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Lonsec

Summary of Key Views

Positioning for recovery

Welcome to 2021! I hope you had relaxing break and found time to reset after a tumultuous year. As we enter 2021 it seems that it's more of the same. Covid, US elections, and growing tensions between Australia and China continue to dominate the news headlines.

You may recall late last year we adjusted our asset allocation position to take a more positive view on equities relative to fixed income assets and cash. Our rationale for taking this view was based primarily on the belief that monetary policy will remain supportive for risk assets (i.e. interest rates will remain low), coupled with the likelihood of continued fiscal support by governments around the world and growing evidence of an economic recovery.

So, what are the numbers telling us thus far? Despite the doom and gloom in the news, US businesses appear to be recovering despite softening payrolls (the number of US workers). Economic indicators such as the ISM Manufacturing and Services Index are improving. Chinese business activity remains relatively strong and the emerging markets are generally showing signs of economic strength. On the domestic front jobs data has continued to improve, housing approvals are up more than 30% since June 2020, and exports are rising, dominated by Australia's iron ore exports.

We are certainly not out of the woods and risks remain. Covid and geopolitical risks can generate spikes in market volatility, but such events are out of our control. As per our investment process we remain focused on the relative price of assets, policy settings and liquidity, and other factors such as investment sentiment and the direction of shorter-term price momentum of assets. As we flagged during 2020, the risk of inflation is something we will continue to monitor in 2021 given the massive amount of economic stimulus we have witnessed.

I wish everyone a healthy and prosperous 2021.

Market developments during December 2020 included:

Australian Equities

Much like new year celebrations, Australian shares ended 2020 without fanfare. The ASX 200 added a modest 1.2% in December to end the year up only 1.4% in what was a tumultuous year for all markets. The IT sector was the best performing in December, returning 9.5% over the month and 57.8% over the year. Unsurprisingly it was Afterpay that led the tech pack in 2020, tripling in value as consumers continued to flock online and ditch their credit cards. Afterpay announced that it exceeded $2 billion of monthly underlying sales in November—more than double the $1 billion of underlying sales in November 2019. Machine learning and AI specialist Appen downgraded its 2020 earnings guidance, citing the impact of lockdowns globally—especially in California where its heavyweight technology clients reside—and a weaker US dollar.

CSL announced in December that its Covid-19 vaccine, developed with the University of Queensland, will not proceed to phase 2 and 3 trials after it was discovered that antibodies produced by the vaccine can result in false HIV positive results. The AstraZeneca vaccines will be made in Australia by CSL after an initial batch arrives from overseas. Domino's was a clear Covid winner, rising 65.6% in 2020 and reporting a year-on-year jump in online sales of 21% in FY20.

Global Equities

Global shares saw mixed performance over 2020, with some markets rebounding strongly in the second half and others finishing the year deep in the red. Overall, it was a positive year, with the MSCI World Ex-Australia

Index returning 5.7% and the MSCI Emerging Markets Index returning 7.8% in Australian dollar terms. The US S&P 500 Index finished on a high, returning 3.8% in December and 18.4% over the year after rallying to record highs in the wake of the pandemic. Wall Street was preoccupied with election-related news in January, with the Georgia runoffs deciding control of Congress and the fate of the incoming Biden administration's economic policy.

European shares fared considerably worse over 2020 compared to the US and Asia. The UK's FTSE 100 Index was down 11.6% over the year and France's CAC finished 5.0% lower, while Germany's DAX managed a modest gain of 3.6%. Cyclical sectors like energy and financial services were the hardest hit, along with exposed sectors such as travel and leisure, while technology shares were the best performing. The pan-European STOXX 600 Index rose 2.5% in December but came under pressure amid concerns of a fast-spreading Covid-19 mutation. The outlook for 2021 is supported by very accommodative monetary and fiscal policy and the start of Covid-19 vaccine rollouts.

Fixed Interest

The end of 2020 saw further recovery in yields, thanks in part to positive vaccine news, which has boosted equities and narrowed spreads between corporate and

government yields. The US 10-year Treasury yield rose from 0.84% to 0.93% in December, before lifting above 1.0% in early January on the back of Democrat victories in the Georgia runoff. As widely expected, the US Federal Reserve left the target range for the funds rate unchanged at 0.00–0.25% during its December meeting.

The Fed will continue to increase its holdings of Treasury securities by at least $80 billion per month and agency mortgage-backed securities by $40 billion until substantial progress is made towards achieving the inflation objective. Central bank officials have indicated they are less concerned about potential overshooting of inflation. The Fed's Charles Evans said, "getting inflation moving up with momentum and delivering rates around 2.5% is important for achieving our inflation objective in as timely a manner as possible." Central bank bond buying programs have helped soak up high levels of government debt issuance in the fight against the pandemic. In Australia, money market rates are still close to zero and the yield on the 3-year government bond is in line with the RBA's 0.10% target.

REITs (listed property securities)

It was an annus horribilis for listed property, with almost every sector under pressure due to lockdowns and social distancing. The S&P/ASX 200 A-REIT Index fell 4.6% over 2020, while global REITs fared even worse, down 13.6%. However, some diversified trusts saw impressive growth over 2020. Charter Hall bucked the trend with a $3.5 billion outlay on real estate deals over the year and benefitted from higher demand for

access to industrial and logistics assets during the pandemic. This was in stark contrast to shopping centre REITs Vicinity Centres and Scentre Group, which fell 35.5% and 27.4% respectively over the year. Australia's housing market is improving but the Reserve Bank notes that the recovery is uneven and there has been considerable variation in price changes across capital cities.

A clear factor has been the slowdown in population growth due to border closures and the decline in net overseas migration.

The US experience has been marked by the permanent closure of well-known chain-store branches and iconic brands filing for bankruptcy. With the holiday season over, a further wave of bankruptcies is expected. The pandemic has prompted investors to diversify into alternative assets such as childcare, healthcare, and data centres, which are less tied to the broader economy than mainstream commercial sectors and office space.

Alternatives

Preliminary estimates for December indicate that the index increased by 8.6 per cent (on a monthly average basis) in SDR terms, after increasing by 2 per cent in November (revised). The rural, non-rural and base metals sub-indices all increased in the month. In Australian dollar terms, the index increased by 6.1 per cent in December.

Over the past year, the index has increased by 11.7 per cent in SDR terms, led by higher iron ore prices. The index has increased by 6.6 per cent in Australian dollar term

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