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April Market and Portfolio Update

New COVID-19 case numbers begin to ease, the RBA sounds a warning for the Australian economy, and oil prices turn negative – we take a look at some popular topics from the last couple weeks.

Have we reached the peak of the COVID-19 pandemic?

In recent weeks, we have begun to see some early signs of progress with regards to a reduction in the number of new daily cases and deaths in various hotspots hit hardest by the Coronavirus pandemic.

Outside of citizens returning from overseas, China is now somewhat back to 'normal', with only a small number of new cases being recorded and economic activity picking up. In Europe, countries like Italy and Spain are witnessing vast improvements. Although new daily cases are still in the thousands, there has been a 50% drop compared with a month ago, giving rise to the hope that new cases may have peaked.

Elsewhere, case numbers across the US are starting to ease slightly from their highs. Progress has been prominent in New York, where not only have deaths slowed, but hospitals are starting to see bed capacity emerge after a tortuous period.

We're also beginning to see a gradual easing of lockdown restrictions across various countries, having already started in some places across Europe and expected to progress further in the coming weeks.

Australia and New Zealand are also weighing up the idea of easing lockdowns, although both stand on the cusp of potentially eradicating the virus and are thus far opting for conservative approaches. Meanwhile, the US is eyeing to slowly reopen the economy, with some states paving the way for business to resume as soon as possible.

In the meantime, although we're not assured that we are any closer to a vaccine or effective treatment for the virus, there have been some promising developments. This includes news that an antiviral drug, Remdesivir, showed some effectiveness in a limited study. However, the study lacked scientific rigour, so eyes will be fixed to early clinical trial results expected any day now. Other clinical trials for alternative drug treatments are ongoing.

For all the hope that we have reached the peak of the pandemic, it should be noted that the virus is still growing quickly in other locations such as the UK, Turkey, Russia and Brazil, among others. In fact, despite early effectiveness containing the virus, Singapore has seen a new outbreak.

Now is a time where every country will need to be realistic about the situation we find ourselves in. This means that as economies begin to reopen, there is a very real risk of a second or third wave of cases. Caution is the order of the day at this stage, and it may well prove too early to say we have reached the peak of the COVID-19 pandemic.

Warning bells ring for the Australian economy, but is there hope on the other side?

Although a recession is all but assured for Australia, there has been some optimism that we might be able to mitigate the effects of this thanks to a strategy where the economy is being placed in 'hibernation'.

However, the RBA effectively hosed down such optimism with its latest update. It is now expected that we will see the most significant downturn since the Great Depression, with national GDP set to plummet up to 10% in the first half of 2020. The IMF, meanwhile, expects Australia's economy to sink 6.7% across the year.

Some observers may have been surprised by upbeat retail sales for March – lifting by a record 8.2% – or the better-than-expected unemployment result, which edged up fractionally higher to 5.2%. However, these numbers don't begin to paint a true picture of the economy. First, retail sales were inflated by panic buying and hoarding, while secondly, unemployment numbers were based on data before the nation locked down.

Instead, a huge contraction in activity within the services sector casts a dire warning. Furthermore, business and consumer confidence has well and truly been decimated.

Unemployment numbers are expected to increase significantly from April, however, the JobKeeper program has just opened. This program is likely to mitigate a worst-case-scenario, with fortnightly payments of $1,500 set to help keep some employees on the books, even though they may not be working in the same capacity.

Alert to the need for a strong rebound when it comes time for the economy to recover, the RBA is calling on the government to implement a concerted shift in economic policy that will underpin future growth.

This includes increasing GST, introducing land taxes in favour of property stamp duties, and cutting the business tax rate. It is company tax cuts, which stand to ignite the economy once we make it through to the recovery phase. Not only would such an initiative encourage new business investment, but it would play a crucial role driving new hiring activity and act as a tailwind for the economy.

Oil takes a plunge

We witnessed a remarkable piece of history when prices for US WTI oil futures turned negative for the first time ever.

To better understand this turn of events, consider the global economy right now. With what could well be more than half the world's population in lockdown, demand for oil has all but evaporated.

In terms of demand, we need to remember that planes are barely flying, there are substantially fewer vehicles on the road and mining operations in many countries are suspended. These are but a few of the factors underpinning low demand, but on top of all this is limited storage capacity in the US.

Due to low consumer demand, many tanks around the nation are already brimming with oil. This means that traders with oil futures contracts set to expire were left between a rock and a hard place as far as not having means to accept physical delivery of oil. To rid themselves of this problem, they were prepared to pay others to take on that obligation, pushing prices for May's contract into negative territory ahead of its expiry.

Even Brent crude, the global oil benchmark, has faced heavy selling pressure. And this ties in with another problem - the supply side of the global oil equation. Production cuts agreed to by OPEC+ have not yet started and ultimately, don't go far enough in this climate where there is little demand.

For the time being, oil prices have pared their losses. However, the prospect of single-digit or negative oil prices could remain prevalent for as long as economies across the world are still in lockdown. If easing lockdown restrictions works, the long-term upside for oil prices is strong, but it is clouded by the risk of subsequent waves of COVID-19 emerging and crippling economic activity once again.

Growth Portfolio update

We recently advised clients that we would be entering some new positions in various tech stocks on the back of some key thematics that we believe are likely to evolve from the current pandemic.

To date, there has been little change in the value of these holdings, however, given the short time that has elapsed since our buying activity, we are not concerned.

As we made clear in our last portfolio update, we are of the opinion that some of these stocks may benefit in the mid-to-long term from ongoing behavioural changes. In the case of the other stocks, it is our view that they may retain their prominence as long as remote working and online shopping continue to trend above normal levels.

We have, however, decided that we will be adding two new additions to the portfolio in CME Group (CME) and Alibaba Group Holdings (BABA). Our opinion is that both of these companies will be well-equipped to navigate a difficult trading environment, not to mention each stock is currently trading off their highs.

CME Group is a stock that offers defensive counter-cyclical qualities, with the company deriving a large bulk of revenue from trading activity. Market volatility is one tailwind that aligns with an increase in trading activity. Should the market continue to trade in the manner it has in recent weeks, we believe the business will be a beneficiary. The company's scale and international growth are also benefits that we believe offer upside.

We see Alibaba as an attractive stock in light of its long-term growth prospects. With its key driver being e-commerce, the company is leveraged to a significantly growing middle class in China.

What's more, Alibaba has diversified into digital entertainment and cloud computing. The business has announced it will invest US$28bn in cloud infrastructure over the next 3 years. This strategic move offers exposure to lucrative international growth in a sector becoming more important by the day.

The importance of patience

During volatile times like these, one of the most important things is to remain patient. The unpredictable nature of events that are unfolding before us is truly once-in-a-lifetime. This means a considerable amount of uncertainty should be taken into consideration through a level of discipline in portfolio management.

From here, things could quite easily get worse before they get better, which means it is only rational to take a safety-first approach.

Whilst one should always eye risk-adjusted investment opportunities that look attractive, there is an even-bigger need to avoid overexposure to a market that is effectively in the eye of the storm. Capital preservation is of the utmost importance in times like this and hasty decision making can wipe out years of profits.

As we are long-term value oriented, there will no doubt be plenty of investment opportunities in the months or year(s) ahead. Even if we miss the market 'bottom' and invest on the way up, there is likely to be significant gains on the table.

However, if we pull the trigger too early, and markets continue to fall - a very likely scenario - we may preclude ourselves from taking advantage of what could be life-changing opportunities. For this reason, the importance of staying patient can never be understated.

For more information please don't hesitate to get in touch

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