Market Review for 12 Months to 30 April 2020

Overview

In an eventful year for global financial markets, it is the period since mid-February that completely dominates the narrative at the end of April 2020. Stock markets were hovering close to all-time highs before the scale and potential impact of the spreading coronavirus became clear. The speed with which the virus went from a flu-like illness in China to a global pandemic that resulted in a shutdown of large parts of the global economy took investors by surprise and sent equity prices sharply lower. Volatility levels shot higher, with the VIX Index (a measure of price volatility in the S&P 500) soaring to record highs, surpassing the peaks seen during the global financial crisis. However, the quick response from central banks and governments to the pandemic's impact helped avert a potential liquidity crisis and remove an element of panic that had crept into markets. Bolstered by an 11% rebound in April, global equities (as measured by the FTSE World Index) ultimately recorded a loss of -3.5% (-2.0% in euro terms) for the full 12 months under review. US equities typically outperformed, with the largest technology stocks extending their leadership as the world adapted to home deliveries and work-from-home mandates.

The April bounceback reflected hope that the virus infection rate had peaked in many countries even as data releases began to reflect the negative impact on economic activity. With restaurants, hotels and stores closed, flights grounded, and non-essential workers sent home, one of the biggest impacts has been on employment – in the six weeks to the end of April, about 26 million US workers made jobless claims after US firms furloughed workers at an unprecedented rate. Similar experiences of varying scales have been noted around the world. The US economy shrank by -4.8% in the first quarter, while the eurozone economy contracted by -3.8%.

In what seems a lifetime ago, market preoccupation for the first nine months of the review period had largely centred around issues such as international trade and Brexit. Market sentiment was more often moved by speculation about whether a positive resolution to these matters could be achieved and what the impact on economic growth and corporate earnings would be in the event of no deal being achieved in either case. The uncertainty created by the US-China dispute and the escalating tit-for-tat tariff war took a toll on China's economic outlook, but the Phase One trade agreement in December injected a pulse of confidence as 2019 came to a close. However, relations have since deteriorated again over US criticism of China's efforts to contain the initial coronavirus outbreak.

For most of the review period, central banks had provided a tailwind, gently easing the strings on monetary policy and helping fuel rallies in both bond and equity markets along the way. A more aggressive approach was adopted in March and April, with central banks slashing interest rates and pledging massive amounts of stimulus to soften the blow that was about to hit the economy. The US Federal Reserve cut rates by 150 basis points to near-zero, while the Bank of England cut from 0.75% to 0.10%. Along with the European Central Bank, and other major central banks, there was also a commitment to buy government (and corporate) bonds amid signals they would do whatever it takes to stabilize financial markets and bolster economies. Governments similarly pledged to offset negative lockdown effects, announcing big spending packages, business supports and emergency payments to the many laid-off workers.

On bond markets, returns for the 12 months were generally positive, although the asset class was not immune from the same volatility that upended equity markets. The low interest rate environment had underpinned bonds through much of last year, and while optimism around Brexit and US-China trade boosted investor risk appetite at the expense of bonds in the final quarter of 2019, heightened COVID-19 related risk aversion alongside falling interest rates spurred gains for government bonds in Q1 2020. At one point, the entire German yield curve (out to 30 years) had dropped into negative territory. It is worth noting that not all bonds benefited from investor caution during volatile market periods, with a notable preference for high-quality sovereigns over lower-rated government debt and corporate bonds evident.

Europe

The FTSE World Eurobloc Index recorded a negative total return of -14.4% for the 12-month period. This was driven by a 25% slide in the opening quarter of 2020 as worries about COVID-19's impact increased. Although a lot had happened in the preceding three quarters, it is events in recent times that dominated outcomes and colours prospects.

Among the region's individual stock markets, Germany's Dax Index posted a decline of -12.0%, with the virus-induced shock knocking hopes at the end of 2019 that weak manufacturing activity had bottomed out. France's CAC Index fell -18.2% for the year. Italy's stock market journey was particularly volatile as a fragile domestic political landscape and disagreement with the EU then gave way to COVID-19 concerns as the country emerged as an epicentre of Europe's outbreak; the FTSE MIB Index ended the review period -19.2% lower, having fallen -27.5% in Q1. Spain's primary stock market (IBEX) also struggled, recording a decline of -27.7% as the scale of its outbreak soon rivalled that of Italy's as one of the hardest-hit European countries.

Looking back over the past year, the economic growth backdrop in the eurozone was lacklustre but it paled into relative insignificance as the most recent data began to emerge. The final quarter of 2019 had seen the region's economy register barely-there growth of 0.1% before the COVID-19 effect drove GDP lower in the latest quarter – the euro area economy shrank -3.8% in Q1. As many service and retail businesses shut their doors, purchasing managers' index (PMI) reports in March and April revealed the impact of the economic lockdown; the eurozone services PMI stood at 52.6 in February and then had record low readings of 26.4 and 12.0 for the next two months – PMI readings below 50 are indicative of contracting activity. Manufacturing PMIs were also weak, but the decline was muted by comparison, dropping from 49.2 to 44.5 to 33.2. Governments across the continent pledged support for workers laid off due to the virus, with state-backed loans also available to help companies avoid bankruptcy.

Ireland

Ireland's ISEQ Index delivered a negative total return of -13.2% for the 12 months, driven by a slide in Q1 2020 that saw it shed more than a quarter of its value. For the first half of the review period, Brexit had cast a shadow across the Irish market, particularly during the third quarter of 2019 when it looked as though the UK was heading for a 'hard' exit. The avoidance of a chaotic no-deal Brexit bolstered confidence in the final quarter, with a Conservative Party election victory in December then removing any remaining likelihood of a divisive second referendum. At the time, stocks with large UK-related operations and sales rallied, with financial and airline stocks doing particularly well – these same stocks were then pummeled in the major sell-off of February/March as planes were grounded and the economic outlook turned grim. A bounce in line with global equity markets in April helped the ISEQ recover some of the losses.

Having achieved the eurozone's best GDP growth in 2019 with an expansion of 5.5%, Irish economic indicators turned sharply negative as fallout from the pandemic drove a steep decline in activity. The manufacturing purchasing managers' index (PMI) fell to 36.0 in April, while the PMI for services slumped to 13.9, its lowest level in 20 years – readings below 50 are indicative of contraction. Retail sales in March were -11.1% lower from a year ago as many retailers were shut in the month. Unemployment and those receiving income assistance surged, with a COVID-19 adjusted unemployment rate calculated by the Central Statistics Office hitting 28.2% in April.

U.K.

The FTSE World United Kingdom Index fell -17.1% over the 12 months (-18.0% in EUR). Just when the Brexit factor that had been a weight on sentiment towards the UK economy and market appeared to have lifted, investors were hit with the unfolding reality of COVID-19. This latest development came at the end of a year that had seen the replacement of a Prime Minister, high-stakes dealing with the EU, and a general election that put the Tories back in the driving seat with an overall majority. Fears of a chaotic no-deal Brexit subsided in October when a deal was agreed on the Irish 'backstop', although both sides' interpretation of what that means remains somewhat at odds with each other. Nonetheless, the market responded positively at the time with equities and sterling rebounding. However, the market had that wind knocked out of its sails by COVID-19, and there has been widespread criticism of the government's approach to the crisis – the UK passed Italy to become the country with the biggest number of fatalities.

Under the Brexit cloud, the UK economy had mixed fortunes in 2019; having grown by 1.4% in 2018 – which was the lowest since 2012 – GDP then rose by just 1.1% in 2019. Data showed the economy effectively flat-lined in the fourth quarter and the most recent release revealed GDP fell -5.8% in March alone for a -2.0% contraction in Q1. The labour market had remained tight through the review period and the unemployment rate was just above its 46-year low at 4.0% for the three months to February – however, that will change considerably as the data catches up with the COVID-19 reality. The Bank of England moved swiftly to offer support, cutting interest rates twice in March to take the benchmark rate from 0.75% to 0.10%. It also announced a fresh round of bond purchases to the tune of £200bn.

U.S.

The US S&P 500 Index fell -1.1% in local terms for the 12 months, an outcome that was well ahead of most of its counterparts. After hitting a new record high as recently as 19th February, the extent of its virus-driven decline was such that it fell 20% in the first quarter of 2020, before rebounding by 12.7% in April. As measured by the FTSE World North America Index, the total return for the year was +0.6% (+2.8% in EUR). The US market had stayed ahead of its peers through the review period, tracking steadily higher in 2019 with a tailwind of interest rate cuts helping to offset concerns around US-China trade talks. The eventual agreement of a phase one deal between the two countries propelled the US stock market to new record highs before global markets slumped in Q1. S&P 500 companies had posted year-on-year quarterly earnings gains for the fourth quarter, following three straight quarters of falling profits, but Q1 profits have fallen by the most since 2009 and most companies have withdrawn estimates for the full year. A steep slide in oil prices amid faltering demand, excess supply and an unexpected price war initiated by Saudi Arabia contributed additional headwinds for the energy sector.

Although the outlook turned bleak in the final two months of the review period, the US economy had proven resilient through much of the preceding year. US GDP expanded in the final quarter of 2019 at an annualised rate of 2.1%; however, this was followed by a -4.8% contraction in Q1 as shutdown measures took effect. Similarly, job creation had been healthy, with over 2 million positions added to the non-farm payroll in the 12 months to February; the jobless rate stood at a 50-year low of 3.5% in February. However, the payroll then shed 880,000 jobs in March and 20.5 million in April and the jobless rate jumped to 14.7%. The Federal Reserve moved rapidly, cutting rates by 150 bps in March and announcing plans to support market liquidity and restart asset purchases. Congress passed a $2.2 trillion spending bill to help firms and individuals impacted by shutdown measures.

Japan

The FTSE World Japan Index generated a negative total return of -6.8% (-0.7% in EUR) for the 12 months. The market's relative outperformance versus many of its peers was in part the result of some easing in the Japanese yen's value in the second half of 2019 – the currency's strength had previously weighed on the exporter-heavy market. Sentiment was also lifted by December's announcement of a government spending package that was larger than expected. With the onset of the COVID-19 pandemic the Bank of Japan, which is thinly stretched, extended its efforts – it has already opened the floodgates, with a Special Fund-Supplying Operation to provide credit availability to small and medium enterprises as well as stepping up purchases of ETFs and J-REITS. The bar for a cut in rates (which are already negative) is high, given the adverse impact on bank earnings as net interest margins get squeezed. Japan has also faced a second wave of infections that necessitated the reintroduction of recently loosened lockdown measures.

The economy tended to perform better in 2019 than was anticipated. Annualised quarterly growth of 2.2%, 1.3% and 1.8% was achieved in Q1, Q2 and Q3, respectively. However, even prior to the pandemic-driven shock, the economy was already at risk of recession as GDP shrank by an annualised -7.1% in Q4 after consumption was hit by a sales tax hike, a major typhoon, and as businesses cut back capital spending. With the coronavirus hitting Asian/global production and travel, a contraction was inevitable in Q1, and so it proved as Japanese GDP fell by a further -3.4% to leave the economy in its first recession in almost five years.

Asia-Pacific

The FTSE World Asia Pacific ex Japan Index recorded a negative total return of -7.9% (-8.1% in EUR). Before COVID-19 became the dominant factor for global markets, the reliance of many Asian economies on international trade ensured the US-China trade dispute was a key focus for much of the review period; this was from both the potential for it to escalate as well as the economic impact of a widening trade war on key export markets. However, progress towards a trade truce (including a phase one deal agreed in December) boosted sentiment, as did US interest rate cuts and some weakening of the US dollar. However, market sentiment pivoted in February when the coronavirus began spreading beyond China. However, many Asia-Pacific countries did not typically see the same lockdowns witnessed in Europe, perhaps because of past experience dealing with the likes of the SARS outbreak. Many countries had significantly eased restrictions by April.

China's Shanghai Composite Index fluctuated amid tariff, growth and virus worries, but ultimately delivered a relatively modest decline of -7.1% for the 12 months. Hong Kong's Hang Seng Index fell -17.0% in the year; the market had underperformed prior to the outbreak as the economy and businesses were rocked by large anti-government protests. South Korea's Kospi Index dropped about -10%, driven by COVID-19 effects, although a trade spat with Japan and some prior economic softness had also weighed on sentiment. Australia's S&P/ASX 200 Index declined about -13%, while New Zealand's S&P/NZX 50 Index proved a particularly strong performer in posting a gain of 5%.

Fixed Interest

Before coronavirus concerns brought about extreme investor caution that was reflected in a sell-off of risk assets and in higher government bond prices, bond investors had already enjoyed gains through the review period. Shifting interest rate expectations, sluggish economic growth and below-target inflation had driven bond yields lower though much of 2019. Optimism around US-China trade prospects and diminishing Brexit fears in the final quarter of the year then reversed some bond gains as confidence in the economic outlook was bolstered.

The US cut rates on three occasions in 2019, reducing the fed funds rate by 75 basis points. However, with the rapid spread of the coronavirus, the Fed then cut twice in March, by 150 basis points, to take interest rates to near-zero. It also embarked on a massive quantitative easing (QE) program and pledged liquidity to ensure market stability. Having never fallen under 2% until January, the 30-year US Treasury yield then dipped below 1% in March, while the 10-year fell to 0.35%; these ended April at 1.28% and 0.64%, respectively, compared to 2.9% and 2.5% a year earlier.

With central banks in firefighting mode and investors seeking shelter from stock market turbulence, government bond yields in many developed countries dropped to new record lows. US and UK bonds outperformed, with the Bank of England following the Fed by cutting rates from 0.75% to 0.10% in March. The European Central Bank, with rates already at zero, had more limited scope for action although it had already restarted bond purchases back in November – and ramped that up by €870 billion (to the end of 2020) in March. Germany's 10-year yield touched -0.85%, a new low, before bunds gave up some gains to end April at -0.59% as risk appetite improved; this was down from 0.01% a year ago. The latest crisis and its economic impact saw investors differentiate between core and peripheral eurozone government debt – so while Spanish and Italian bonds enjoyed positive returns over the full year, the yield on their 10-year bonds increased through March and April as investors gravitated towards higher-quality sovereigns.

The ICE BofAML 5+ Year Euro Sovereign Index recorded a positive return of 7.7% for the 12 months.

Real Estate

Having experienced exceptionally strong levels of activity in 2019, with over €7 billion of turnover, the Irish market started the new year with a carryover of deals from Q4 and a strong pipeline of new transactions against the backdrop of a growing economy. However, after some strong activity through January and February the market all but came to an abrupt halt during March. In light of the transactional evidence and supply pipeline of January and February, it's fair to say the virus outbreak and its far-reaching implications blindsided the market. Since early March, governments, COVID-19 and the widespread resultant disruption has hit both economic activity and financial markets. Given the physical nature of property and the logistical difficulties associated with arranging inspections and conducting technical due diligence, agents and valuers reported a slowdown in transactions amid restrictions on movement.

Investment activity levels are expected to remain very slow during the coming months in this environment. However, low interest rates typically benefit property as an asset class and, while there is clearly significant uncertainly at this stage, the low rate environment looks likely to continue as the ECB maintains support for the European economy.

The UK investment property market also began 2020 strongly with transaction activity up on a year earlier. The removal of Brexit uncertainty in late 2019 had looked like a positive development for the market, although according to Savills, overall UK commercial property investment volumes fell 23% year-on-year between 2018 and 2019, from £63 billion to £48.4 billion. Hopes for a sustained Brexit bounce have been upended by the coronavirus outbreak. CBRE reported that yields at the end of February were unchanged since the end of December, with the exception of shopping centres, which were weaker. By mid-March, the UK Government had introduced stricter containment measures.

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