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Global Economic & Market Review

Third Quarter 2020

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Summary:

In the third quarter, the global economy rebounded, but the pace of growth remained far below pre-pandemic levels. Early in the quarter, newly released second quarter GDP data confirmed that the global economy contracted at an exceptional rate due to week-long lockdowns and the closure of businesses. In the third quarter, the data improved as some countries continued to relax measures which led to an immediate boost in economic activity. Unprecedented policy actions by central banks also helped to support the recovery as companies and individuals received varying degrees of stimulus. Global equity markets continued to perform well, however, investor fears about a resurgence in the spread of the coronavirus resulted in a sharp market sell-off in September. This trend will likely continue in the fourth quarter as many countries around the world move into the winter season when it is expected that COVID-19 cases will escalate. Notably, the IMF improved its forecast for global growth this year, on the basis that economic developments in the second and third quarter were much better than expected. The IMF now expects the world economy to shrink by -4.4% this year compared to the -4.9% estimated in June.

CFAL Global Economic & Market Review Q3-2020

United States

US equity markets ended the third quarter higher, however gains were modest relative to those seen in the previous quarter. A market sell-off in September drove stocks lower as investors took gains and shed risk amidst uncertainty related to the virus and the presidential election in November. All three major indices, namely the Dow Jones Industrial Average (+7.63%), S&P 500 Index (+8.47%) and the Nasdaq Composite Index (+11.02%) ended the quarter with positive returns. However, the DJIA remained the only one out of the three still in negative territory for the year, down -2.65%. In the bond market, US Treasuries 1-10 years posted a slight gain of +0.19% for the quarter. As with the previous quarter, USD corporate (+1.69%) and high yield (+4.71%) issues posted positive returns but like equities, the gains were muted compared to those seen in the second quarter. The US Federal Reserve continued to support the economy and by extension securities markets throughout the quarter. The Fed made no changes to its benchmark interest rate which remained at a target range of 0% - 0.25%. In mid-September, the central bank forecasted that rates would remain near zero at least through 2023. The Fed specified that it would not tighten its monetary policy until the job market reached full employment and the inflation rate was higher than 2% "for some time".

The US economy continued to recover during the third quarter, although major economic indicators remained well below their pre-pandemic levels and showed signs of faltering towards the end of the quarter. In particular, the unemployment rate fell to 7.9% in September, however, the reported monthly job gains of 661,000 indicated a slowdown when compared to the average monthly gains of 1.6m in the preceding two months. So far, the economy has recovered about 50% of the total jobs lost during the early months of the pandemic. As expected, US economic growth plunged by an annual rate of 31.4% in the second quarter as economic activity was significantly hampered by pandemic related shutdowns. The decline in GDP was three times larger than the previous record highest quarterly contraction which occurred in the first quarter of 1958. The economy is expected to have substantially rebounded in the third quarter, with some estimates showing growth of nearly 30% as a result of the reopening of businesses, persons returning to the workforce and increases in consumer spending. Growth in the fourth quarter is likely to slow down significantly, as a resurgence of cases in the fall months could threaten economic activity. The IMF now expects that the US economy will shrink by -4.3% in 2020, an improvement from its previous forecast of -8.0%. 2021 growth is forecasted at 3.1%, down from the previous projection of 4.5%.

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Europe

After rebounding during the second quarter, European stock markets fell further behind their US counterparts as COVID-19 infections continued to rise across the region. The DJ Euro Stoxx 50 lost -1.25% during the third quarter, reversing a portion of the double digit gains it seen in Q2. As predicted, the economy reported a double-digit contraction in the three months ending in June. GDP for the euro area fell by an historic 11.8% in the second quarter, the largest quarterly drop ever for the bloc. Amongst the member states, Spain (-18.5%), which was severely hit by the virus early on, recorded the largest drop in GDP while France (-13.8%), Italy (-12.8%) and Germany (-9.7%) also saw sharp declines. In late July, European Union leaders agreed on a €750 billion coronavirus stimulus package to assist member states whose economies had been weakened by the pandemic. The agreement came after a five-day summit, the second longest in the bloc's history. The package called for significant borrowing in the capital markets by the European Commission with EU countries selling large amounts of bonds collectively rather than individually. Over half the funding (€390 billion) was earmarked to be allotted as grants, while the remaining €360 billion was to be distributed as loans to member states. While the Eurozone economy did show signs of improvement at the beginning of the third quarter, a slowdown was evident by the end of the quarter as some countries including France, struggled to contain new outbreaks of the virus. At its September policy meeting, the European Central Bank decided to keep its policy rates and its €1.35 trillion-dollar emergency bond buying program unchanged. The central bank also updated its 2020 economic growth forecast for EU to -8.0%, an improvement from the -8.7% contraction forecasted in June.

The UK economy was especially hard hit by the coronavirus pandemic in Q2, but the easing of lockdown measures at the beginning of the summer led to a surge in consumer spending which bolstered economic activity in the third quarter. Economic data for July and August indicated that while growth remained well below pre-pandemic levels, the economy was on track to report a strong third quarter in contrast to the record breaking contraction of -14.5% seen in the second quarter. However, by late September, an uptick in cases led UK Prime Minister Boris Johnson to signal a harsh winter ahead when he announced that measures to control the coronavirus, including the shutdown of pubs and restaurants, could be in place for six months. Many Brexit related issues still remained unresolved and tensions escalated after the UK government unveiled draft legislation that could undermine key elements of the Brexit Withdrawal Agreement. The legislation was intended to govern trade between England, Wales, Scotland and Northern Ireland after Brexit. However, some portions of the bill were seen to nullify agreements with the EU in relation to Northern Ireland. Amidst investor fears of increasing coronavirus cases and a disorderly Brexit, the FTSE 100 index continued to underperform other developed stock markets. The index was down -4.92% in Q3, extending its year to date losses to -22.23%.

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Asia Pacific

Asian equities trended upward during quarter in part due to China's continued success in reducing the spread of COVID-19. The Shanghai Composite Index increased by +7.82% for the quarter for a year to date return of +5.51%. On the economic front, China's GDP grew by 3.2% in Q2, rebounding from the previous quarter's contraction of -6.8%. The IMF still projects that China will be the only major economy with positive growth in 2020 of 1.9%. The country's manufacturing sector showed signs of recovery and trade activity grew in June for the first time since the COVID-19 outbreak. In addition, the country maintained a relatively low unemployment rate when compared to other major economies, standing at 5.6% as of August. Despite signals of an economic recovery, external risks still exist for China, as global growth remains challenged and a prolonged recession in the US and China's other top trading partners could hamper the country's growth. US-China trade tensions continued in Q3, as new restrictions were placed on Chinese telecom company, Huawei. In addition, US President Trump signed an executive order preventing US companies from doing business with Chinese social media companies TikTok and WeChat, citing national security concerns.

"Despite signals of an economic recovery, external risks still exist for China as global growth remains challenged"

In Japan, the resignation of Shinzo Abe, Japan's longest-serving prime minister, was major news during the quarter. The leader resigned due to worsening health conditions and was succeeded by Chief Cabinet Secretary, Yoshihide Suga. Japanese shares posted gains of +4.02% for the quarter, however, year to date the performance of the Nikkei 225 remained negative at -1.99%. After officially entering a recession in the first quarter, the world's third largest economy experienced its third consecutive quarter of decline, contracting by -7.8% in Q2, as exports fell by -18.5% compared to the previous quarter. This represented the largest decline in GDP since 1980, and a sharper decline than Q1/09 after the Global Financial Crisis. Unlike other major economies whose economic contractions followed the onset of the pandemic, Japan entered 2020 with a shrinking economy due to the increase in sales tax in October 2019. Elsewhere in Asia, South Korea entered a recession in the second quarter as GDP fell -3.2% from the previous quarter. Similar to Japan, the export-reliant economy has experienced weak trade activity due to the pandemic. Exports saw a sharp decline of -16.1% in Q2 from the previous quarter, with the majority of the drop seen in cars and petrochemicals.

Emerging Markets

The COVID-19 pandemic continued to take a toll on emerging markets due limited health infrastructure and limited fiscal space for stimulus efforts. Over the quarter, many emerging markets experienced large increases in cases leading the IMF to revise its 2020 emerging markets ex-China growth forecast downward from -5.0% to -5.7%. Growth is expected to rebound by 6.0% in 2021. Latin America was one of the hardest hit regions with Chile, Peru, Brazil and Colombia reporting more than 10,000 cases per one million people. At the end of September, Brazil reported over 140,000 COVID-19 deaths, second only to the United States. The pandemic pushed the country into a recession in the second quarter, when economic growth fell by -9.7%. In order to support the economy, Brazil's government maintained the largest stimulus package in the region, costing about $38 billion to August. Elsewhere in Latin America, Mexico's GDP contracted by -18.9% in the second quarter as shutdowns brought many factories and services to a standstill. This decline represented the fifth consecutive quarterly contraction, and the country is on track for the deepest recession since the Great Depression. A major driver of the decline was a downturn in the country's tourism industry which makes up more than 15.0% of GDP. Tourism arrivals fell 87.0% in June as major tourism destinations like Los Cabos and Cancun experienced little to no economic activity. The IMF projects that Mexico's GDP will decline by -9.0% in 2020.

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Meanwhile, India also experienced a sharp drop in second quarter GDP after the country implemented one of the world's strictest lockdowns in March. The economy shrank by -23.9% in Q2, the worst decline since the country started reporting quarterly data in 1996. COVID-19 cases spiked after the easing of lockdowns and in September, India surpassed Brazil to record the second largest number of cases. India's 2020 GDP forecast experienced a large downward revision by the IMF from -4.5% to -10.3%. In South Africa, coronavirus cases remained elevated, with the country reporting the seventh highest number of cases worldwide in September. The country's GDP plummeted -17.6% in the second quarter and unemployment was reported as 23.3%. As a result, the government resorted to borrowing $4.3 billion in emergency funding from the IMF to assist with the payment of unemployment and other benefits. Due to an already shrinking GDP and strained finances prior to the pandemic, it is expected that the country, like others, will have a long road to recovery post-COVID-19. Despite these challenges, emerging market equities experienced another positive quarter as the MSCI Emerging Market Index gained +8.73%, outperforming the MSCI World Index by 1.2 percentage points. However, year to date, the MSCI Emerging Market Index is down -2.93%.

Commodities

In the commodities market, gold (+5.89%) and silver (+27.62%) both extended their 2020 gains as investors continued to use the metals as a hedge against equity market movements. With geopolitical tensions remaining high and ongoing uncertainties surrounding the economy as COVID-19 cases rose globally, investors remained cautious in their portfolios despite a continued rise in equity markets. Silver increasingly outperformed Gold as usage of the industrial metal grew. As governments and central banks carry on with efforts to stimulate the economy, both metals are poised to extend their performance during the final quarter of the year. In contrast, after a volatile first half of the year, oil was flat during the quarter, as the mismatch between supply and demand persisted. Despite the unattractiveness of current prices for oil producing nations and agreed supply cuts, countries maintained production levels as opposed to further cuts in an attempt to protect their market share. Efforts by oil producing cartel OPEC did not yet bear fruit, as oil prices remained stuck around the $40 per barrel level during the quarter. Prices are likely to remain around these levels until global economic activity returns to near pre-pandemic levels. US WTI crude prices gained +1.62% during the third quarter but were down -29.25% year to date.

"With geopolitical tensions remaining high and ongoing uncertainties surrounding the economy as COVID-19 cases rose globally, investors remained cautious in their portfolios despite a continued rise in equity markets."

Conclusion

Prior to the pandemic, developed and emerging market economies were experiencing positive economic growth, low unemployment levels, reductions in poverty rates and a subsequent rise in the number of persons in the middle-class. However, the pandemic caused major setbacks in this progress and the challenges are expected to continue. While there is strong evidence that the global economy rebounded in the third quarter, by the end of the quarter, it was evident that governments and investors alike were preparing themselves for the possibility of a bleak reality in the final three months of the year and perhaps into 2021. It is certain that stimulus measures by governments worldwide will have to continue into the foreseeable future in order to keep the global economy afloat. However, it remains to be seen if most governments can sustain these measures for the time necessary to get their economies back on solid footing. For the time being, the global economy remains in unfamiliar territory.

Market Returns Q3-2020

	As at 30 September 2020			
	MTD	QTD	YTD	1 year
Equity Indices *(% local currency)*				
S & P 500	-3.92	8.47	4.09	12.98
Dow Jones Industrial Average	-2.28	7.63	-2.65	3.21
NASDAQ	-5.16	11.02	24.46	39.61
S & P TSX	-2.38	3.91	-5.52	-3.23
FTSE 100	-1.63	-4.92	-22.23	-20.82
DJ Euro Stoxx 50	-2.41	-1.25	-14.73	-10.53
Shanghai SE Composite	-5.23	7.82	5.51	10.77
Nikkei 225	0.20	4.02	-1.99	6.57
Ibovespa Brasil	-4.80	-0.48	-18.20	-9.68
MSCI Emerging Markets	-1.77	8.73	-2.93	8.09
MSCI World	-3.59	7.52	0.37	8.59
ICE BofA Bond Indices *(% local currency)*				
US Treasuries 0-3 months	0.01	0.03	0.52	0.96
US Treasuries 3-5 years	0.02	0.16	6.09	6.20
US Treasuries 1-10 years	0.07	0.19	5.90	5.92
US Corporates	-0.26	1.69	6.61	7.84
US High Yield	-1.04	4.71	-0.30	2.30
UK Gilts 1-10 yrs	0.26	-0.08	2.99	1.68
Canada Government 1-10 yrs	0.22	0.13	5.45	4.84
Euro Government	1.42	1.70	3.68	0.67
Global High Yield & Emerging Markets	-1.66	4.62	-0.85	2.56
Global Broad Market Index	-0.32	2.53	6.10	6.34
Currencies vs. USD				
British Pound	-3.37	4.19	-2.54	5.13
Euro	-1.80	4.34	4.53	7.54
Canadian Dollar	2.08	-1.89	2.53	0.59
Japanese Yen	-0.41	-2.27	-2.88	-2.41
Australian Dollar	-2.90	3.75	2.01	6.10
Swiss Franc	1.90	-2.79	-4.73	-7.70
Commodities *(% USD)*				
Gold	-4.17	5.89	24.29	28.07
Silver	-17.44	27.62	30.15	36.71
Copper	-0.95	10.57	7.33	15.66
WTI Crude Oil	-6.25	1.62	-29.25	-20.56
Alternatives *(% USD)*				
HFRX Global Hedge Fund	-0.17	2.74	1.62	4.23