

Vanguard®

VANGUARD COMMENTARY

# Vanguard economic and market update

21 April 2020

## Navigating the new normal

### Key points

- Vanguard continues to anticipate the sharpest global recession in recent history.
- Despite China's GDP contracting 6.8% in the first quarter in 2020, Vanguard cautions against reading too much into this figure for its global or its domestic implications.
- The coronavirus outbreak threatens to drag Australia to two consecutive quarters of economic contraction for the first time in nearly 30 years.
- Vanguard's 10-year annualised outlook for equity returns, at March 2020, has improved since the start of the year as the COVID-19-inspired sell-off reduced valuations.

Starting with some well-needed positive news, several countries recently among the world's hardest-hit by the COVID-19 pandemic are beginning to talk about how and when they might start to reopen their economies.

But renewed containment efforts in countries including Japan and Singapore, which had enjoyed early success in containing the coronavirus through vigorous testing and tracking, remind us that the battle isn't easily won,

and may not be over until a vaccine is developed or broad populations achieve immunity.

### Economic growth

Vanguard continues to anticipate the sharpest global recession in recent history, with growth in the United States and Europe contracting in the second quarter at the steepest pace since at least the 1930s. But we continue to anticipate that the global recession will be short, with

global growth turning positive in the second half of 2020. That said, we expect the recovery will be “U-shaped” in that it will be at least the end of 2021 before economic activity returns to its pre-COVID-19 level. We expect recovery to proceed in two stages, as we’re beginning to see in China: a bounce-back in growth as supply constraints recede, but a longer wait for demand to strengthen.

### China

Business has resumed in China, with estimates of activity as high as 90% of pre-coronavirus levels, just over two months after the first lockdowns in several cities.

Despite China’s GDP contracting 6.8% in the first quarter in 2020, Vanguard cautions against reading too much into this figure for its global or its domestic implications.

Vanguard expects China’s growth for 2020 will be the lowest in the four decades since it opened its markets. This first quarter drop is the first contraction since 1992 (when Beijing first started releasing its quarterly figures), but that shouldn’t necessarily suggest an ensuing V-shaped recovery (sharp contraction followed immediately by strong growth) because the reopening of China’s economy will coincide with many trading partners’ second-quarter lockdowns. China’s first-quarter GDP numbers also shouldn’t be viewed as a signal for second-quarter GDP data in other countries, given vast differences in economic structures and epidemiology.

### United States

Vanguard believes that GDP in the US could contract at a significantly greater degree in the second quarter than it did at the worst point of the global financial crisis, with the extent and timing of recovery dependent on when containment efforts can be rolled back. Even then, it will take time for activity to return to normal as consumers come to terms with their fears about re-engaging with important face-to-face sectors of the economy such as entertainment and hospitality. We believe that the unprecedented response by the US Federal Reserve and Congress will stave off even worse outcomes.

### Europe

Evidence that the virus outbreak has peaked in Italy, Spain, and Germany is leading to expectations that lockdowns within the euro area will begin to gradually be lifted soon. Vanguard’s view that the economy can start to rebound in the third and fourth quarters as lockdowns are removed is tempered by the risk of a second wave of infection that could necessitate containment measures to be reinstated. The assessment is similar for the United Kingdom, which infection data suggest may be a week behind Europe in virus transmission.

### Australia

The economy in Australia was vulnerable even before COVID-19, with summer bushfires most likely shaving 0.2% to 0.3% from GDP. The coronavirus outbreak threatens to drag Australia to two consecutive quarters of economic contraction for the first time in nearly 30 years.

### Japan

The economy in Japan was struggling even before the outbreak. GDP fell at an annualized rate of 7.6% in the fourth quarter of 2019, with imposition of a value-added tax straining an economy already late in the business cycle and with monetary policy stretched seemingly to its limits. Although Vanguard had foreseen recession in 2020 as a risk for Japan at the start of the year, it wasn’t our base case. Now we see an economic contraction for the year as inevitable.

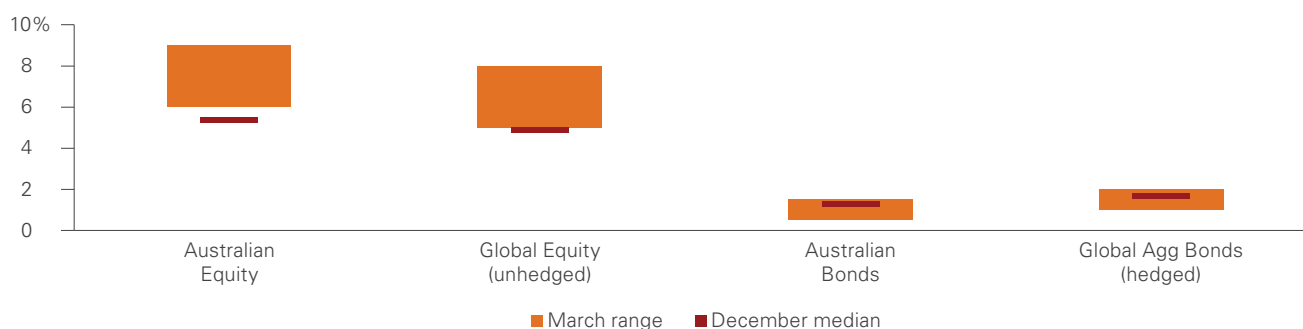
We foresee flat growth at best for **Canada** in 2020, and modest contraction for **Mexico**.

### Asset class return outlook

The Vanguard Capital Markets Model® forecasts for December (Figure 1) utilised data through 31 December 2019 – little over a quarter ago, yet a time that is feeling increasingly distant.

As in our 2020 Economic and Market Outlook, return projections had continued to be subdued as both equity valuations remained elevated, and outlooks of restrained growth and inflation dampened fixed income.

Figure 1: Interim projected 10-year nominal return outlook



Source: Vanguard, 31 December 2019 and interim March 2020 VCCM simulations.

However, a lot has unfolded since then – in order to frame these projections in the context of recent market events, we have contrasted our December forecast with an interim March outlook. This off-cycle update provides an indicator for the range of annualised returns we might expect, given market movements and volatility.

The median 10-year annualised return for December is shown alongside a range of central expectations for March.

As previously mentioned, more attractive valuations have buoyed our long-term equity return, placing December’s medians at the bottom end of our revised range as stocks are afforded more room to grow. Meanwhile fixed income returns have been further pressured by historically low yields, shifting our expectation for the asset class downwards.

Vanguard’s preliminary March 2020 outlook for equity returns has improved since the start of the year as the COVID-19-inspired sell-off reduced valuations. These 10-year annualised return ranges are shown in the table and referenced in Figure 1.

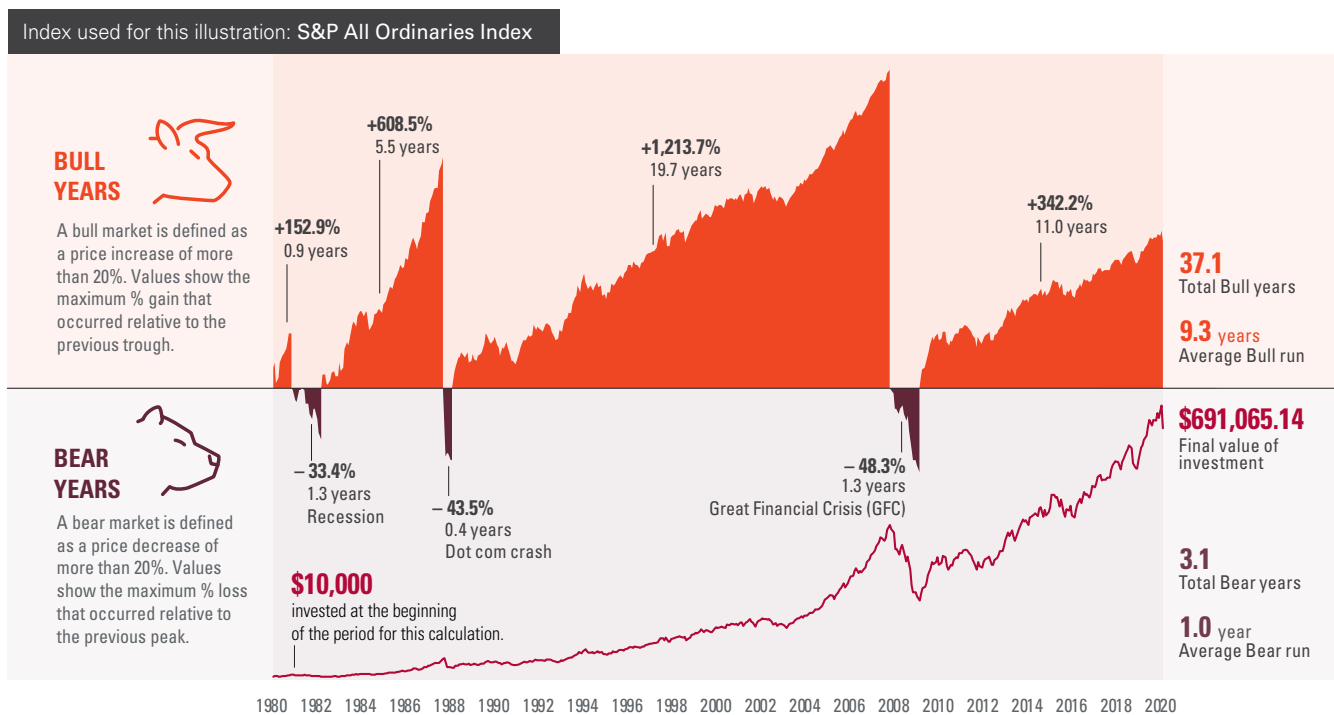
Asset class	10-year annualised return forecast
Australian Equity	5.9 – 8.9%
Global Equity (unhedged)	5.0 – 8.0%
Australian Bonds	0.5 – 1.5%
Global Agg Bonds (hedged)	1.0 – 2.0%

### The new normal

Navigating daily uncertainty is everyone’s new normal. We’ve all been thrust into a world where all aspects of our lives are being re-evaluated and re-examined using a new lens. It’s forcing many of us to focus on the things that will keep our eye on the end game.

It is true that this downturn is different. Each downturn has had its own fingerprint, and differing factors driving down market performance. Yet, they’ve all recovered. The good news is that the recovery from this current downturn is predicted to be relatively swift.

Figure 2: Illustrating the effects of Bull and Bear markets on investments for the past forty years.



Notes: Calculations are based on the S&P All Ordinaries Index for the period 1/1/1980 to 1/1/2020. A bear market is defined as a price decrease of more than 20%. A bull market is defined as a price increase of more than 20%. The plotted areas depict the losses/gains ranging from the minimum following a 20% loss to the respective maximum following a 20% appreciation in the underlying index. Calculations based on monthly data. Logarithmic scales are used for this illustration. All distributions are reinvested. Source: Morningstar Data.

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