

***In summary***

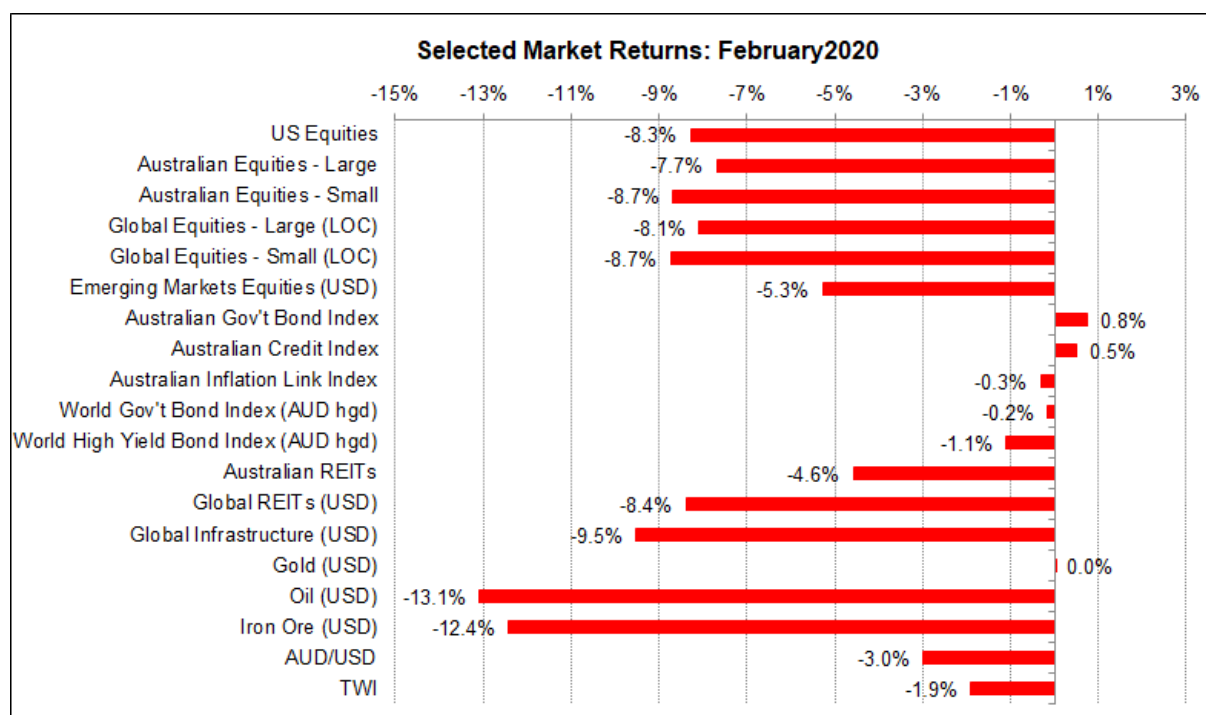
The first three weeks of February saw further good performance by global equity markets. The news from China about Covid-19 seemed to be getting better and the latest economic data was still quite positive. This changed quickly from 21 February, when markets became alarmed by reports of the virus spreading to several countries around the world, including Italy, Iran, South Korea and the US.

These developments reignited fears of global recession seen last year, and equity markets fell sharply, as did the price of oil and the A\$, which ended the month at US0.652. Bonds rallied as equities fell. The US 10-year government bond yield dropped to a new record low around 1.15%, and the Australian equivalent yield falling to 0.84%. Gold initially rallied, but then gave up all its gains at the very end of the month as traders took profits in order to pay margin calls on other assets.

The big question is where to from here with these developments? We are moving into a phase where we will get more information about both Covid-19 and its impact on the global economy. There is a risk that the news gets worse before it gets better, but it will get better, though no-one knows exactly when.

In the meantime, central banks are in wait and see mode. And, for now, the authorities in China are sticking with their policies of support rather than stimulus, for fear of reigniting the problems in their financial system they have been striving to fix.

**Chart 1: Spread of Covid-19 outside China hit global equity markets very hard**



Sources: Thomson Reuters, Bloomberg

***Key developments in February***

The big developments in February involved Covid-19. For most of the month financial markets largely took the virus in their stride. Infections were almost exclusively in China and official reports suggested the authorities were getting on top of things. Also, the economic data available at the time was yet to show the impact of the virus on key economic activity. Earnings reports from firms in both the US and Australia were close enough to expectations for the markets to be comfortable with the news. However,

Apple waived a red flag when it said it would temporarily close 42 stores in China and later issued sales warning based on the impact of the virus on the supply of its products.

Certainly, there was already some less positive news, including Japan where 2019 Q4 GDP came in much weaker than expected, raising fears the country may be more vulnerable to recession than previously thought. Here in Australia, the January Labour Force report showed both the unemployment and underemployment rates rising by 0.2% - 0.3% in January. Leading indicators continue to suggest the unemployment rate will edge up in coming months. Measures of local business confidence and conditions remained at subdued levels in January, as did measures of consumer confidence.

Overall, equity markets performed well in the first three weeks of February. The S&P 500 was up about 3.36% and the ASX200 was up 2%. In commodity markets, gold was up 3.5%, as was the price of oil, which had been hit quite sharply by Covid-19. The mood in the markets at this point was that Covid-19 would cut China's growth in Q1 but that it would bounce back quickly in Q2 and therefore the markets could "look through" the temporary dip in growth and just keep going.

However, on 21 February the mood took a sharp turn for the worse. The catalyst for this was reports of the virus spreading around the world, including some deaths. These reports included South Korea, Italy, Iran, Croatia and Spain which represented a broad enough geographic spread to surprise the markets. Italy and Spain present the risk of contagion spreading into France and Germany, the two big economies of Europe. Germany is already with weak growth induced by tighter economic policies implemented in China last year. Like Japan, Germany is not in a particularly strong position.

However, the markets were probably most disturbed by a warning from the US Centre for Disease Control and Prevention that it is not a matter of if, but when, the virus spreads across the country and that people should start preparing for this.

Equity markets sold off very quickly. By the end of the month, the S&P500 was down 8.3%, and the ASX200 had fallen 7.7%. Other assets exposed to global growth also fell, with oil down 13.1% for the month and the A\$/US falling 3% to US\$0.652.

Bonds rallied as equities fell. The US 10-year government bond yield dropped to a new record low around 1.15%, and the Australian equivalent yield falling to 0.84%.

The big question is where to from here? We are moving into a phase where we will get more information about both Covid-19 and its impact on the global economy. Scientists outside China will be able to observe the virus firsthand, which will help give a clearer picture of how the virus operates and how the risk must be managed. Also, we will start getting economic data which will shed light on how just how much trade and growth are being impacted. There is a risk that the news flow gets worse before it gets better, but it will get better, though no-one knows exactly when.

In other news, in the US the Democratic Party primaries have seen Bernie Sanders consolidate his lead over the other candidates, many of whom have faded as the primaries have progressed. Michael Bloomberg has entered formally the race and is running second to Sanders. There is much water to flow under the bridge yet before the Democrats select a candidate to go up against Trump, but Sanders does not seem a safe choice. His policies are probably too radical for American voters and they are certainly anathema to Wall St. Sanders as the Democratic candidate would make the markets very nervous.

## MAJOR MARKET INDICATORS

	28-Feb-20	Changes over periods shown:*			
		1 Month	3 Months	6 Months	12 Months
<b>Cash rates</b>					
Australia	0.75%	0.00%	0.00%	-0.25%	-0.75%
USA	1.58%	-0.01%	0.02%	-0.53%	-0.82%
Japan	-0.10%	0.00%	0.00%	0.00%	0.00%
Europe	0.00%	0.00%	0.00%	0.00%	0.00%
<b>10 Government bond yields</b>					
Australia	0.84%	-0.12%	-0.20%	-0.05%	-1.26%
USA	1.15%	-0.37%	-0.64%	-0.36%	-1.57%
Japan	-0.16%	-0.10%	-0.08%	0.11%	-0.14%
Europe	-0.61%	-0.17%	-0.26%	0.10%	-0.80%
<b>Equity markets</b>					
ASX200	6441	-8.2%	-5.9%	-2.5%	4.4%
AREITs	3694	-5.1%	-5.6%	-4.0%	8.6%
S\$P500	2954	-8.4%	-5.9%	0.9%	6.1%
Topix	1511	-10.3%	-11.1%	-0.1%	-6.0%
EuroStoxx	3329	-8.6%	-10.1%	-2.8%	0.9%
MSCI Emerging Markets	476	-5.3%	-3.0%	2.9%	-1.9%
VIX volatility index	39	113.0%	216.1%	109.3%	170.2%
<b>Currency markets</b>					
Aud/Usd	0.6524	-3.0%	-3.7%	-2.9%	-8.7%
Aud TWI	57.00	-1.9%	-3.4%	-3.2%	-6.1%
Usd/Yen	107.87	-0.5%	-1.5%	1.6%	-3.1%
Euro/Usd	1.0985	-0.9%	-0.4%	-0.3%	-3.5%
<b>Commodity markets</b>					
Gold	1586.7	0.0%	8.6%	3.8%	20.6%
Oil	44.8	-13.1%	-22.9%	-18.6%	-21.6%
Iron Ore	84.5	-12.4%	-2.9%	-2.3%	-0.6%
Coal	69.1	0.0%	2.8%	3.4%	-28.1%

\* For cash rates and bonds the changes are % differences; for the rest of the table % changes are used.

## MAJOR MARKET INDICATORS

	31-Jan-20	Changes over periods shown:*			
		1 Month	3 Months	6 Months	12 Months
<b>Cash rates</b>					
Australia	0.75%	0.00%	0.00%	-0.25%	-0.75%
USA	1.59%	0.03%	0.04%	-0.78%	-0.81%
Japan	-0.10%	0.00%	0.00%	0.00%	0.00%
Europe	0.00%	0.00%	0.00%	0.00%	0.00%
<b>10 Government bond yields</b>					
Australia	0.97%	-0.41%	-0.17%	-0.22%	-1.28%
USA	1.52%	-0.40%	-0.17%	-0.49%	-1.12%
Japan	-0.06%	-0.05%	0.07%	0.09%	-0.07%
Europe	-0.44%	-0.26%	-0.04%	-0.01%	-0.60%
<b>Equity markets</b>					
ASX200	7017	5.0%	5.3%	3.0%	19.7%
AREITs	3892	6.1%	1.9%	2.9%	16.4%
S&P500	3226	-0.2%	6.2%	8.2%	19.3%
Topix	1684	-2.1%	1.0%	7.6%	7.5%
EuroStoxx	3641	-2.8%	1.0%	5.0%	15.2%
MSCI Emerging Markets	503	-4.7%	2.3%	3.4%	3.8%
VIX volatility index	18	35.8%	41.6%	16.2%	13.7%
<b>Currency markets</b>					
Aud/Usd	0.6724	-4.0%	-2.9%	-2.5%	-7.5%
Aud TWI	58.10	-3.6%	-3.2%	-2.4%	-5.7%
Usd/Yen	108.39	-0.3%	0.3%	-0.2%	-0.4%
Euro/Usd	1.1082	-1.3%	-0.7%	-0.5%	-3.4%
<b>Commodity markets</b>					
Gold	1586.7	4.4%	5.1%	11.1%	20.0%
Oil	51.6	-15.6%	-4.5%	-11.9%	-4.2%
Iron Ore	96.5	4.9%	16.3%	-20.2%	14.2%
Coal	66.6	0.0%	-0.6%	-9.5%	-32.8%

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