DECEMBER 2020

HOUSE VIEW

EXECUTIVE SUMMARY

Risk markets made impressive gains in November, following the dampening of near-term risks — the U.S. election and continuation of the COVID-19 pandemic — as investors embraced positive news flow. Given the diminishing tail risks and lack of inflationary pressure (due to remaining output gaps) the overall macro picture appears to be a temporary 'goldilocks scenario'. Whilst we are now more bullish for the 3-6 month outlook for risk assets, we believe some markets may have already run ahead of themselves. We await any temporary pull-backs in order to reassess and potentially add to risk assets

OUR VIEW

Markets started November in emphatic fashion as a messy U.S. election, gave way to a pleasing result for investors – a narrow victory for the Democrats. This was followed by positive announcements from trials of COVID-19 vaccines and suddenly two significant downside risks for markets appeared to be placated.

The victory for President-elect Joe Biden and failure of the Democratic "Blue Wave", seemed to appease investor concerns as the potential winding back of corporate tax rates and introduction of greater regulation is significantly diminished with Republicans controlling the Senate.

Biden reigning over a split congress should provide investors with a supportive backdrop for corporate America, and a more stable and predictable leader on the trade front.

As mentioned in our note earlier this month, given the political vagaries at this stage, we are still somewhat unsure as to how long-lasting and significant the impacts from the U.S. election will be for markets.

The other good news — the results of vaccine trials from companies including Moderna, Pfizer and AstraZeneca — is certainly positive for markets and growth prospects in 2021, despite questions now being raised over the efficacy of the AstraZeneca results.

The results have already seen a significant rotation from investors towards cyclical stocks and those which were hit hardest during the initial stages of the pandemic. We shifted our portfolios to capture more exposure of this segment of the market in mid-November, via increases to Australian equities and GREITs, and will continue to monitor this sentiment closely in the near-term. Value and cyclicals are unlikely to outperform should there be a near-term market pull-back.

Given the diminishing tail risks and lack of inflationary pressure (due to remaining output gaps) the overall macro picture appears to be a temporary 'goldilocks scenario'. A vaccine would be a real 'game changer' allowing economies to reopen, which coupled with a lack of inflationary pressure, should allow central banks to continue their accommodative stance and fiscal support to remain.

WHAT THIS MEANS FOR OUR DIVERSIFIED PORTFOLIOS

In mid-November we increased our allocations to Australian equities and GREITs — both of which should benefit from the 'reopening trade' as economies and markets show signs of returning to normal. Given the cyclical nature of Australian equities, this purchase has provided further exposure to this segment of the market which is currently outperforming. At present, GREITs appear undervalued, and provide portfolios with additional exposure to 'the reopening trade' whilst balancing any value tilts in portfolios. These increases were funded at the expense of liquid cash in the portfolios.

Following our investment committee meeting in late November we have elected to retain this positioning, allowing our positive equity drift to remain.

Whilst the dampening of near-term downside risks — U.S. election and COVID-19 pandemic — has us more bullish, we believe risk markets may have already run ahead of themselves. We wait for any minor corrections in order to reassess and potentially add to risk assets.

PORTFOLIO POSITIONING

	SAA	TAA	Over/ Underweight
Growth assets	70%	72.5%	+2.5%
Australian equities	26%	26.5%	+0.5%
Developed market equities	28%	29.5%	+1.5%
Emerging market equities	4%	4%	0%
Listed real assets[1]	6%	6.5%	+0.5%
Alternative growth	6%	6%	0%
Defensive assets	30%	27.5%	-2.5%
International fixed income	8%	9.5%	+1.5%
Australian fixed income	12%	13.5%	+1.5%
Cash	10%	5%	-5%
Foreign currency hedge ratio[2]	30%	28%	-2%

SAA – strategic asset allocation
TAA – tactical asset allocation

Figures may not add up due to rounding

1. Comprises of 50/50 split between GREITs and infrastructure securities.
2. Percentage of developed market and emerging market equities hedged from foreign currency into Australian dollars.

Representative diversified portfolio with 70/30 growth/defensive assets.
As at 1 December 2020.

STRATEGY POSITIONS SUMMARY

GROWTH ASSETS:	In mid-November we took our portfolios to a mild overweight to growth assets by increasing allocations to Australian equities and GREITs. Our mild overweight is expressed primarily via mild overweight positions in global developed market and Australian shares. The portfolio also holds an overweight to GREITs which should benefit from the reopening trade and where valuations currently seem depressed. Following the dampening of near-term downside risks — U.S. election and COVID-19 pandemic —we are now more positive towards risk assets, however believe some markets may have already run somewhat ahead of themselves. Given this, we await any minor corrections, and will reassess adding to growth assets at such time.
Developed market equities:	We expect equities to prosper in most geographies. The U.S. is benefitting from stronger fiscal stimulus and an exceptional Fed backstop. The U.S. is more growth heavy, which we believe will remain a structural winner longer term. The Eurozone is a beneficiary of the stable peripheral spreads, Recovery Fund support and the more resilient labour market. Eurozone has a higher beta to normalising PMIs and should benefit from a further style rotation, as it has a much lower exposure towards Tech. The UK is currently trading at the lowest forward P/E level vs global peers in the last two decades. This holds even if one were to exclude Banks and Energy from the calculation. The last two times UK traded this cheap, it has beaten the global benchmark over the following 12 months. Japan is a global cycle play and tends to do better when bond yields are rising and value & cyclicals shares are outperforming.
Australian equities:	We increased our position to Australian equities in mid-November and now hold a mild overweight position to the asset class. Given the highly cyclical nature of Australian equities, this purchase should provide additional exposure to this segment of the market, which has rallied in November and looks set to continue.
Emerging market equities:	We remain neutral in Emerging Market (EM) equities however view the asset class favourably and believe it should benefit from the USD weakness and provide portfolios with cyclical exposure if we see economies recovering further. EM also offers favourable sector tilts, with high exposure to Tech and Consumer Services. The asset class should benefit from further US dollar weakness and provide cyclical exposure if we see the economy recover further. Besides that, EM offer favourable sector tilts, including overweights to Technology and Consumer Services. Within EM, the Asian region is where we expect to see the most upside, especially China, Korea and Taiwan.

Listed real assets[1]:	Despite the business model for the sector requiring repricing as a result of COVID-19, we believe this has been somewhat overdone and based on current valuations find GREITs relatively attractive. Should inflationary pressures begin to pick-up in 2021 the sector should provide some protection for portfolios. We continue to see strategic opportunities in listed infrastructure given the "lower for longer" rates scenario and potential fiscal support via infrastructure spending. We maintain benchmark weight and prefer GREITs at this stage.
Alternative growth:	We continue to advocate a long-term strategic allocation to alternative risk and return drivers in order to provide diversification from equity beta. This asset class typically has less volatility than listed real assets (which has continued to play out) and is therefore a valuable diversifier in periods of extreme markets conditions. Therefore, alternative growth remains at benchmark.
DEFENSIVE ASSETS	We shifted our allocation to defensive assets to underweight in mid-November as growth prospects lifted and near-term risks dissipate. This reduction came at the expense of cash, with global and Australian fixed income continuing to be our preferred asset classes within defensive assets. They provide duration to the portfolio and we remain overweight relative to benchmark.
International fixed income:	We are overweight international fixed income. Central banks have reaffirmed their commitment to a 'lower for longer' environment with further monetary stimulus expected to keep yields and spreads low. We retain preference for U.S. Treasuries, primarily due to their long duration characteristics and as a low yielding but stable investment, offering diversification and downside protection.
Australian fixed income:	We are overweight Australian fixed income. 'Aussie' rates look attractive on many metrics and have second most room to zero in the Developed Markets rates space. We like Aussie duration as an addition to the US duration position.
Cash:	We are underweight the asset class, having recently further reduced the levels of cash in portfolios to fund increases in Australian equities and GREITs, as our outlook has become more positive. As demonstrated in recent months, cash remains an important source of liquidity in portfolios, enabling us to deploy capital as necessary, alongside its risk reducing characteristics.
FOREIGN CURRENCY HEDGE RATIO[2]	We remain mildly underweight the AUD as portfolio protection, given the AUD is a risk currency, and should act as a form of protection in the event of any market pull-back. The AUD has appreciated strongly in the last couple of months mainly driven by risk-on market environment.

Notes:
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