Economic & Investment Update – October 2020

Despite encouraging signs of a recovery in global economic growth towards the end of the June quarter, rising Covid infection numbers across the world resulted in the reintroduction of social restrictions, particularly across Europe. Australia (and in particular Victoria) have not been immune from this second wave.

In Australia, the Federal Budget allayed fears that fiscal policy wasn't doing enough of the heavy lifting with the Government injecting further monies by way of tax cuts and infrastructure spending on top of the existing JobKeeper, JobSeeker, JobMaker and JobTrainer schemes. Treasury forecasts economic activity to pick up from late 2020 and into early 2021 however, this is dependent upon an easing of social restrictions and eventually the discovery and distribution of an effective vaccine. The RBA hinted at further monetary policy easing with further Quantitative Easing widely expected to be announced prior to Christmas.

Recent data from the US suggests the US recovery has lost some stream with September employment numbers not recovering as fast as expected (the unemployment rate only fell from 8.4% to 7.9% despite a fall in the participation rate). June quarter GDP shrank by 9.1% quarter on quarter.

The US election on 3 November is taking centre stage with the Democrats pushing to gain control of both Houses as well as the Presidency. Markets seem concerned about a close result which could lead to a court challenge.

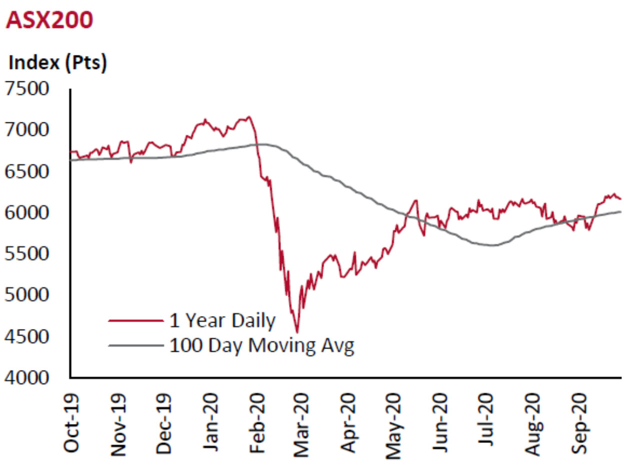
Most EU economies remain under pressure from Covid 19 containment measures as governments fear a new wave of infections could forestall the recovery. Across the Euro area, GDP fell by 11.8% in the June quarter.

China has largely contained the virus and its economic recovery is well underway, supported by infrastructure spending and record bond issuances. Estimated growth rates are 1.75% for 2020 before jumping significantly to 8% in 2021.

MARKETS

Equity market performance was mixed in the first three months of the new financial year as the focus shifted in September back to the uncertain path to recovery and the ongoing public health risks.

In Australia, the S&P/ASX 200 Accumulation Index was flat over the quarter finishing down 0.4% (and down 10.2% over the past 12 months). The top two performing sectors were again Information Technology (+13.0%) and Consumer Discretionary (+10.1%), continuing their strength in the new Covid environment. The Energy sector (-13.5%) produced the lowest return.



Source: Bloomberg

The Small Ordinaries Index (top 100-300 companies) again outperformed the top 100 companies, finishing up 5.7% for the quarter (but down 3.3% over the last 12 months).

Global equity markets again produced solid gains over the quarter with the MSCI World (ex-Australia) Net Return Index (AUD hedged) up 6.4% (also up 6.4% over the past 12 months). However, the month of September saw falls off the back of rising global infection numbers and uncertainty re fiscal support in the US.

Across global markets, the strongest performer was the Shanghai Shenzhen CSI 300 index, up 10.2% for the quarter (and 20.3% over the twelve months) with the US S&P 500 also showing strength, up 8.5% for the quarter (and 13.0% over the twelve months). The UK FTSE index was down 4.9% for the quarter (down 20.8% over twelve months).

Gains on unhedged global equity investments were lower during the September quarter with the Australian dollar appreciating against both the US Dollar and the Japanese Yen. The MSCI World (ex-Australia) Net Return Index (unhedged) rose by 3.8% for the June quarter (4.3% over twelve months).

After a fall of 34.4% in the March quarter, Australian listed property securities continued their recovery, with a better than expected reporting season resulting in a gain of 7.0% for the September quarter, following a 19.9% rise over the June quarter. Global property securities returns were flat, up just 0.6% and down 21.6% over the past twelve months. Discretionary retail and office continue to struggle compared to sectors such as industrial, logistics and non-discretionary retail.

Within fixed interest markets, the Australian bond market, as measured by the Bloomberg AusBond Composite Index, increased by 1.0% over the September quarter as bond yields finished lower. The cash rate was kept on hold by the RBA at 0.25%. Global bonds, as measured by the Bloomberg Barclays Global Aggregate TR Index (AUD Hedged) index, returned 0.7% for the quarter and 3.5% over the twelve months.

The price of Gold continued to strengthen, up 5.9% for the September quarter as government stimulus measures, falling interest rates and general market uncertainty provided tailwinds for gold prices. For the financial year, the gold price has now risen 28.1%. The price of oil continued to recover, up 2.4% for the quarter, but was still down 25.6% over the previous twelve months.

The table below (sourced from Lonsec) summarises the returns from a number of market sectors.

Sector	Index	3 mths (%)	1 year (%)	5 years (% p.a.)
Equities				
Australia	S&P/ASX 200 TR (Accumulation) Index	-0.4	-10.2	7.3
	S&P/ASX Small Ordinaries TR (Accum) Index	5.7	-3.3	10.0
International	MSCI World ex Aust NR Index (AUD)	3.8	4.3	10.1
	MSCI World ex Aust NR Index (AUD Hedged)	6.4	6.4	10.4
Emerging Mkts	MSCI Emerging Mkts NR Index (AUD)	5.2	4.0	8.5
Listed Property				
Australian	S&P/ASX 200 A-REIT TR (Accumulation) Index	7.0	-16.7	5.6
International	FTSE EPRA/NAREIT Dev NR Property Index (AUD Hedged)	0.6	-21.6	1.8
Infrastructure				
Global	S&P Global Infrastructure TR Index (AUD Hedged)	-0.4	-17.9	4.5
Currencies				
AUD v USD	Against US Dollar	3.7	6.1	0.4
Fixed Interest				
Australian	Bloomberg Ausbond Composite All Maturities	1.0	3.2	4.5
	Bloomberg Ausbond Credit All Maturities	1.5	3.5	4.7
International	Bloomberg Barclays Global Agg TR Index (AUD Hedged)	0.7	3.5	4.5
Commodities				
Gold	Gold – USD	5.9	28.1	11.1
Oil	WTI Oil $/b – USD	2.4	-25.6	-2.3

Outlook

While record cases of the coronavirus around the world look set to forestall the global economic recovery, this could soon be solved as the race towards the development and distribution of an effective vaccine gets closer. However, uncertainly remains not only with the timing of approval and production of a vaccine but also with a vaccines ongoing effectiveness given the potential mutation of the virus.

In the meantime, a global avalanche of fiscal and monetary policy continues to provide support to individuals, businesses and markets. With a pandemic relief package in the order of US$2 trillion to US$3 trillion expected to pass the US Senate and potentially further buying back of Government bonds by the US Treasury, significant increased stimulus is likely to be unleashed by the US. The short term implications of easy money provides stimulus to equity and property markets as interest rates are kept at near zero rates. However, the long term impact is likely to see markets retreat and the US dollar come under significant pressure.

Uncertainty surrounding the upcoming US election is contributing to market volatility and may continue if the result is dragged through the courts in the coming months.

Regionally, China's recovery is ahead of the rest or the world, particularly within its industrial activity whereas Europe's progress is being hampered by the continuing record number of coronavirus cases and further lock down restrictions. Plus don't forget Brexit!

In Australia, markets will be watching to see if we succumb to the so-called "fiscal cliff" with the scaled down Job Seeker 2.0 initiative set to conclude on 28 March 2021. Around the world, new world ecommerce growth stocks continue to thrive as more traditional old world business struggle in a world of social distancing.

In relation to investment portfolios, markets may be very sensitive to the US elections and the ongoing pandemic noting however that over the short to medium term they are likely to be supported by the low interest rate environment and fiscal spending.

Our views on various asset classes are outlined below.

Australian Equities

We recommend investors hold a neutral position to Australian Equities. This applies to both large cap stocks as well as smaller companies.

The level of fiscal and monetary policy being unleased around the globe will continue to provide significant support to Australian equities as easy money keeps interest rates lower for longer.

Government support via the cocktail of different job initiatives aimed at business will also provide short to medium term support. The extension of the JobKeeper program demonstrates a willingness of the Government to help businesses survive given the record number of insolvencies that would otherwise prevail.

International Equities

Within International Equities, we recommend investors move to a neutral position. Again, this is based on the level of fiscal and monetary policy around the globe and in particular the US support package expected to pass the US Senate soon.

Regionally, Europe is likely to continue to struggle and consequently, we recommend an underweight holding to European equities. We feel investments in the Asian region continue to look more attractive from a valuation perspective and are in a better position to recover. We recommend a neutral to overweight exposure to emerging markets, noting that low US interest rates are supportive of money flows to such markets.

Investors should consider the benefits of hedged options (where available) on International Equity holdings. Although the US Dollar has traditionally provided protection as a safe-haven in times of extreme volatility, the US Dollar may weaken further over the medium term, given the likelihood of further stimulus packages and increasing levels of Government debt.

Property

We recommend investors retain a neutral position to Australian and International property with a continuation of a bias away from the retail sector.

Strong gains have been made over the quarter in the Australian Real Estate Investment Trust (REIT) sector, however the spread over 10-year bonds remains well above its long term average of 200 basis points.

Global monetary policy is keeping interest rates lower for longer and is likely to remain very supportive for this sector.

Fixed Interest

We recommend investors remain underweight to fixed interest securities.

While recent Central bank intervention in the developed world bond primary and secondary markets has significantly reduced market volatility, this is likely to lead to extremely low yields and, in some cases, negative yields for bond investors. Superior security selection by fixed interest fund managers will be needed to add value above benchmark returns and fees

Despite a recent tightening in credit spreads, credit securities appear more attractive and significantly in excess of cash rates.

Alternatives

We remain positive about the longer-term prospects for Infrastructure investments on a hedged (currency) basis.

Private Equity investments will benefit from the existence of opportunities coming out of the pandemic and from low interest rates in their geared structures.

In the current economic climate, we continue to suggest consideration be given to an allocation to the gold sector within portfolios. Exposure to gold, either through gold producers or via an investment in physical gold, provides additional diversification within portfolios.

Sources: Lonsec