FEBRUARY 2021

HOUSE VIEW

EXECUTIVE SUMMARY

Investors hoping for a predictable start to the year needed to only wait until the first week of January to see 2021 would be anything but a smooth ride, as riots on Washington's Capitol Hill followed an unexpected Democratic sweep in Georgia. Markets looked past the riots and the once feared Democratic 'Blue Wave', focussing on the prospects of increased fiscal stimulus rather than the potential for corporate tax hikes under a Biden administration. It is this fiscal support, low rates and the continuation of 'TINA' which has seen us maintain our mild overweight to growth assets in February. With an expectation of further volatility in the early part of 2021, we await better buying opportunities to potentially increase our exposure to growth assets.

OUR VIEW

The outcome of the Georgia run-off elections and inauguration of Joe Biden as President in January has provided markets with a clearer and more predictable administration for the foreseeable future.

Despite the clarity, the Democratic mandate is amongst the narrowest in 60 years. Biden won the White House with only 51% of the popular vote (compared to Obama's 53% in 2008), the Democrats' House majority is only 11 seats and their control of a 50/50 Senate comes only via the tie-breaking vote of Vice President Harris. As a result, we expect the control of congress to result in higher fiscal stimulus measures (albeit Biden's $US1.9trillion package will likely be watered down), but believe fears about major tax or regulatory changes are overstated given the narrow majority.

Markets also looked favourably upon the outcome, grinding higher in early January, to reach new all-time highs, before a small sell-off late in the month pared them back.

While prospects of further fiscal support, low rates and vaccine-driven momentum are supporting markets at present; COVID-19 infections surpassed 100 million globally in January and continue to impact large parts of the globe.

Despite the commencement of vaccinations across much of the world, new case numbers in key regions including the U.K. and U.S. are still at elevated levels and lockdowns of varying degrees remain enforced.

Markets rallied late in 2020 following promising vaccine news with a precondition of quick delivery and high efficacy. Any downside disappointments in the months ahead are likely to trigger short-term weakness across markets.

We expect a gradual reopening of economies over the next six months — with varying speeds across countries — as the threat of new strains of COVID-19 and potential supply constraints slow progress in some regions.

WHAT THIS MEANS FOR OUR DIVERSIFIED PORTFOLIOS

Markets still appear somewhat stretched at present and we believe volatility is likely to persist for at least the early part of 2021.

Despite murmurings of inflation prospects (which we don't expect to become meaningful until next year) and some concern over vaccine disappointments, further fiscal stimulus, liquidity and TINA 'There Is No Alternative (to equities)' should continue to support risk markets. Accordingly we have retained our mild overweight to growth assets. We await any minor corrections for the possibility of further building our position in growth assets.

Within defensive assets we continue to favour U.S Treasuries and Australian rates, which continue to provide duration to the portfolio and act as a low yielding but stable investment, offering diversification and downside protection.

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%	+1%
Australian fixed income	12%	13%	+1%
Cash	10%	5.5%	-4.5%
Foreign currency hedge ratio[2]	30%	28.5%	-1.5%

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 February 2021.

STRATEGY POSITIONS SUMMARY

GROWTH ASSETS:	We have maintained our mild overweight to growth assets which is currently expressed via mild overweight positions in global developed markets, Australian shares and listed real assets. Within listed real assets, the portfolio continues to holds an overweight to GREITs which have significantly underperformed global shares during the pandemic and which should benefit further from the reopening trade. We are closely watching emerging market (EM) equities for more appealing entry points to increase our position in the asset class. The cyclical exposure should benefit in the medium-term due to the global reopening of economies.
Developed market equities:	We expect equities to significantly outperform cash and fixed income in 2021, however envisage a volatile ride for investors. Within the major developed markets we believe the U.S. is most likely to outperform due to its quality/growth characteristics. While 'value' rallies are expected over the course of 2021 we believe 'growth' stocks still have some way to run. We expect ex-U.S. markets to continue trading at elevated valuation discounts to the U.S., given the lower relative weight of high-growth stocks, however have downgraded both Japan and Europe in the short-term. A defensive barbell approach to equity exposure via quality/growth (U.S) and cyclical/value (Australia and EM) characteristics remains.
Australian equities:	We retain our mild overweight position to the asset class. Given the highly cyclical nature of Australian equities, the position is expected to provide exposure to this segment of the market, which is expected to outperform in the short-to-medium term. Longer-term we see more favourable opportunities in other developed markets.
Emerging market equities:	EM provides portfolios with cyclical exposure as economies recover further. EM also offers favourable sector tilts, with high exposure to Tech and Consumer Services. Within EM, the Asian region is where we expect to see the most upside, especially China, Korea and Taiwan. Despite holding a benchmark position in EM, the asset class sits high in our equity rankings and should further weakness present we may seek to increase our allocation.

Listed real assets[1]:	We are mildly overweight listed real assets, due to our overweight positioning in GREITs. While grinding higher on an absolute basis, GREITs have continued to underperform global equity markets given lockdowns and higher U.S. yields. However, we hold on to the active overweight call due to high cash returns, cheap valuations and economies reopening. 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 increased potential for fiscal support via infrastructure spending that a Biden administration brings. We maintain a 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 retain a mild underweight to defensive assets which is maintained due to an underweight cash position within our portfolios. U.S. Treasuries and Australian rates have moved in tandem for the last couple of months or so. While moderately higher yields cannot be ruled out in the short-term given vaccine-driven market dynamics, economic expectations and additional fiscal support; structural forces are expected to keep yields capped and low in general. We watch for slightly higher yields in order to extend duration positioning in the equally attractive U.S. and Aussie rates markets.
International fixed income:	Persistence of global output gaps and labour market slack points to inflation risks remaining limited within the forecast horizon – and most likely for some time after. Coupled with accommodative central bank policy, this should keep nominal yields low and real rates in negative territory, ensuring the economic recovery and rising levels of fiscal debt can be sustained for a prolonged period. We are overweight international fixed income as a result. We retain a 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 the second most room to zero in the Developed Markets rates space. We like Aussie duration as an addition to the U.S. duration position. This position is due to the additional yield pick-up, relative to cash, from the asset class. Given the RBA's QE program, we see little risk for the sector in the foreseeable future.
Cash:	We are underweight the asset class, preferring the relatively low-risk yield pick-up afforded by fixed income at present. The portfolios continue to hold cash as a form of liquidity and favourable risk reducing characteristics.
FOREIGN CURRENCY HEDGE RATIO[2]	We are at benchmark weight for the AUD. Having appreciated strongly in 2020 there is still some potential for further upside before the year finishes, particularly if 'TINA' and stronger commodity prices eventuate. Despite this, the AUD is a risk currency and we elect not to shift overweight at this stage as a defensive hedge.

Notes:
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