OCTOBER 2020

HOUSE VIEW

EXECUTIVE SUMMARY

Following months of rising equity markets, September saw a substantial sell-off, led by the U.S. Technology sector. Volatility ensued, as the S&P 500 fell more than 9% from its all-time high in early September. We've been underweight growth assets for some time now, primarily premised on valuation concerns and an uncertain macro backdrop. Whilst valuations are still somewhat rich and a global recession looms, we believe the recent correction has presented a sound opportunity to build our growth exposure back towards benchmark, awaiting further re-entry points should additional sell-offs occur.

OUR VIEW

September saw volatility return, as a Technology sector sell-off triggered weakness across the broader market — investors locking in profits as valuation concerns finally came to the fore.

The S&P 500 fell more than 9% in September — from its all-time high earlier in the month — and was teetering on the cusp of "technical correction" territory.

This "healthy" correction was accompanied by falling investor sentiment surrounding COVID-19 outbreaks, particularly in India and parts of Europe, where daily case numbers reached new highs.

Further headwinds reside in the short-term, namely the inability of US Congress to formally agree on a new fiscal package, and concerns surrounding the U.S. Presidential election — specifically an increasing likelihood of delays in the President being confirmed — as the postal vote saga continues and President Trump currently refuses to commit to a peaceful transfer of power if he loses the November election. This would likely be the worst possible outcome for investors, as the market seeks certainty in these most uncertain of times.

On a more positive note, despite geopolitical tensions continuing to simmer, economic activity in China appears to be reaching pre-crisis levels. Recent data on industrial production, retail sales, and fixed asset investment suggests that its economic recovery in the aftermath of COVID-19 is on track, providing hope the rest of the globe can follow-suit once the virus is brought under control or a vaccine is found — the latter has potential to lift investor sentiment.

Alongside this, global central banks continue to inject liquidity into economies, back-stopping financial markets and 'propping' up investor confidence.

We have remained underweight growth assets for several months now, believing a correction in the vicinity of 10% was likely, and would represent a good re-entry point to buy growth assets back towards benchmark.

Whilst short-term risks remain we believe now is an appropriate time to increase our allocation to growth assets and seek to further build our equity exposure in coming weeks if additional weakness presents.

WHAT THIS MEANS FOR OUR DIVERSIFIED PORTFOLIOS

We have elected to increase our exposure to equities — increasing both developed market and Australian equities.

The increase in equities has been funded from our cash position — which has been built up over previous months — as we believe exposure to US Treasuries and Australian government bonds remains sensible given they provide the most dependable (but not constant) source of diversification and negative correlation to risk assets — something which is becoming increasingly difficult to find.

We retain our underweight to the Australian dollar as a continued form of portfolio protection, given there is still some downside risk in the near-term.

PORTFOLIO POSITIONING

	SAA	TAA	Over/ Underweight
Growth assets	70%	67%	-3%
Australian equities	26%	24%	-2%
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%	33%	+3%
International fixed income	8%	10%	+2%
Australian fixed income	12%	14%	+2%
Cash	10%	9%	-1%
Foreign currency hedge ratio[2]	30%	22%	-8%

SAA – strategic asset allocation
TAA – tactical asset allocation

Figures may not add up due to rounding

STRATEGY POSITIONS SUMMARY

GROWTH ASSETS:	We remain underweight growth assets despite electing to buy-back towards benchmark following the recent market sell-off. Whilst short-term headwinds — geopolitical tensions, COVID-19 outbreaks and U.S. election uncertainty — persist, we believe central banks and governments will continue to provide fiscal and monetary stimulus to support risk markets. We expect there to be further volatility ahead and will use this to find further re-entry points to bring growth back to benchmark.
Developed market equities:	We maintain a preference for developed market equities relative to emerging markets — with a preference for U.S. stocks. Whilst near-term risks, namely the U.S. election and COVID-19 outbreaks across Europe are concerning, we believe the recent sell-off has brought equities back closer to fair-value.
Australian equities:	We remain underweight Australian equities, but have bought back closer to benchmark in September. Australian equities are heavily skewed towards cyclical stocks in Financials and Resources and we believe these may provide some upside in the near-term relative to other parts of the market. The government's recent announcement to wind-back responsible lending and the continued strength of commodity prices should be supportive.
Emerging market equities:	We remain neutral towards the sector, despite the recent sell-off further improving its standing within our scorecards, preferring developed market and Australian shares. The potential for further strengthening of the U.S. dollar could see the sector come under increased pressure in the near-term.
Listed real assets[1]:	Valuations and yields are becoming more attractive in the sector however we hold our view, for the time-being, that a global recession is likely to put further downward pressure on rents, with retail and offices expected to be hit harder than residential 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. We await better entry opportunities and 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 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 assets remain at benchmark.
DEFENSIVE ASSETS	Our overweight position to defensive assets was reduced in late September following a pull-back in equity markets. This reduction was at the expense of cash resulting in global and Australian fixed income being our preferred asset class within defensive assets. Australian and Global fixed interest provides duration to the portfolio, which remains one of our preferred diversifiers in a volatile environment.
International fixed income:	We continue to favour duration within defensive assets. Central banks have reaffirmed their commitment to a 'lower for longer' environment with further monetary stimulus expected to keep yields and spreads low. Overall we retain a slight overweight to global bonds as our preferred defensive asset class, primarily due to its long duration characteristics and as a low yielding but stable investment offering, diversification and downside protection.
Australian fixed income:	We maintain an overweight position to domestic bonds for the time-being. Australian government bonds continue to provide a good source of diversification and negative correlation to risk assets.
Cash:	We are neutral cash, having recently used our previously overweight position in the asset class to fund equity purchases in developed market and Australian shares. 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 have maintained our underweight to the AUD. Given the AUD is a risk currency, the position aims to provide additional protection in the event of further equity weakness and acts as a hedge as we look to push growth assets back towards benchmark 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 1 October 2020.