Market observation

We are meant to be celebrating Christmas but this year it doesn't feel quite right to celebrate anything, does it? At least we have some positive signals from the market.

But why are conditions so positive at present:

1. Federal and State governments have implemented unprecedented fiscal stimulus;
2. a new US administration and fiscal stimulus is imminent; and
3. COVID vaccines are on the way.

Yes China is causing problems for Australian exports but the rally in iron ore actually mitigates most of the impact, in terms of GDP.

But we might have some inflation problems ahead and the yield curve might be hard to hold down.

That seems to be the key risk ahead, rising inflation (in the short term) and rising interest rates. And as a result, a rising AUD.

Rising bond yields will test the central banks. And if they keep rising, obviously bond funds will move into negative territory and eventually the pressure will mount on stocks (as discount rates increase).

Maybe this is why the market is switching from Growth to Value at the moment?

To us it looks like "a rising tide lifts all boats" and the value stocks were the last to come to the party.

We see value stocks as undergoing a one-off rerating and then growth issues will emerge again. For example, we expected the rerate in the Banks, as non-recurring costs and loan impairments decrease. Energy stocks are rallying off a low base but the issue of falling global demand for coal and oil won't go away. Similarly with BHP and RIO, will China act on rising iron ore prices? We remain very conservative on energy and miners. Positive on banks.

Right now we are seeing some weakness in stocks with higher growth rates and that is where the value seems to be emerging.

Overall, we remain bullish in the short term and expect markets to remain buoyant into 2021.

The key risks ahead seem to be:

1. the efficacy of the COVID vaccine rollout;
2. short term inflation issues emerging; and
3. East/West relations.

Our market view

Over the long term, it will get harder and harder for large incumbent companies to maintain margins and find earnings growth. And monetary and fiscal policy ammunition will be close to exhaustion. Overall, we are short term bulls but long term bears. Our focus remains unchanged on quality companies, with sustainable earnings and low gearing.