EXECUTIVE SUMMARY

Rising geopolitical tensions and COVID-19 infections couldn't dampen investor sentiment in June as shares continued their remarkable rally, capping an incredible quarter for equity markets. Despite the gains, we remain concerned about share market valuations and have heightened concerns surrounding the geopolitical landscape — particularly as the US election draws near — the US-China trade tension shaping as a political pawn to sway voters. Given these near-term headwinds, we remain slightly underweight growth assets and materially underweight the AUD as a form of portfolio protection in the event of an equity market sell-off.

OUR VIEW

Share markets have risen further recently, albeit in a more muted fashion than previous months, to test all-time highs and cap a remarkable quarter for the asset class — the S&P500 (+20%) recording its largest quarterly gain in more than a decade.

Incredibly these gains have come against a backdrop of heightened geopolitical tensions and a surge in COVID-19 infection numbers across the US.

This appreciation has only served to solidify our view that equities appear overvalued and susceptible to a risk-off event in the near term. Traditionally a safe-haven asset, gold's ascent to US$1800 per ounce in June — the first time since 2011 — partly reflects underlying concerns amongst some investors.

In the US, reporting season commenced last week, with results encompassing the darkest period of economic lockdowns. Market participants are resigned to the fact earnings will be poor, the question is how poor? Insights into corporate profits and accompanying forward guidance adds further potential for a pullback in risk markets.

Despite the near-term headwinds, we continue to view equities favourably over the longer-term, with fiscal and monetary stimulus likely to serve as a floor and ample source of liquidity for equity markets in the medium-term. Our base case, a recovery sometime in 2021 — with pre-crisis GDP levels not expected to be reached before the end of 2022 — will likely be preceded by further market sell-offs.

A longer-term recovery is reliant on continued and further containment of the virus, and the resultant opening of economies more broadly.

Whilst there are clear risks ahead for equities in the short-term, we prefer equities to bonds in the medium-to-longer term — due to the relatively low yield on offer from bonds — hence our reluctance to push further underweight growth assets at this stage.

Our currency positioning continues to offer additional downside protection in the event of further market sell-offs.

WHAT THIS MEANS FOR OUR DIVERSIFIED PORTFOLIOS

Equity outperformance has allowed our allocation to risk assets to drift closer to benchmark again this month, however despite this we remain underweight growth assets. Similarly our underweight to the AUD has decreased slightly, owing to strong appreciation of the AUD in June. We retain this position as further protection in the event of a risk-off event.

Within developed market equities we now favour European equities, which should offer greater upside potential. Additionally they should benefit from style rotations into Cyclicals and Value, given their greater exposure to these areas.

PORTFOLIO POSITIONING

	SAA	TAA	Over/ Under weight
Growth assets	70%	68%	-2%
Australian equities	26%	25%	-1%
Developed market equities	28%	27%	-1%
Emerging market equities	4%	4%	0%
Listed real assets[1]	6%	6%	0%
Alternative growth	6%	6%	0%
Defensive assets	30%	32%	+2%
International fixed income	8%	9%	+1%
Australian fixed income	12%	12%	0%
Cash	10%	11%	+1%
Foreign currency hedge ratio[2]	30%	17%	-13%

SAA – strategic asset allocation
TAA – tactical asset allocation

STRATEGY POSITIONS SUMMARY

GROWTH ASSETS:	We have a small underweight position to growth assets, which was reduced further last month due to strong equity market performance. Economic headwinds remain, accentuated by near-term risks, namely increasing pandemic infections and geopolitical tensions — which have potential to escalate further as the US election nears.
Developed market equities:	Downside risks remain within developed market equities. Despite a small sell-off in mid-June the continued rally has meant earnings multiples remain ahead of fair value. We have a slight preference for European equities over other developed markets, as they should benefit from style rotations into Cyclicals and Value, given their greater exposure to these areas.
Australian equities:	We remain underweight Australian equities, primarily due to relative valuations and a subdued outlook for the market's key sectors (Financials and Resources). As domestic equities are heavily biased towards these sectors relative to global peers, both lower interest rates and lower commodity prices are detrimental. Second-wave lockdowns in the state of Victoria will also stall the economic recovery further and have potential to weigh on the domestic share market.
Emerging market equities:	We remain neutral emerging market equities. Although the region scores relatively well within our framework, COVID-19 infection rates continue to rise across much of the region and therefore remain a major headwind in the short-to-medium term.

Listed real assets[1]:	A global recession is likely to put downward pressure on rents, with retail and offices expected to be hit harder than residential and industrial Real Estate. REITS remain under further pressure, with shopping centres challenged by e-commerce and office spaces suffering from the mobilisation of workforces into homes. We see strategic opportunities in listed infrastructure given the "lower for longer" rates scenario and potential fiscal support via infrastructure spending, however without a compelling case for real assets outperforming or underperforming other growth assets, we remain neutral and seek to avoid unnecessary turnover in the portfolio.
Alternative growth:	We 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 assets remain at benchmark.
DEFENSIVE ASSETS	Our overweight position to defensive assets is expressed via global fixed interest and cash. Whilst yields are low and expected to remain so, this position provides downside protection in the event of our base-case - an anticipated equity sell-off in the near-term. Duration remains one of our preferred diversifiers in a volatile environment. Rates markets remain well supported by central bank policies and geopolitical risks which appear to be gathering momentum.
International fixed income:	Unprecedented monetary stimulus should keep yields and spreads low, however fiscal stimulus needs to be financed and is leading to higher supply that needs to be absorbed. Overall we retain a slight overweight to global bonds as a low yielding but stable investment offering, diversification and downside protection.
Australian fixed income:	We maintain a close to neutral position in domestic bonds for the time-being, preferring to express our overweight to defensive assets via cash and global fixed income.
Cash:	We remain slightly overweight cash. This position is retained to reduce risk in our diversified portfolios. Cash along with global fixed income remains our preferred asset class within defensive assets.
FOREIGN CURRENCY HEDGE RATIO[2]	Despite the Australian dollar continuing its rally in June, pushing our hedging position further underweight, we maintain our conviction that this position will provide additional downside protection in the event of a global equity sell-off in the near-term.

Notes:
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 20 July 2020.

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