
- Where shutdowns have been invoked there are large increases in unemployment, underemployment, consumer spending and therefore sizeable negative impacts on overall productivity, economic growth and business profits.

Positives

- Asset prices are cheaper than they were in February.
- Interest rates are very low, in fact close to record lows in most countries.
- Central Banks are engaged in massive "quantitative easing" (*money printing of a sort*) resulting in very low medium and long term interest rates and increased liquidity in financial markets (*which is a plus for asset prices*).
- Governments are providing huge fiscal stimulus via various programs to put money in people's hands and keeping businesses running.
- Enormous global effort to find vaccines and treatments for COVID-19. From what I read I think we may soon have some viable treatments, although vaccines may take some time. For example, HIV still doesn't have a vaccine, but treatments have enabled it to be dealt with fairly effectively.
- As various countries loosen their restrictions, I expect consumer spending to increase substantially (*catch up* spending), e.g. I might now upgrade my motor vehicle which I was thinking about a few months ago but put off because of the virus.
- Share prices may improve further due to not many other options to invest in. Even if company dividends are reduced, they are still going to be much larger than the interest you can earn off bank deposits (*not much more than 1%)*.

As far as share markets are concerned, this is what has happened to date:

Share Price Movements

	Fall since PEAK in February		% of the fall
	To 23rd March	to 4th June	Recovered
Australia	37%	16%	21%
USA	34%	8%	26%
Europe	34%	14%	20%
Japan	28%	8%	20%
UK	34%	17%	17%
Emerging Markets	28%	8%	20%

OUTLOOK FOR FINANCIAL MARKETS as at 5/6/20 (Cont'd)

And this is how I see them positioned:

Australia

- The outcomes from COVID-19, medically speaking, are not as bad as first thought and as a consequence, various lockdown restrictions are being removed sooner than originally anticipated.
- The massive fiscal and monetary stimulus as outlined above are helping to reduce the negative impacts on our economy of the shutdowns.
- Not all businesses are suffering, some are even growing their profits.
- In my opinion the extreme sell off from 20/2/20 to 23/3/20 (*share prices down 37% on average*) was overdone. Since then prices have recovered a bit over half the fall and are at a more reasonable level now.
- I think some share prices are now reasonable to good value on a medium to long term perspective (*2 to 5 years* +) and some are expensive, but I can't help feeling that maybe we might see another downward leg in prices at some stage during the next 6 months. But because large institutional investors are sitting on lots of cash, presumably waiting to buy shares on dips, any downside may well be limited. So it is probably ok to have slightly more than normal invested in Cash or Cash Equivalents for now, but taking advantage of any good opportunities as or if they arise.
- An example of an expensive stock could be Woolworths which is trading on a Price to Earnings Ratio (*PE*) of 28.5 (*28.5 years of current profits to recover your investment*) which is expensive for a relatively low growth stock. Morningstar research has fair value at $27.50 but the last sale price on market was $37.06. By comparison Coles PE ratio is only 17.6. An example of a cheap stock could be Woodside Petroleum which is trading on a PE of 17.6, has good potential for further growth (*particularly when oil and gas prices normalise – current prices are at a level where no producers worldwide can make a profit – Woodside is a low cost producer with long life reserves*) and Morningstar has fair value at $44.60 while its last price on market was $23.36.

USA

- If you look at US share indexes you would have to say that their share market looks expensive, particularly given their situation regarding COVID-19, the economic consequences (*huge increases in unemployment*) and their current political disfunction (*they have a 2 year old as president*).
- But when you dig a little deeper you discover that share price indexes are greatly influenced by the 10 longest companies (*Microsoft, Apple, Amazon, Alphabet / Google, Facebook, Berkshire Hathaway, Visa, Johnson & Johnson, Walmart & Mastercard*) who are mostly quite expensive. These prices are probably so high because of the momentum the "in flavour" stocks have no competition from extremely low interest rates and a lack of obvious alternatives.
- However due to the sheer size of the US economy, there are plenty of companies whose prices still represent reasonable to good value (*mostly smaller to mid-sized companies with good prospects*).

Rest of the World

A cross section of the comments made for Australia and the USA apply. Share prices from cheap to expensive.

Sectors other than Shares

Fixed Interest and Credit Securities (*other than Government Bonds*) also sold off during the share market sell off and have recovered a fair bit. At current levels most of these don't appear particularly attractive investment options. Bank term deposits in Australia are only paying around 1% per annum and Government Bonds are paying even less – some European and Japanese Bonds still have negative interest rates. Who wants to give their money to the Australian Government for 10 years at the current rate of approximately 0.94% per annum?

Property valuers have ben reducing their valuations a bit, although good quality commercial property with low or no vacancies, blue chip tenants (*e.g. Government departments, large corporates etc*), on long term leases with automatic annual rental increases should continue to do well. During the February to March share market sell off, Listed Property Trusts (*REIT'S*) prices fell more than the overall share market – from being a little on the expensive side to cheap to now being reasonable value on average (*despite some short term rental recovery issues*) – AREIT yields are now 5% to 8.5% per annum.