NEWSLETTER
July 2020

EVEREST PARTNERS
PRIVATE WEALTH MANAGEMENT

Introduction

Welcome to our newsletter for July. This is also the newsletter in which we reflect on the month of June, which is of course the last month of the 2019/2020 financial year. And what a year it's been! We have never seen anything like it - and we sincerely hope never to see anything like it again.

In this newsletter, we focus on the impact of the Coronavirus on the two major investment markets: the sharemarket and the residential property market. We also look at some representative pieces of commercial property to examine the impact of the virus on the commercial property sector to date and the expected impact on that sector into the future.

We hope you enjoy the newsletter and we wish you all the very best for the financial year just commencing.

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The Share Market

Australia's share market, as measured by the ASX 200, has finished down for both the month of June 2020 and the twelve months ending 30 June 2020. Here is how the year looked, thanks to Alphabet and the ASX:

From the start of the financial year until its end, the market fell by 11.29%. However, as the graph shows, it really was a year of two halves. By 20 February 2020, the ASX 200 had risen to its all-time high of 7,162 points. By that stage, the year was going quite well, with prices rising on average by 7.7%. Over the next month, the market fell dramatically, reaching its nadir on March 23 when it closed at 4,546 points. This represented a fall of 31.6% from the start of the financial year, and an even more stark fall of 36.5% from the February high.

Bizarrely, the state of the market on March 23 was almost to be expected. Over the preceding few weeks, every capital city had gone into lockdown. In many industries, economic activity had ground to a halt. Uncertainty reigned and a collapse in share prices seemed completely consistent with what was happening in the real economy.

Suffice to say, from that point forward, things took a decidedly unexpected turn. Between March 23 and the end of the financial year, prices *rose* by 29.7%. Nobody predicted this. Similarly, few people seem able to fully explain it. The reality is there is no single explanation for what has happened to share prices in the last three months of the financial year. Price movements have been affected by at least two quite different factors.

Undoubtedly, the arrival of many new investors into the market has driven prices up. As new investors, the only activity these people could participate in was buying - as new participants in the market, they have nothing to sell! On 6 May, the Australian Securities and Investments Commission (ASIC) reported that 140,000 new online trading accounts had been opened between the last week of February and the first week of April. This increased the total number of accounts by a whopping 21%. Of course, this does not mean that there was 21% more money chasing the same number of shares - not all trading accounts have the same amount of capital to trade, and we would expect that new accounts would be relatively small in dollar terms. However, there is no doubt that all these new accounts, which could only impact on the demand side of the sharemarket caused share prices to rise.

Only time will tell whether these new investors have the temperament to hold on to their newly bought shares when prices start to fall. So far, these new investors have not really faced falling prices. In the month of June, for example, prices on the ASX 200 basically went sideways, albeit with substantial volatility within the month. Once again, here is how it looks according to Alphabet and the ASX:

Amongst the sideways movement, one of the most striking things about the performance in the month of June is how large the daily changes in prices were. Of the 20 trading days for the month of June, prices moved by more than 1% on 13 of those days. This tells us that investors were moving *en masse* - they were taking their cue from very similar pieces of information.

Almost certainly, the major piece of information that Australian investors were basing their trading activity on was the day-to-day state of the US market. We hinted at this last month, but have a look at the graph for the June performance of the major US index the S&P 500. Once again, the data is thanks to Alphabet and, in this case, S&P:

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The graphs of the US and Australian markets are eerily similar. Indeed, of the 20 trading days shown for the US market (actually only going to June 29), the market moved by more than 1% on 12 of those days. Prices moved in the same direction on both markets 16 of the 20 trading days. And, like the Australian market, by the end of the month the US market had barely moved.

Clearly, the US market is having a huge impact on the day-to-day changes in prices in the Australian market. The US market has long held substantial influence on the Australian market, but the confluence of movements seen since the Coronavirus became a pandemic is unusual. One of the particularly unusual aspects is that the US market is being disproportionately driven by a relatively few stocks. On June 4, investment education website Investopedia reported that shares in just five companies comprised more than 20% of the S&P 500.

This means that the Australian market is in the following situation: it is being heavily influenced by the US market, which itself is being heavily influenced by the performance of the shares of just 5 companies. These 5 companies are, in order: Microsoft, Apple, Amazon, Alphabet (Google) and Facebook. That's right, they are all tech companies for whom the impact on demand of the Coronavirus has been either positive or neutral.

But the funny thing is, the Australian market has no such company. Our top five companies are CSL, the Commonwealth Bank, BHP, Westpac and NAB. These companies comprise 27.5% of the ASX 200 (source: ASX). (Our next top five companies are ANZ, Wesfarmers, Woolworths, Fortescue Metals and Macquarie Group. These companies comprise 13.42%. Our top 10 companies, therefore, together comprise almost 41% of the ASX 200). Our index is even more dominated by its top five companies than the US Market. But our top five (and, indeed our top 10) is made up of companies that are very different to the dominant companies on the US index. The US top five is all tech stocks. Our top ten comprises five banks, two mining companies, a biotech company, a grocer and a bulky goods provider.

One would think that this should mean that the US and Australian markets do not perform all that much in concert with one another. And one would think that companies such as banks, which perform quite directly in concert with the Australian economy, would not be performing so strongly in an economy like ours, which is in the middle of its first recession for 30 years.

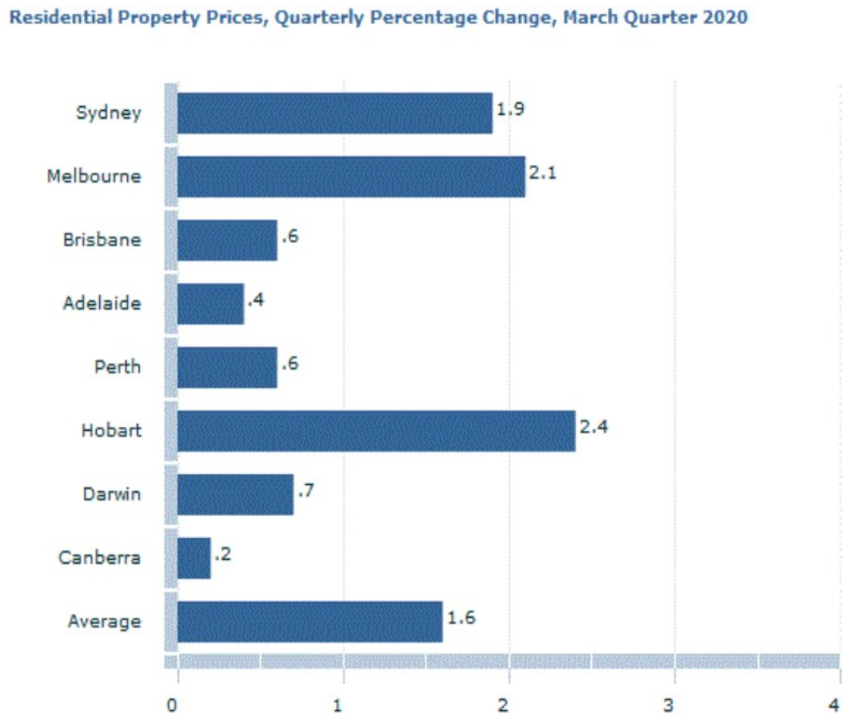
That last point might be a key to all of this. Most of the new investors in the Australian market will have never seen a recession before. This is likely to lead to a very big test for these investors in the coming months and years. At the moment, almost certainly, Australian investors are trading shares in Australian companies based on the performance of relatively few US companies, the like of which do not exist in our market. At some stage we should expect prices in the Australian market to come to better reflect the state of our economy, not the US one.

Experience has told us never to try to predict what the sharemarket is going to do next. But a cynic might suggest that the Australian market, at least in the last quarter of the financial year that has just ended, has been overly influenced by a combination of new money and irrelevant information. Time will tell what the impact of this influence will be.

Residential Property Market

It is the end of the financial year, and most of the property researchers have yet to release their conclusions about the state of the residential property market in the month of June. Most are taking their time to compile, not only the results for June, but also for the financial year that has just ended.

Prior to the arrival of the Coronavirus, residential property was performing very strongly in Australia. The Australian Bureau of Statistics, for example, reported price growth in each of our capital cities during the March quarter:



For the 12 months that ended at the end of March 2020, Melbourne and Brisbane had recorded average price rises of more than 10%. Australia's largest market, Sydney, had risen by 7.4%. So, the Coronavirus arrived at a time when residential property prices were actually steaming ahead.

Undoubtedly, the virus has impacted the market. Research house Corelogic compile a number of reports and other indicators of the state of the market. As we wrote last month, for the month of May Corelogic reported that, across the country, residential property prices fell by 0.4%. The smaller markets of Canberra and Hobart went against this trend, both rising (although both by less than 1%). Prices in all other capitals fell. Perth and Darwin, which have been reporting the weakest growth in property prices for quite some time now, fell by the most.

Corelogic also compile what they call their *Daily Home Value Index*. This index uses a proprietary statistical technique to indicate the state of the residential property market in the mainland capitals (these are the cities for which there is adequate data for the statistical technique). Part of the index appears to be predictive, and so Corelogic have been able to release figures right up to the 30 June 2020. These figures indicate a national fall of 1.22% in residential property prices for the June quarter. Falls ranged from 2.49% in the Melbourne market to an increase of 0.5% in the Adelaide market. Sydney and Brisbane fell by less than 1%, while Perth fell by 1.4%.

Taken together, these two pieces of research from Corelogic suggest that residential property prices fell by small amounts in each of May and June 2020. This is almost certainly correct: to be honest, the big surprise would be if prices hadn't fallen given the ructions in the general economy. One of the factors that appears to be keeping prices high is a relative drop off in supply of houses for sale. Well-known property commentator Michael Yardney, on his website www.propertyupdate.com.au, reported an 18% reduction nationwide in the number of properties listed for sale between June 2019 and June 2020. Interestingly, he then reports that the change has been lowest in Australia's two largest residential property markets (Sydney and Melbourne), and that there appears to have been a flurry of new listings in those two markets during the month of June. In Melbourne, for example, total listings are only 5% down between June 2020 and June 2019.

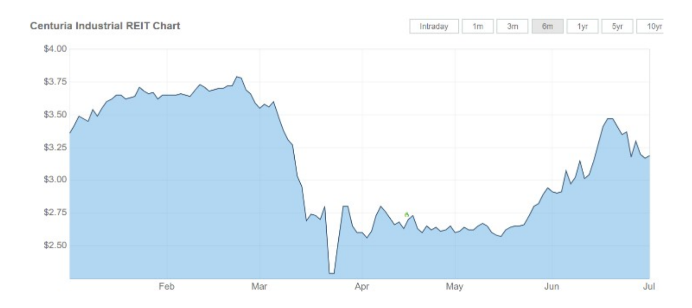
If this trend continues, then we can expect property markets will soon be as well supplied as they were at the same time last year. Only then will we be able to gauge the true impact on the market of any reduction in demand triggered by the Coronavirus. Basically, for now, residential property is a case of 'watch this space.'

Commercial Property Market

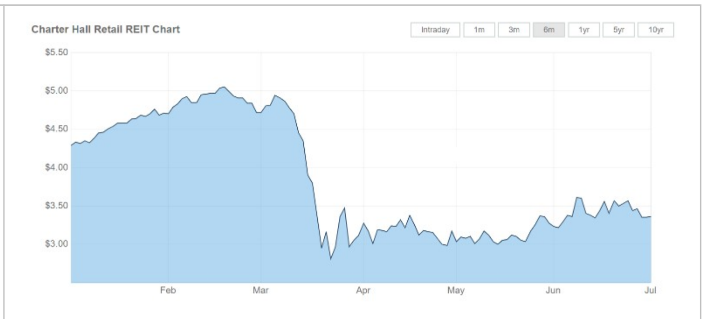
We typically do not comment much on the commercial property market. There are a number of reasons for this, including that the commercial property market is a very varied market about which it is difficult to obtain representative information.

One thing that appears clear, however, is that commercial property that is used for retail purposes has suffered more from the Coronavirus than property used for other purposes, such as industrial property. One way of estimating what is happening in the general market is to look at the sharemarket performance of property trusts that focus on particular types of commercial property. When we do this, we see that the retail sector of our commercial property market has been hard-hit - especially 'shopfront' retail that requires face-to-face trade (online providers have not been as negatively affected).

To see this visually, compare the following two graphs which show the closing market price for two types of property trust that have been chosen at random to represent the class of property on which they focus - the Charter Hall Retail REIT and the Centuria Industrial REIT (REIT stands for Real Estate Investment Trust. The graphs have been sourced from market information provider www.marketindex.com.au):



Centuria Industrial Trust



Charter Hall Retail Trust

The graphs show the market performance for the six months to 30 June 2020. As can be seen, up until late March, prices in both sectors had risen by approximately 10% and were rising in relative correlation with each other. The immediate impact of the Coronavirus was to reduce prices by about 40% for each trust. From mid-May onwards, however, the industrial trust started to recover while the retail trust remained quite flat. By the end of June, the retail trust had fallen 21.9% from its opening price on 1 January. As of the same date, the industrial trust had fallen by just 5.6%.

This differential performance reflects the basic financial situation within these two sectors. Retail has been much harder hit than has the industrial sector. Investors expect the impact of these hits to continue into the future, which is why they are pricing retail property more pessimistically than they are pricing industrial property.

Commercial property tends to be valued on a much more 'mathematical' (that is, non-emotional) basis than residential property. The value of a property is a direct reflection of the rental returns that the property is expected to generate. If we compare the performance of the retail trust to the sharemarket as a whole (the retail trust trades on that market and the prices reflected in the graph are the prices being achieved on the ASX), we see that the market is more pessimistic about retail property than it is about shares in general. The fall of almost 22% reported by the Charter Hall trust far exceeds the fall across the market reported in the previous section on the sharemarket.

What this means is that investors feel that the enduring negative impact of the Coronavirus will be most keenly felt in the retail property sector. Once again, time will tell, but in this case we must agree that the market's conclusion seems perfectly logical. Tenants of retail property outlets are almost universally struggling and this can only have a negative impact on rents paid for those properties. Retail property must be worth less now than it was before the virus arrived.

The Legal Stuff

General Advice Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

We recommend you seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

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