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UPDATE

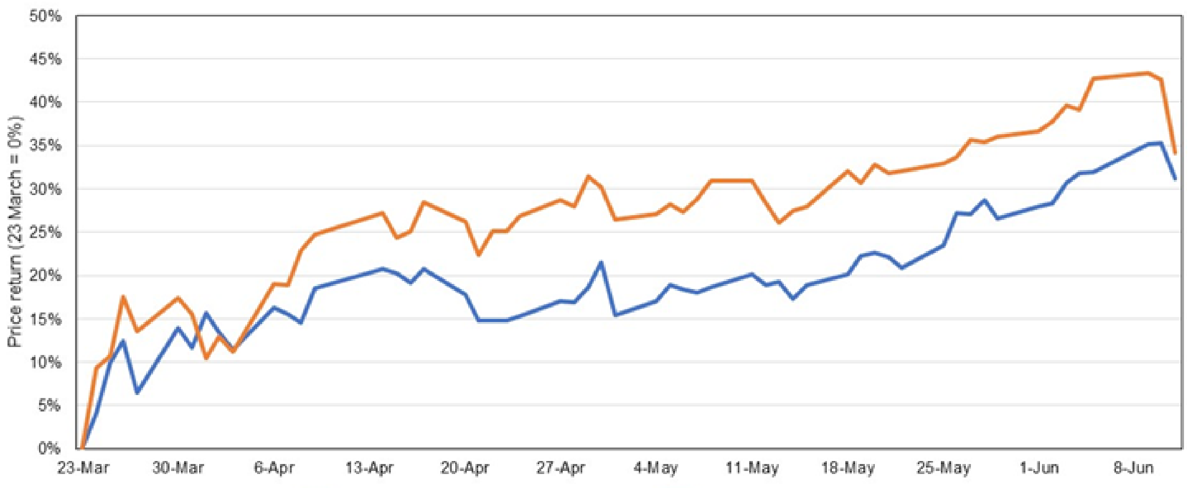
Is the recent sharp share market recovery sustainable or a trap?

June 2020

Many investors are having a difficult time reconciling the share market recovery in the past few weeks, with what they've perceived to be a dire economic situation. The Coronavirus pandemic and the Government shutdowns to contain it have sparked a global recession.

Australian and US share markets dropped over 36% and 33% from their previous highs to the lows on 23 March. However, since then we have seen recoveries of over 30% and 40% for Australian and US shares, see graph below.

Share market returns since they bottomed (23 March to 11 June 2020)



Sources: FactSet, IOOF Research

Why have share markets risen so sharply?

Share markets have responded positively to the actions of Governments and central banks in dealing with the Coronavirus crisis. Unlike the global financial crisis in 2007-2009, authorities have responded much more quickly and in larger monetary amounts than we have seen before on a global scale. That has lowered the risk of more business failures and job losses.

Governments increased their spending to assist economies, particularly by supporting the jobs market. According to the International Monetary Fund this injection is ~$8trn or 10% of global economic production.

The Australian Government's JobKeeper subsidy (a wage subsidy to help businesses keep staff) is one example.

Central banks (including the Reserve Bank of Australia) have also been proactive. We have seen large cuts to interest rates, with the Australian cash rate at a record low of 0.25%. Central banks have been conducting large bond purchasing programs (in the trillions of dollars) to keep long-term borrowing costs low. This also contributes to investors seeking returns elsewhere (including the share market) as term deposit rates and bond yields fall to low levels.

Is the share market recovery sustainable?

Forecasting movements in share markets is difficult at the best of times, as many factors can influence their direction. The coronavirus pandemic adds another layer of complexity making it harder to anticipate how the economy will recover and how businesses will perform in the future.

The current recovery in share prices may continue, particularly as restrictions ease and Government and central bank stimulus continues. These are factors that should contribute to a bounce in activity. However, the longer-term outlook gives us cause for caution.

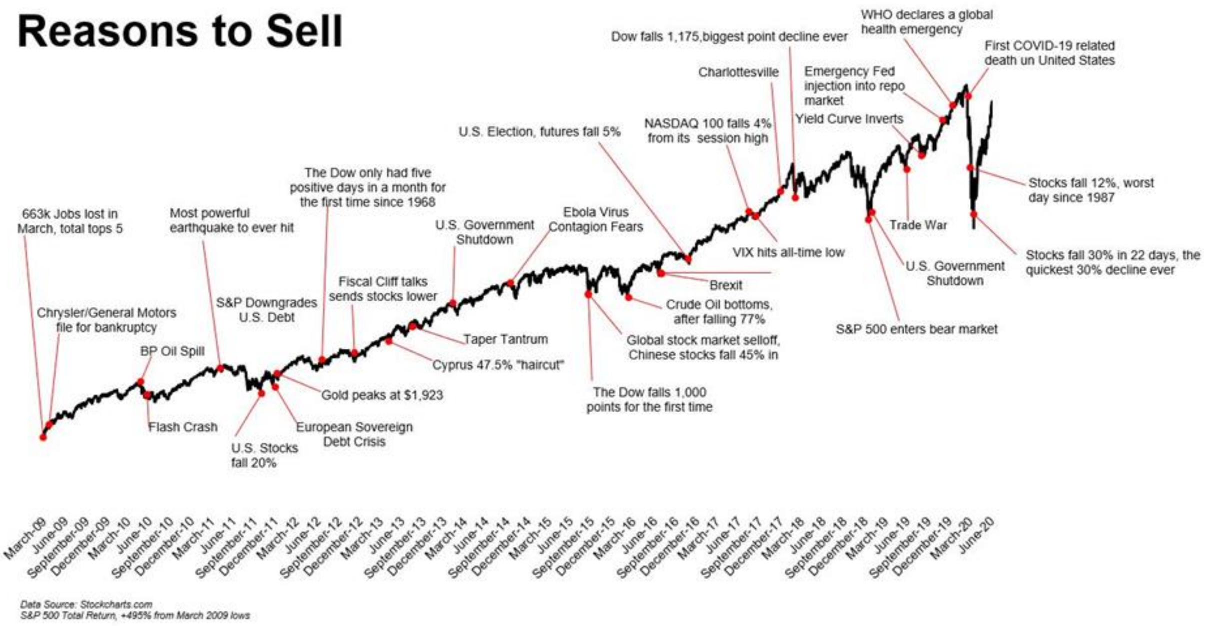
- An easing of restrictions globally raises the risk of new waves of infections as people start moving around and interacting with each other more.
- In some countries like Brazil or parts of the US the Coronavirus outbreak is still not under control, raising the risk of further shutdowns.
- Continuing Government support is likely to be required. The job losses and reduced business as a result of the pandemic will likely require ongoing government spending for some time to cover the gap in the economy until recovery begins. If that spending does not happen it could be another catalyst for share market falls.
- Lastly, there are other factors that may reappear and weaken investor confidence. Tensions between China and other countries (notably the US and Australia) have started to reappear in recent months. Partly this is due to blame over the Coronavirus outbreak and China's reaction to this, and partly due to concerns on tighter control over Hong Kong.

What action should you take?

Share markets have risen strongly, on the expectation of a quick resolution to the crisis. That resolution may or may not eventuate. A successful Coronavirus vaccine could help share markets. On the other hand, tensions with China and whether or not we will see new waves of this pandemic would cause market falls from the current levels.

Longer-term, markets should continue to face challenges, as the reality of impacts on the economy start showing into company earnings results. Markets may see periods of sharp weakness, particularly after the such strong rises we have seen recently.

That said, it is important to consider the long term picture. The chart below highlights the many reasons you might have had to sell out of US equities, as an example, since the global financial crisis. However, note the overall upward direction with a total return of 495% from the lows in March 2009 to early June 2020.



Source: The Irrelevant Investor

Time in the market continues to be key in achieving your longer-term goals as markets can and will climb a "wall of worry". If current events are still playing on your mind we suggest reaching out to our office. It will give you the best opportunity to ensure that your portfolio is positioned appropriately to provide for your future goals and so that you can invest for the long term in line with a level of risk appropriate to you.

Please contact us if you have any questions or would like further information, **1800 012 134** or email **advicedivisionresearch@ioof.com.au.**