JUNE 2020

HOUSE VIEW

EXECUTIVE SUMMARY

Share markets continued their ascent in May and early June, buoyed by economies reopening and further hope of a COVID-19 vaccine. Following the recent rally — driven largely by cyclical stocks — we are concerned earnings multiples may be too far ahead of fair value and believe markets are susceptible to additional drawdowns in the near term. Indeed, a big sell-off in equities on 11 June was what we expected and we fear there may be more to come. We retain a minor underweight to growth assets and material underweight to the AUD as an additional form of protection in the event of a further sell-off.

OUR VIEW

Global share markets soared again in recent weeks following several countries easing their lockdown measures and economic activity commencing the long road back to normality. Positive news from initial human testing of a COVID-19 vaccine in the US provided investors with a further glimmer of hope as other vaccine producers commenced human trials globally. The S&P 500 erased its year-to-date losses on 9 June, while the Nasdaq reached a new high on 10 June — before both crashed on 11 June.

The price of West Texas Intermediate crude oil surged an emphatic 88% during May — due to continued OPEC production cuts — yet still finished the month more than 40% below its January high.

These initial gains came despite the continued US-China tit-for-tat, widespread demonstrations in the US and disappointing data prints.

May's economic data releases remained firmly entrenched in the mire, however did show occasional green shoots — US ISM data climbed to 43.1 from an 11-year low of 41.5 in April, however remains in contractionary territory. Across the Atlantic the UK recorded its worse GDP reading in 11 years, contracting 2.0% quarter on quarter.

Both the US and European central banks continued their quantitative easing program, the European Central Bank purchasing more than 125b of government and corporate bonds during May, while the US Federal Reserve indicated some reluctance to push rates into negative territory.

Our base case is for a recovery sometime in 2021 however we remain concerned over asymmetric downside risks in the near-term.

Any longer-term recovery will be contingent on further containment of the virus, and the subsequent unlocking of economies.

We identify two key risks to our base case. Firstly a secondary wave of infections — which is almost unavoidable. How quickly, and with what level of associated shutdowns, these additional outbreaks are curtailed will be critical.

Secondly the US-China trade tensions which have begun to gather steam. We believe these are likely to escalate into year-end — dependant on political posturing in the US — as the election nears.

While medium to longer-term perspectives for equity markets remain favourable relative to bonds, we are mindful of the recent equity market rally which has come against a backdrop of deteriorating fundamentals and uncertainty ahead for economies and the corporate sector. Strong monetary and fiscal stimulus is in place but should be largely priced in.

WHAT THIS MEANS FOR OUR DIVERSIFIED PORTFOLIOS

We are concerned market exuberance has advanced too far ahead of fair value and as such retain our minor underweight to growth assets — expressed via global hedged equities and Australian equities — in favour of cash and international fixed interest.

Our hedging position is also maintained — favouring foreign currency. This position, owing to the Australian dollar's sensitivity to risk, should provide some downside protection in a market sell-off.

ANZ PRIVATE

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 marginally last month due to the strong equity performance. Economic headwinds remain, accentuated by near-term risks of second-wave pandemic infections and US-China trade tensions.
Developed market equities:	Downside risks remain within developed market equities. Another rally in May and the start of June has led to earnings multiples moving further ahead of fair value. Despite this we have a preference for developed market vs. emerging market equities, in particular the US and its quality and growth bias relative to more cyclical and value-oriented regions.
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. We expect the recent cyclical rally to be a temporary one.
Emerging market equities:	Recent deterioration in valuation data and growth expectations amongst emerging markets has led us to recently reduce our overweight EM position. COVID-19 infection rates continue to rise across much of the emerging market countries leading to additional downside risk.
Listed real assets[1]:	Despite lower yields, global REITS remain under pressure with shopping centres challenged by e-commerce and offices suffering from the COVID-19 inspired "work from home" movement. We see strategic opportunities in listed infrastructure given the "lower for longer" rates scenario and potential fiscal support via infrastructure spending. 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:	Alternative growth assets are held at benchmark. 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.

DEFENSIVE ASSETS	Countering our underweight growth position, is our overweight to defensive assets 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 an anticipated equity sell-off. Duration remains one of our preferred diversifiers in a volatile environment. Rates markets remain supported by an accommodative central bank stance and (geo)political risks.
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:	Cash remains our preferred asset class within defensive assets in order to maintain our minor overweight positioning. This position has been retained to reduce risk in our diversified portfolios.
FOREIGN CURRENCY HEDGE RATIO[2]	We have maintained our Australian dollar (AUD) hedge ratio for global equities given the AUD is a risk currency and risk appears skewed to the downside.

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 June 2020.