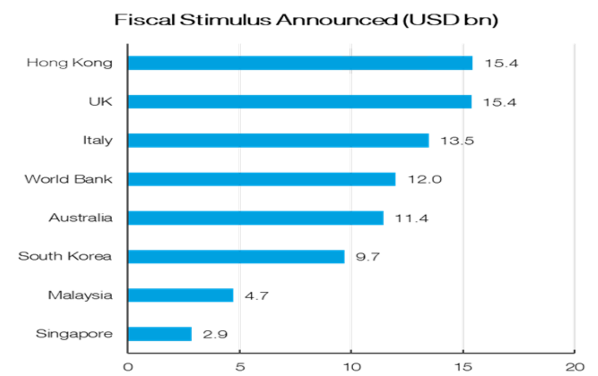
Research
Macquarie Wealth Management

Quick Comment

Our "markers" for a sustainable equity bottom

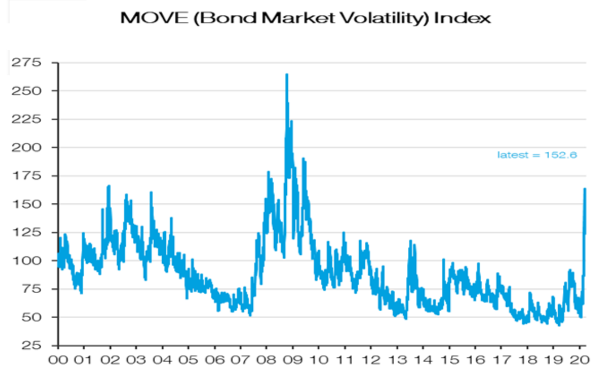
There is one way to change disappointment into delight. Give the market what they want and that's an ambitious, appropriately sized, and coordinated policy response. If history has taught us anything, it's that you (generally) don't bet against central banks (and/or governments). But, during crisis periods, while they might not get it right the first time, eventually they probably will. For instance, during the GFC, the Fed worked with US Treasury and the Government on a host of programs including cutting the fed funds rate to 0%, implementing TAF and TARP, opening swap lines, nationalising Fannie Mae and Freddie Mac, guaranteeing money market shares, injecting money directly into financial institutions as well as implementing 2 stimulus plans - the Economic Stimulus Act and the American Recovery and Reinvestment Act. *This all took time, and at the start, it was not enough, but by the end, it proved enough.*

Governments are now rushing to boost fiscal stimulus



Source: FactSet, Bloomberg, MPW March 2020

But…bond market volatility has spiked and remains high

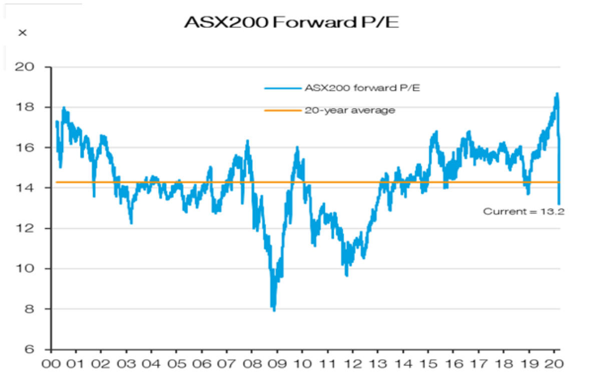


Source: FactSet, Bloomberg, MPW March 2020

We believe policy makers have the desire and the tools to act as a circuit breaker. If this is the case, then *it's just a matter of time before they strike the right chord,* even if the first attempts have been underwhelming and disappointing for markets. After last night's strong intraday rally, there is an emerging debate as to whether the bottom has been seen in equity markets and whether we should be buying the market. We are *not focused on trying to time a bottom, but rather to assess whether downside risks have reduced enough,* so that should markets fall further, it will be limited and if weakness persists, it will be short term. From the start, we have said that markets will not bottom until we see a combination of factors. This includes monetary policy, fiscal policy and a transparent and appropriate healthcare response. Just one month ago, the narrative was that markets would bottom when infection rates peaked. This was the case in China, but infection rates have not peaked outside of China so if markets have bottomed, then they are doing so because they believe policy response is sufficient.

This response is understandable, but if infection rates were to skyrocket (because testing increases), or if infection rates were to start spreading deeper into the most highly populous countries, then we are not so sure that markets would look through this. Similarly, the potential for policy disappointment has not gone away even if it is now moving in the right direction, and if past crisis periods have taught us anything, it is that it does take time for the appropriate scope of policy to emerge. We believe that by year end, we will be looking at the back of the coronavirus, and so for long term investors who can stomach ongoing volatility, there are now a lot of stocks which have been heavily discounted *(we will have a full list of stock recommendations to hedge against further volatility/downside and to play the upside on Monday)*, but we are wary about jumping at the first large intra market reversal.

Australian valuations are now entering "cheap" territory



Source: FactSet, MPW March 2020

Australian equity market intra-day reversal was significant

Name	Opening Bell	Move to Low	Rally From Low	Ended the Day
Energy	-0.3%	-9.8%	20.4%	8.3%
Health	-0.1%	-7.2%	19.3%	10.6%
Gold	-0.2%	-15.0%	17.6%	-2.6%
Discretionary	-1.5%	-7.2%	16.2%	6.2%
Financials	-1.4%	-9.1%	15.7%	3.7%
Industrials	-0.7%	-9.7%	13.7%	1.9%
ASX 200	**-1.2%**	**-7.0%**	**13.7%**	**4.4%**
Telecom	-0.8%	-6.0%	13.4%	5.8%
Staples	-0.7%	-5.3%	13.0%	6.3%
Materials	-2.5%	-6.1%	12.1%	2.6%
Technology	-2.6%	-4.9%	11.8%	3.5%
REITs	-0.1%	-9.2%	10.2%	-0.9%
Utilities	-2.6%	-5.4%	7.9%	-0.6%

Source: Factset, MPW March 2020

Lastly, let us not forget that economies are still in the process of shutting down. Activity will drop precipitously in the months to come (no one knows with confidence, what the business response will be) and corporate earnings expectations are a long way behind the curve. For the most part, this could all be in the price, but not all the markers are in place to confidently say we are through the period of high volatility. On this basis, we look towards the following list to be satisfied in order to confidently say we have put in a sustainable bottom. It is not a necessary condition that corporate earnings begin to factor in a growth hit and nor is every condition listed below required. But, we will not be guided by price action alone and nor are we swayed by a single intra-day rally where technical factors were also at play. We are looking for the start of the next major upswing, and we think we are still in the bottoming process even though it’s becoming far less bad.

Markers for a Sustainable Equity Market Bottom	Satisfied
Cyclicals are no longer the loss leader (Energy stocks also bottom);	**Partially**
Equity and bond market volatility stabilizes at a lower level;	No
Capitulation selling within and outside of equities (immune assets are also repriced lower);	**Yes**
Equity valuations back to fair value (around long term average);	**Yes**
Sustained stabilization in credit markets (areas of weakness must stabilize such as Energy);	No
Concerted global policy action – both fiscal and monetary;	**Partially**
Bond (bunds) begin to sell-off and stabilize at higher levels, yield curves begin to steepen;	**Partially**
Funding market stress/volatility normalizes;	**Partially**
Commodity prices begin to recover / gold begins to weaken	**Partially**
Infection rates stabilize / decline	No

Jason and the Investment Strategy Team

The report was finalised on 16 March 2020

Recommendation definitions (Macquarie Australia/New Zealand)

Outperform – return >3% in excess of benchmark return

Neutral – return within 3% of benchmark return

Underperform – return >3% below benchmark return

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