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Global Economic & Market Review

Second Quarter 2020

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Summary:

The second quarter of 2020 was slightly less brutal than the first as the initial shock of the coronavirus pandemic abated. However, evidence of a global economic slowdown continued even as global risk markets rebounded due to investor confidence about the post pandemic outlook. While major markets partially recovered from the carnage seen in the first quarter, global economies continued to suffer as stringent lockdown policies arrested economic activity, particularly in the first half of the quarter. Near the middle of the quarter, once economies gradually began to reopen as new cases of coronavirus subsided, there was some pickup in economic activity. However, the data remained relatively weak and not significant enough to set the stage for a robust recovery. As well, a surge in cases at the end of the quarter, notably in the United States, pointed to trouble ahead. In its June 2020 World Economic Outlook, aptly titled "A Crisis Like No Other, An Uncertain Recovery", the International Monetary Fund (IMF) described the pandemic as having a more negative impact on the global economy than previously anticipated and downgraded its estimates for global growth. The IMF now expects the global economy to contract by 4.9% in 2020, down nearly 2 percentage points from its previous estimate of -3.0%.

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United States

U.S. equity markets rebounded sharply in the second quarter, despite negative pandemic related developments and poor economic data. All three major stock indices posted double digit gains, a sharp reversal from the previous quarter when investor uncertainty resulted in swift declines. While the Dow Jones Industrial Average (+17.77%) and S&P 500 Index (+19.95%) were unable to erase all of their Q1 losses, the Nasdaq Composite Index (+30.63%) outperformed hitting an all-time high on June 23 after passing the 10,000 mark for the first time earlier in the month. At the end of June, the tech heavy index was up +12.11% year to date. Investors also rotated towards risk in the bond market, US Treasuries 1-10 years were up only +0.42% for the quarter, while corporate (+9.27%) and high yield (+9.61%) debt recovered. The US Federal Reserve made no further revisions to its benchmark interest rates, but the central bank continued to take extraordinary action to support the US economy amidst the pandemic. At the beginning of the quarter, the Fed announced that it would provide an additional $2.3 trillion in funding to assist households and businesses as well as states and local government. In May, for the first time in history, the Fed also started buying exchange traded funds invested in corporate debt to support credit markets.

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As expected, the pandemic continued to take a toll on the US economy in the second quarter. In particular, the US labor market was hard hit with weekly jobless claims exceeding one million throughout the quarter. The US economy shed over 20 million jobs with the unemployment rate peaking at 14.7% in April before unexpectedly falling to 13.3% in May and to 11.1% in June. The final reading of GDP showed that the US economy shrank by 5.0% in the first quarter as coronavirus related lockdowns shutdown large portions of the country in late March, ending the longest economic expansion in US history. It was the first decline in GDP since 2014 and the worst quarterly contraction in over a decade. Consumer spending which accounts for two-thirds of US GDP fell sharply as consumers remained home in compliance with stay at home orders. Economists suspect that the economy, which grew by 2.1% in the final quarter of 2019 was already in a downturn before the pandemic caused a steep plunge in economic activity. GDP in the second quarter is projected to fall by over 30%. A resurgence of coronavirus cases at the end of June also indicates that the economic decline will continue in the third quarter. The IMF expects that the US economy will shrink by -8.0% this year before rebounding by 4.5% in 2021 down from its previous projections of -5.9% and 4.7%.

Europe

European risk assets also rebounded in the second quarter with investors gaining confidence as lockdown restrictions were relaxed and the European Central Bank (ECB) remained committed to supporting the Eurozone economy. In early June, the ECB announced that it would purchase an additional €600 billion in bonds to further boost the economy as a part of its pandemic emergency purchase program (PEPP). The additional purchases increased the PEPP to €1.35 trillion in total. However, GDP data for the first quarter revealed that the severe lockdown measures taken to prevent the spread of the coronavirus resulted in the sharpest quarterly contraction in history. The Eurozone economy contracted by 3.8% in the first three months of the year compared to the previous quarter. The largest economies including France (-5.8%), Spain (-5.2%) and Italy (-4.7%) recorded even deeper contractions. Meanwhile, the German economy fared much better, shrinking by 2.2%. Finland was the only economy in the bloc that grew, posting a small expansion of 0.1%. The EU is likely to enter a recession, with the ECB projecting that the EU economy will contract by 13% in the second quarter. These projections were supported by various economic releases during Q2/20 which showed the adverse effect of the widespread lockdowns. In particular, German industrial production fell by a record 18% in April from the previous month, with activity in the automotive industry shrinking by a quarter. While the IHS Markit flash composite purchasing managers' index for the Eurozone improved to a level of 47.5 in June from 31.9 in May and a dismal 11.7 in April, the index remained under the 50 mark which indicates economic contraction. Additional estimates by the central bank show the EU economy contracting by 8.7% in 2020 before rebounding by 5.2% in 2021. The DJ Euro Stoxx 50 Index was up +16.05% in the second quarter, recouping more than half of its Q1 losses.

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Brexit issues remained under the radar in the second quarter as the UK continued to grapple with fallout from the coronavirus. The UK economy contracted by a record 20.4% for the month of April, as pandemic related lockdowns resulted in a closure of the majority of the economy. It was the largest contraction since monthly records began in 1997. The sharp decline came as economic activity came to a near standstill, resulting in significant job losses. Revised data from the Office of National Statistics showed that the UK economy shrank by 2.2% in the first quarter, down from the initial estimate of a 2.0% contraction. While the economy is expected to rebound as businesses reopen, the OECD expects that the country will experience the steepest decline amongst developed nations and forecasts that the economy will contract by -11.5% this year. The FTSE 100 Index rose +8.78% in the second quarter, lagging other developed market indices in the US and Europe.

Asia Pacific

Similar to other regions, Asian markets experienced gains over the quarter as countries began to ease restrictions. By April, most of China's economy had re-opened. The Shanghai Composite Index increased by +8.52% for the quarter for a year to date return of -2.15%. On the economic front, China's GDP contracted by 6.8% in Q1/20, representing the first contraction since China began reporting quarterly GDP data in 1992. Economists forecast that China will lead the world's recovery due to the country's earlier shutdown and re-opening. However, the country may face headwinds due to weak internal and external demand. The IMF projects that the country will be one of the few with positive growth for 2020 with the Chinese economy expanding by an estimated 1.0%. Meanwhile, neighboring Hong Kong, suffered its worst quarterly decline in the three months to March 31 since records began in 1974, with GDP plunging -8.9% from a year earlier. The semi-autonomous territory never implemented a full lockdown, however near-universal mask wearing, contact tracing and quarantines helped minimize coronavirus cases.

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Elsewhere in Asia, Japan entered a technical recession for the first time since 2015. The world's third biggest economy shrank at an annual pace of -3.4% in Q1/20 following a -6.4% decline in GDP in Q4/19. The country's growth is largely dependent on trade and tourism which have both been severely impacted by the spread of COVID-19. Japan's exports fell at the fastest pace since the Global Financial Crisis due to weak global appetite for cars and car parts. Exports fell -28.3% for the year to May. In June, the Bank of Japan announced an increase in stimulus via market operations and lending facilities from 75 trillion yen (US$700 billion) to 110 trillion yen (US$1 trillion). The IMF projects that the country's economy will shrink by 5.8% in 2020 and grow by 2.4% in 2021. The Nikkei 225 led the gains in the region, jumping +17.82% for the quarter. Year to date the Index is down -5.78%.

Emerging Markets

A number of emerging market economies experienced increases in COVID-19 cases over the quarter. Brazil struggled to control the spread of COVID-19 infections, reporting over 1 million cases and more than 50,000 deaths by the end of June, second only to the United States. Latin America's largest economy saw a contraction of -1.5% in the Q1/20 from the previous quarter and is likely to enter a recession in the second quarter due to a drop in activity. Mexico was also hard hit by the fallout from the pandemic, hurt by the sharp drop in oil prices, lower demand for its exports, a drop in tourism and lower remittances from Mexicans working in the U.S. due to high unemployment. The country's GDP shrank 1.2% from the previous quarter after experiencing a full year contraction of -0.3% in 2019. Elsewhere, Argentina's woes continued when the country defaulted on its sovereign debt for the ninth time in its history. In May, the country was unable to make a US$500 million interest payment after President Alberto Fernández failed to reach a deal with bondholders to restructure about $65 billion in foreign debt. The pandemic added to the country's existing struggles: the world's highest inflation rate, rising levels of poverty, and a two year recession. Meanwhile, India surpassed China in number of cases over the quarter even as the government implemented a strict two month national lockdown to curb the spread of the virus. This lockdown severely impacted domestic economic activity, which led the Reserve Bank of India to slash rates by 0.4 percentage points to an all-time low of 4.0%. The central bank also revealed an economic package totaling 6 trillion rupees or US$79 billion primarily directed towards lending programs for small and medium sized businesses. India saw growth of +3.1% in Q1/20 which was the slowest pace in nearly 8 years. GDP is expected to decline by double digits in the second quarter.

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Emerging market equities rebounded during the quarter as the MSCI Emerging Market Index gained +17.27%, underperforming the MSCI World Index by 1.57 percentage points. Growth prospects contradict these numbers as the IMF projects that all emerging market regions excluding China will experience negative growth, for a collective contraction of -3.0%. As most emerging market countries entered the crisis with limited room for fiscal and monetary stimulus, it is likely that these countries will experience more severe downturns due to the pandemic. Large declines in GDP are expected in Mexico (-10.5%), Brazil (-9.1%), and South Africa (-8.0%). Oil exporters like Russia, Saudi Arabia and Nigeria are also expected to experience recessions due to the large declines in oil prices. Like developed countries, emerging markets are expected to rebound in 2021 by 5.9% largely due to a spike in growth in China of 8.2%.

Commodities

In the commodities market, gold (+12.92%) and silver (+30.29%) both posted strong quarters as investors continued to seek some safety and diversification in their portfolios. Rising geopolitical tensions, increased government spending and uncertainty surrounding the economic recovery all drove investors to remain cautious despite the strong bounce back in equity and bond markets. As governments and central banks continue efforts to stimulate the economy, both metals are poised to extend their performance during the second half of the year. Meanwhile, oil prices saw violent swings during the quarter even after OPEC and their allies including Russia and Mexico reached an agreement in early April to cut oil production by a 9.7 million barrels per day in May and June, the largest cut ever. The action was taken in an effort to offset the sharp collapse in global demand as economies shutdown due to the pandemic. However, later in the month, the price of WTI crude oil (the U.S. benchmark) May futures contracts plummeted into negative territory for the first time in history. These negative prices were short-lived as some countries slowly reopened leading to a pickup in demand and causing prices to rebound to around $40 by the end of the quarter. Nevertheless, oil prices at these levels are unattractive to oil producing nations as well as oil companies and supply will likely remain low in

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an effort to drive prices higher. WTI crude surged +31.82% for the quarter, but remained down -32.65% year to date.

Conclusion

The global economy remains in unchartered territory. The uncertainty surrounding the coronavirus will continue to make it difficult to predict the economic effects of the pandemic in both the short and long term and even harder to prepare an appropriate response. For the most part, central banks and governments appear to remain committed to minimizing the negative effects of the virus on their economies. However, these efforts are widely funded by increased government borrowing which has led to a sharp rise in debt levels that could result in a separate economic crisis. It is also possible that central banks may run out of suitable tools to support their economies on a prolonged basis. As well, due to the unprecedented nature of this crisis, it will be difficult for governments to navigate how best to reopen their economies as any missteps could result in a dreaded second wave of coronavirus cases. The second half of the year is likely to bring more of the same as the global economy will continue to suffer from the pandemic and global risk markets will remain volatile.

Market Returns Q2-2020

	As at 30 June 2020			
	MTD	QTD	YTD	1 year
Equity Indices *(% local currency)*				
S & P 500	1.84	19.95	-4.04	5.39
Dow Jones Industrial Average	1.69	17.77	-9.55	-2.96
NASDAQ	5.99	30.63	12.11	25.64
S & P TSX	2.12	15.97	-9.07	-5.29
FTSE 100	1.53	8.78	-18.20	-16.91
DJ Euro Stoxx 50	6.03	16.05	-13.65	-6.90
Shanghai SE Composite	4.64	8.52	-2.15	0.19
Nikkei 225	1.88	17.82	-5.78	4.76
Ibovespa Brasil	8.76	30.18	-17.80	-5.85
MSCI Emerging Markets	6.96	17.27	-10.73	-5.67
MSCI World	2.51	18.84	-6.64	1.08
ICE BofA Bond Indices *(% local currency)*				
US Treasuries 0-3 months	0.01	0.02	0.48	1.47
US Treasuries 3-5 years	0.14	0.53	5.92	7.12
US Treasuries 1-10 years	0.09	0.42	5.70	6.96
US Corporates	2.03	9.27	4.84	9.32
US High Yield	0.99	9.61	-4.78	-1.06
UK Gilts 1-10 yrs	0.11	0.97	3.07	3.55
Canada Government 1-10 yrs	0.11	0.96	5.31	5.07
Euro Government	0.99	1.74	1.94	2.73
Global High Yield & Emerging Markets	2.39	12.03	-5.23	-2.43
Global Broad Market Index	0.87	3.20	3.49	4.65
Currencies vs. USD				
British Pound	0.47	-0.15	-6.46	-2.32
Euro	1.20	1.84	0.19	-1.22
Canadian Dollar	-1.48	-3.46	4.51	3.67
Japanese Yen	0.09	0.36	-0.63	0.07
Australian Dollar	3.54	12.59	-1.68	-1.67
Swiss Franc	-1.49	-1.44	-2.00	-2.97
Commodities *(% USD)*				
Gold	2.93	12.92	17.38	26.35
Silver	1.91	30.29	1.99	18.88
Copper	11.92	21.94	-3.24	-0.80
WTI Crude Oil	9.57	31.82	-32.65	-29.57
Alternatives *(% USD)*				
HFRX Global Hedge Fund	1.75	6.19	-1.09	3.09