Lonsec

Summary of Key Views

Buckle up for a wild ride

In recent weeks we've seen increased market volatility. The Nasdaq, which represents the leading technology stocks in the US market, has seen a pull back following an incredible rally, and markets seem to be in a range-trading pattern. We all know the saying that when the US market sneezes, the rest of the world catches a cold, and there is some truth in that.

The much-anticipated upcoming US presidential election is certainly contributing to market volatility. Historically, in the months leading up to US elections, markets have exhibited an increased level of volatility, and it is no different this time. Markets are not political, but they are sensitive to uncertainly, so as we get closer to the election in November, we are likely to see the market gyrate. As to how markets will react to a Republican or Democratic win, history is not conclusive on this, however what has been observed is that in the lead up to an election, avoiding recessions and a positive stock market tend to assist re-election.

On the policy front, attention has shifted from monetary policy to fiscal policy and markets are looking to see to what extent fiscal support will continue to prop up economies across the world. In Australia, as we await the wind back of policies such as the JobKeeper payment scheme, markets will be watching carefully to see if we succumb to the so-called 'fiscal cliff' and to what degree some sectors have been supported by government money. The retail sector in particular will be interesting to observe given the incredible rebound and resilience the sector has shown since March, with companies such as Harvey Norman and Nick Scali posting strong sales.

Amidst this backdrop we have not shifted our Lonsec asset allocation views. While we have seen some valuation support appear within Australian equities, much of the value is being driven by down beaten-down parts of the market, such as the banks, and we still think the sector will face challenges in a world dominated by low interest rates, so at this stage we have opted to retain our 'Neutral' exposure to Australian equities. If we see a material pull back in markets over the next few weeks or months, we will reconsider our position across Australian and global equities.

Importantly, we have adjusted our portfolios to assist in managing downside risk by taking specific sector and investment strategy tilts within the portfolios, and at the same time having exposure to growth parts of the market should markets appreciate. Alternative allocations such as our gold exposure have performed in line with expectations, holding up better than equity markets on down market days.

In the meantime, buckle up because the ride may be bumpy over the coming months!

Market developments during September 2020 included:

Australian Equities

Australian shares followed global markets down through September as the focus shifted to the uncertain path of recovery and the ongoing public health risks due to the pandemic. The IT sector (-6.8%) was hit by the risk-off wave, with buy now pay later fintech Afterpay trimming 12.5% from a $26 billion market cap, while Consumer Staples (-6.6%) also took a sizeable hit during the month. A2 Milk (-17.4%) noted the company has experienced additional disruption to the corporate daigou / reseller channel, which has been impacted by the prolonged lockdown in Victoria. A2 expects Australia and New Zealand revenue to be materially below expectations for 1H21, with sales in the daigou channel representing a significant portion of infant formula sales in the segment.

Harvey Norman (+2.5%) released a sales update for the period 1 July 2020 to 17 September 2020 showing revenue up 30.6% on the prior corresponding period. Sydney Airport's traffic performance for August showed total passenger numbers for the month down 96.5% on the prior corresponding period. Domestic passengers totalled 91,000 for the month, down 96.1%, and year to date total domestic passengers of 3.63 million, down 67.5%.

Global Equities

Global shares were down in September as rising infections in Europe and uncertainty around further fiscal support in the US dampened the outlook. In the US, the S&P 500 Index fell 3.8% in US dollar terms as air was taken out of extended valuations. The Nasdaq Composite Index dropped 5.1% following an incredible rally, and markets seemed to be in a range-trading pattern. In early October, President Trump walked back his pledge of no additional stimulus cash before the presidential election, giving the market hope for further support.

The White House and Congress are negotiating standalone legislation to support the airline industry, which could involve as much as US$25 billion for carriers, which have announced plans to furlough thousands of workers in the absence of federal aid. In Europe, the STOXX Europe 600 Index fell 3.3% in euro terms in September, with banks and insurance sectors down, while retail and health care were positive. The German DAX Index fell 1.4%, with online food delivery service Delivery Hero gaining as fears of a second wave of infections intensified. The MSCI World Ex-Australia Index fell 0.3% in Australian dollar terms and the MSCI Emerging Markets Index rose 1.5%. In Asia, Hong Kong's Hang Seng Index fell 6.4% and China's CSI 300 Index fell 4.7%, while Japan's Nikkei 225 Index rose 0.8%.

Fixed Interest

The market volatility throughout the pandemic has seen global sovereign bond yields rally lower in yield. Governments have embarked on a series of large-scale fiscal programs that have resulted in substantial sovereign bond issuance. Yet all this issuance has been soaked up by massive central bank bond buying, which has reduced the cost of funding for governments and their banking systems.

In Australia, the RBA flagged that the high rate of unemployment was now a national priority and would keep interest rates at the record low of 0.25% and continue to buy government bonds and provide banks with cheap credit for quite some time in order to stimulate the economy out of recession. Financial markets continue to speculate that the RBA may have to consider a further interest rate cut to 0.10% alongside additional quantitative measures to help lower the unemployment rate and support the economic recovery. In the US, minutes from the September FOMC meeting revealed members were pricing in additional fiscal stimulus from Congress. The staff projections "assumed the enactment of some additional fiscal policy support this year," adding "without that additional policy action, the pace of the economic recovery would likely be slower."

REITs (listed property securities)

The Australian property securities market saw most prices continue to recover in the September quarter with a better than expected reporting season. Several AREITs have embarked on capital raisings during 2020, so balance sheets are well-positioned with average gearing around 27%. At the same time the cost of debt has reduced with interest costs for new debt down from around 3.0–3.5% to 2.0–2.5% over the last 12 months. However, the bifurcation between sub-sectors is similar to that seen in the global property securities markets. Industrial and logistics, specialist, large format, and non-discretionary retail sectors have outperformed in calendar 2020, while discretionary retail and office sectors have underperformed.

The retail sector has dealt with forced store closures (excluding supermarkets and essential provisions), with prolonged lockdowns in Victoria adding to the pressure. The government mandated Leasing Code of Conduct has shared the pain of reduced revenues for eligible SMEs, although some larger retailers have been attempting to withhold rents and renegotiate based on a revenue-linked model. In the US, REITs fell 3.2%, with the biggest losses coming from office property (-6.9%) and manufactured homes (-6.5%).

Alternatives

Preliminary estimates for September indicate that the index increased by 1.5 per cent (on a monthly average basis) in SDR terms, after increasing by 0.2 per cent in August (revised). The non rural, rural and base metals sub-indices all increased in the month. In Australian dollar terms, the index increased by 1.1 per cent in September.

Over the past year, the index has decreased by 5.8 per cent in SDR terms, led by lower LNG and coal prices. The index has decreased by 8.5 per cent in Australian dollar terms.