

What signposts can we watch to be confident shares have bottomed?



Antipodean Advisory

April 2020

Introduction

After a roughly 35% plunge from their February high point to their lows around 23rd March, global and Australian shares have had a 15-20% rally.

What's more this rally has occurred despite increasingly bleak economic data ranging from plunges in business conditions surveys or PMIs to a record 10 million surge over two weeks in claims for unemployment payments in the US. Volatility remains very high but at least we are seeing up and down volatility rather than all down as was the case into mid-March.

Markets usually lead and so may have already factored in the worst. And we have seen massive fiscal and monetary stimulus over the last few weeks to match the coronavirus threat to economies. So maybe we have already seen the low for shares, or maybe not.

There is still a lot of bad news ahead regarding the virus and the economic hit and we still don't know how long the shutdown will be for and hence it's hard to gauge the size and duration of the economic hit, when the recovery will come, and what it will be like.

What's more past bear markets have often been interrupted by strong rallies, eg October/November 2008 saw two 19% rallies in US shares followed by the ultimate low in March 2009. This could be the case here even if we have entered into a bottoming process.

So, what should investors look for in terms of when we can expect a bottom, or be at least somewhat confident that the bottom has been reached? The following are what we are looking for:

- confidence the coronavirus can soon be contained;
- measures to minimise collateral damage to the economy;
- confidence collateral damage is being kept to a minimum and signs that growth momentum is bottoming; and,
- technical signs of a market bottom.

Confidence the coronavirus will soon be contained

This is important as it will give guidance as to the duration of the shutdowns and their severity and hence the first round hit to the economy. There are several things to watch:

The severity of suppression measures

After containment policies (quarantining and contact follow up) failed to control the virus (South Korea may be an exception), most countries have moved on to suppression, ie social distancing. This has been made necessary to allow hospital systems to cope without a blow out in deaths as in Italy. The question is; are they being applied rigorously. The evidence suggests that they are. Of 41 major countries, nearly 80% now have severe restrictions in place, including Australia.

Is suppression working?

The best thing to watch for is a turn down in the number of new cases. Italy is a good one to watch as it went into national lockdown around 9 March and if they get it under control it gives other countries hope. And there are some positive signs with a downtrend in new cases evident in Italy, Spain, Germany, the EU generally and Australia. In the US it's too early to tell, but its New York epicentre is showing a decline in new cases.

Based on China's experience; 11-21 days after the lockdown new cases peak, and a month or so after that, the shutdown can begin to be relaxed, which is why Chinese economic indicators began to improve in March.

This would suggest that the lockdown in Italy, and maybe even Australia, may be able to be relaxed later this month or in May if the number of new cases continues to trend down. Of course, if the lockdown is eased too quickly this may risk a second wave of cases (as occurred in relation to the 1918 Spanish flu pandemic).

To guard against this, quarantining of new cases and contact follow up will have to be aggressive and international travel bans would likely have to remain in place to prevent imported new cases (as China has found). There are two things that could short circuit this:

1. Antibody tests

It's likely the actual number of coronavirus cases is being significantly underestimated because those with mild or no symptoms are not showing up for testing, but mass testing for antibodies to Covid-19 would reveal what proportion of the population have already been infected and recovered. It is likely they will no longer be transmitters of the virus and should be able to return to work. Some estimates suggest that it's already 40-60% of the Italian and UK populations. If so, there would already be a degree of "herd immunity" making it easier to safely relax the shutdowns. Such testing may still be several months away though.

2. Antivirals or a vaccine

A vaccine may still be 12 months away but antivirals are being rapidly tested.

The bottom line on this is that there are a lot of balls in the air but the decline in the number of new cases in several countries including Australia indicates that shutdowns are working which in turn holds out the hope that they can be relaxed in a month or so (providing containment measures are rigorous). International travel will likely be the last restriction to be lifted.

Policy measures to support the economy

The past month has seen a massive ramp up in monetary and fiscal measures globally and in Australia to support businesses, jobs and incomes through the shutdown period and to keep financial markets functioning properly.

Collateral damage being kept to a minimum - growth indicators bottoming

There are a range of indicators to track on this front, including:

- *Credit spreads*

Corporate and government bond yield gaps need to narrow. They are off their highs, but above normal.

- *Money market funding costs*

As measured by the gap between three month borrowing rates and expected official rates these have narrowed in Australia but remain high in the US.

- *Default rates up only slightly*

This is important in terms of assessing whether public support and debt/rent payment holidays are working. It's too early to tell in most countries.

- *Daily activity indicators stabilising*

This has been a good indicator in China, but it's too early in developed countries.

- *Business conditions PMIs stabilising/improving*

They've improved in China but are still falling elsewhere.

Technical signs of a market bottom

Market bottoms usually come with a number of signs:

- *Extreme oversold conditions*

This got a tick in March.

- *Apocalyptic investor sentiment*

It's very negative but maybe not apocalyptic yet.

- *Signs of falling downwards momentum*

This may only become apparent on a re-test of the March low.

Signpost table

The following provides a summary. The key ones are in blue.

Signpost	Why	Current status
Control of the virus		
Suppression	Is social distancing stringent?	Yes, in most countries
Curve flattening	Are restrictions slowing new cases?	Yes, in China, Italy, Spain, Australia. Not yet in US or UK
Containment/quarantine	Are new cases being quarantined successfully?	Successful in China and Korea. Insufficient in most countries
Antibody test	Guide to 'herd immunity'	Maybe a few months away
Antivirals/vaccine	Could end the virus threat quickly	Lots of activity but still some way off
Government support for the economy		
Fiscal support	To limit collateral damage and boost the recovery	Positive
Monetary support		Positive
Collateral damaged minimised/signs growth momentum is bottoming		
Credit spreads narrowing	Sign of functioning financial markets	Some narrowing but mixed
Default rates only slightly up	Is public support working?	Too early to tell
Daily activity indicators stabilise	They are timely	Up in China, still falling elsewhere
PMIs stabilise/improve	Sign of economic momentum	Improved in China, falling elsewhere
Market technical signs of a bottom		
Extreme oversold conditions		Yes, in March
Ultra-negative investor sentiment	Bottoms have max bearishness	Yes, but it could get more negative
Less stocks making a new low		Need to see a re-test of the new low though

Concluding comment

Many of these signposts tick off positively so we may have seen the low. But given the uncertainty around the length of the shutdown, risks of a second wave and very poor economic data to come, it's still too early to say that with confidence.

Trying to time market bottoms is always very hard so a good approach for long term investors is to average in over several months.

Further information:

Michael Clapham

133 Alexander Street

Crows Nest NSW 2065

1300 101 250

michael@antipodeanadvisory.com

www.antipodeanadvisory.com

Source: Dr Shane Oliver, Head of Investment Strategy & Chief Economist, AMP Capital. Antipodean Private Pty Ltd (T/A Antipodean Advisory) is a Corporate Authorised Representative (No.1271526) of Capstone Financial Planning Pty Ltd. ABN 24 093 733 969. Australian Financial Services Licence No.223135. Information contained in this document is of a general nature only. It does not constitute financial or taxation advice. The information does not take into account your objectives, needs and circumstances. We recommend that you obtain investment and taxation advice specific to your investment objectives, financial situation and particular needs before making any investment decision or acting on any of the information contained in this document. Subject to law, Capstone Financial Planning nor their directors, employees or authorised representatives gives any representation or warranty as to the reliability, accuracy or completeness of the information; or accepts any responsibility for any person acting, or refraining from acting, on the basis of the information contained in this