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Lonsec

Summary of Key Views

Ignore the crowd and focus on your investment game plan

US elections, daily pandemic updates, and political scandals are dominating the news headlines. In this world of hyper-connectivity and a constant flow of information, investors must be focused on their game plan and learn to tune out the noise of the crowd. As we witnessed during October's grand final (AFL or NRL depending on your favoured code), discipline is the key to success.

Markets don't like uncertainty. True to label in the current environment, markets have been range-trading as significant uncertainty surrounds the outcome of the US elections, as well as the size and scope of a US fiscal package, which requires an agreement with Congress. Add to this ongoing concerns over the pandemic, especially in the US and Europe, and the fraught process of reopening, which has seen mixed success globally.

Managing our portfolio through times like these calls for a solid game plan and the patience to see it through. We can't afford to bank on one particular outcome (a strategy akin to flipping a coin). We must determine which part of our portfolio will provide protection and which part will allow us to capitalise on the upside and take advantage of potential growth.
Lonsec's game plan is simple. In a low yield world, you need growth. We have retained our exposure to growth assets such as equities, especially as interest rates remain low and markets continue to be supported by liquidity from central banks. However, we are cognisant that there are risks in the market and therefore we have diversified our equity exposure to incorporate a mix of investment styles that can perform well in different market conditions.

We're also consciously ensuring that we have exposure to some traditional defensive sectors and investment strategies that we expect to hold up better than the market should we experience a correction. Incorporating diversifying assets that can behave differently from equities and bonds is prudent. We have therefore incorporated alternative assets such as gold in some of our portfolios to bolster our defensive positioning.

Periods of uncertainty can provide opportunity as well as risks, and a dynamic approach is essential for managing both. We have invested in parts of the bond market where we identified significant mispricing opportunities, and we continue to have a positive view on emerging market equities, where we believe the additional potential returns warrant the risk.

As investors, we're not just playing a single match, or even a single season—we're playing for long-term success. Markets are unpredictable, but having the right strategy that takes into account a range of possible scenarios, including those that might seem unlikely to us today, will assist in generating more consistent outcomes over the long-term. We can't win every game or every premiership, but we can increase our chances of accumulating some silverware over time.

Market developments during October 2020 included:

Australian Equities

Australian shares bucked the global trend to post a 1.9% return in October as easing restrictions, low case numbers, and a highly supportive federal budget bolstered confidence. Information Technology (+9.0%) was the top performing sector, followed by Financials (+6.3%). Even the beaten-down banks enjoyed a reprieve having been impacted by provisions, a rise in customer deposits, and contracting net interest margin.

In earnings news, Resmed (+16.9%) announced 1Q21 results with revenue up 9% on the prior corresponding period and operating profit was up 27%. Revenue in the US, Canada, and Latin America, excluding Software as a Service, increased by 9%, driven by strong mask sales and increased demand for ventilators due to COVID-19, which was partially offset by lower demand for sleep devices. Brambles (-8.6%) released a 1Q21 trading update in early November with sales revenue up 5%, lifting its FY21 outlook to the upper end of its guidance provided in August 2020. Global biotech leader CSL will begin producing 30 million doses of the Oxford University-developed AstraZeneca vaccine to be ready for distribution should trials prove successful. The vaccine is still subject to approval by the Therapeutic Goods Administration for use in Australia.

Global Equities

In contrast to the Australian experience, global markets were down in October due to resurgent COVID-19 cases in Europe and the US, while an uncertain presidential election added to volatility in US shares. The CBOE

Volatility Index (VIX) jumped to 40.28 at the end of October before easing below 25 points in the first week of November as Joe Biden was projected to win the presidency and Republicans looked to hold their majority in the Senate. Markets responded favourably to news in November of the Pfizer/BioNtech vaccine, which saw a rotation back into cyclicals and value.

While earnings were largely overshadowed by politics, reporting is on track to soundly beat expectations. As at 6 November, 89% of S&P 500 companies had reported for 3Q20, of which 86% reported actual EPS above estimates. Apple reported its 4Q20 results, with revenue of US$64.7 billion and EPS of US$0.73, beating expectations. In Europe, the STOXX Europe 600 Index fell 5.7% in euro terms in October, with the largest losses coming from the Technology and Health Care sectors. The MSCI World Ex-Australia Index fell 1.1% in Australian dollar terms and the MSCI Emerging Markets Index rose 4.2%. In Asia, Hong Kong's Hang Seng Index rose 2.8% and China's CSI 300 Index rose 2.4%, while Japan's Nikkei 225 Index fell 0.9%.

Fixed Interest

In November the RBA delivered largely as expected, reducing the cash rate to 0.10% and introducing additional policy measures, including $100 billion in additional outright bond purchases in the 5-10-year maturity buckets. The target for the three-year bond remains in place, meaning the RBA will be combining yield curve control at the short end with quantitative easing at the middle to long end of the curve. While the US Fed has ruled out yield curve control, it will be watching the Australian experience with some interest. Australian credit spreads are expected to continue to remain well bid as issuance by financial institutions remains subdued thanks to strong growth in bank deposits with negligible interest rates and the low-cost option of the RBA's TFF funding facility.

In the US, the yield on 10-year Treasuries pushed higher through October from 0.69% to 0.88% and reached a four-month high of 0.90% on 3 November, with an unclear election result and additional COVID-19 cases weighing on markets. Yields have been under pressure due to large-scale fiscal programs driving a substantial sovereign bond issuance. 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.

REITs (listed property securities)

Australian listed property could not match the positive month for local shares, sliding 0.4% in October as the effects of the pandemic threw up mixed results from the A-REIT index. The office sector has continued to collect a high level of rents, and valuations have seen limited reductions given the level of local investor interest in high quality Australian property (albeit international interest is more subdued given that travel is not possible for inspections). Medical and tech-related space is also well sought after by smaller investors. However, rental incentives are rising and sub-lease space in Sydney and Melbourne is increasing. According to CBRE, in Sydney alone, the amount of sublease space jumped 56% in the September quarter to 164,950 square metres, its highest level since 1992.

The industrial sector has been led by Goodman Group (+2.8% in October), which reported strong FY20 earnings and reaffirmed its positive outlook based on its global development pipeline and recurring funds management fees. Logistics developments are expanding to cater for the ongoing shift to online networks with some vacancy increase on the east coast. In the US, REITs fell 2.8% in US dollar terms, with the biggest losses coming from shopping centres (-12.4%), office property (-10.1%) and regional malls (-10.0%)

Alternatives

Preliminary estimates for October indicate that the index increased by 1.2 per cent (on a monthly average basis) in SDR terms, after increasing by 2.1 per cent in September (revised). The rural, non-rural and base metals sub-indices all increased in the month. In Australian dollar terms, the index increased by 2.8 per cent in October.

Over the past year, the index has decreased by 0.3 per cent in SDR terms, led by lower LNG coal and oil prices. The index has decreased by 2 per cent in Australian dollar terms.