ALLIEDWEALTH

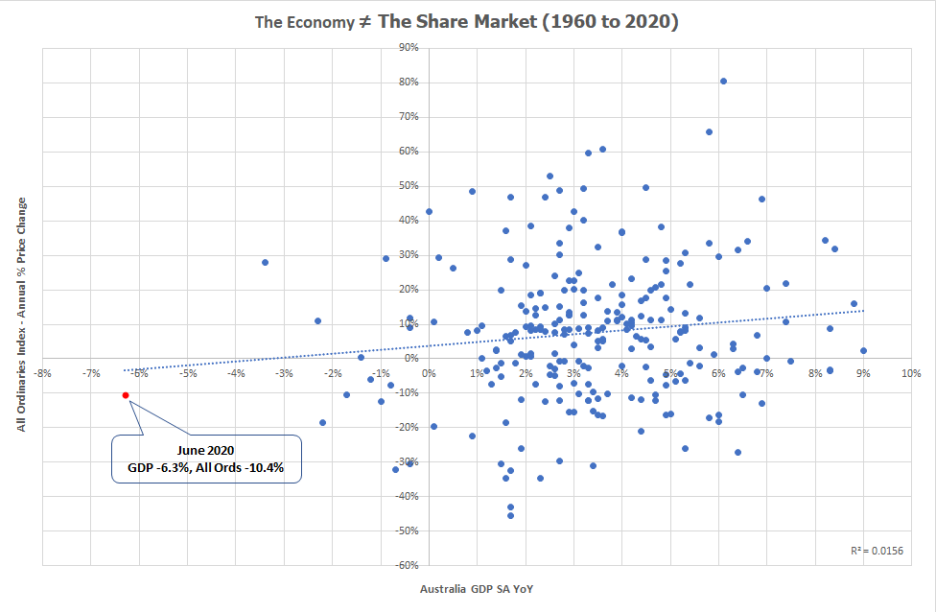
Implemented Portfolios

# Monthly Economic & Investment Market Commentary

## September 2020

The world continues its efforts to recover from both the health and economic impacts of the coronavirus, but it must be said with widely diverging degrees of policy support, patience and effectiveness. One of the questions that has been asked many times is why is it that in many countries the share market seems to be doing so much better than the underlying economy? Perhaps the better question to ask though is why should we expect these to have similar performance in the first place?

Whilst our largest listed companies are of course very important contributors to our economy, they are but one part of the business sector, which is also comprised of many thousands of unlisted businesses. More broadly than that, our economy is much more than just the business sector. When the statisticians total up our economic output as a nation, they of course need to also consider activity and consumption from the household sector, public sector spending and investment and the value of everything we export, netted against the amount we import from overseas.




In this chart we plot Australian GDP growth on the horizontal axis, against the returns from the share market on the vertical. Clearly, looking at 60 years of annualised quarterly numbers, there is just not a particularly strong relationship between these two variables.

The red dot shows clearly just how big an outlier our current circumstances are, but also that negative GDP can come with both positive and negative share market returns.

As mentioned above, the uneven nature of the various recoveries around the world appears to be widening. As we continue to relax social restrictions here and re-open our borders slowly, and with that our economy, much of the world is sadly headed in the opposite direction. For those of us with itchy feet and eyeing the stronger Australian dollar, international travel plans are seemingly still likely to be sharply curtailed, perhaps through 2021. Much of the United Kingdom and Europe is having to reimpose lockdowns

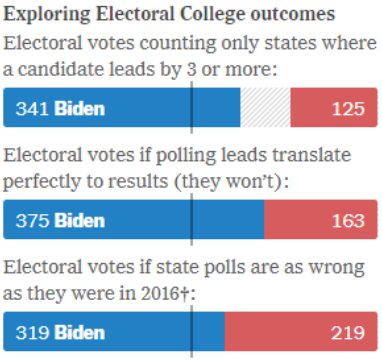
as virus cases start recording a second, or in some cases a third peak. As we all know well this comes with both immediate and longer-term economic consequences.

However, the situation in the United States, as it often does, takes things to another level. The president holding campaign rallies with packed, mask-less, not socially distanced crowds, in states where the virus count is soaring simply defies rational explanation. And of course, there is perhaps no better example of the divergence between a share market and an economy, as that which exists in America between Wall Street and Main Street.

That brings us to the pending US elections, where there have been some very interesting developments. The most recent polling data shows an overwhelming likelihood of victory for Joe Biden, and increasingly a strong likelihood that the Democrats will win a majority in the Senate and retain control of the House of Representatives. From a markets and portfolio management perspective, the interesting change in attitude has been for Wall Street to welcome this development. Whilst such an outcome would mean higher taxes and more regulations, it does seem that investors are tiring of the current chaos.

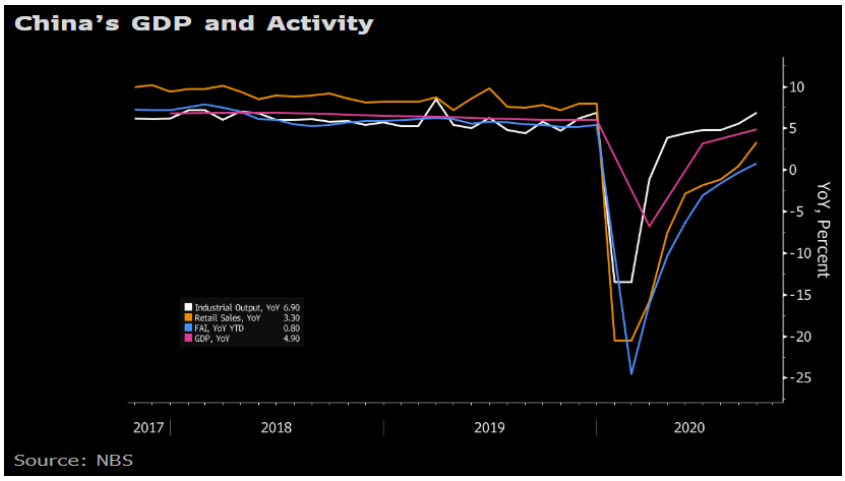
At this point a few weeks out from voting, and where the possibility of a contested election can't be discounted, the short-term impact on markets is still likely to be an increase in day to day volatility. We have certainly seen this recently as the talks on further stimulus to support the US economy lurch from on again to off.

People will of course remember that Democrats were in front in 2016 too, however this graphic from the New York Times[1] shows that even adjusting polling data for a similar error shows a Biden victory.




## China

We have just had confirmation that China is, as anticipated, leading the world in the economic recovery.




The GDP data for the September quarter was slightly below forecast, but growth is still expected to soon be back at pre-pandemic pace.

The result was held back by the services sector, where some virus impacts are still being felt. However, "the acceleration in retail sales growth confirmed that demand -- particularly private demand -- is coming back to support the recovery."[2]

In China, we have in fact seen a recovering economy and a rebounding share market. The mainland share indices have recorded strong growth for 2020 YTD of 18.4%. As you will recall, this recent performance has provided us the opportunity to make an adjustment away from your broader Asia-Pacific investment, towards Japan where our long-term forecasts show better value is available.

**Japan**

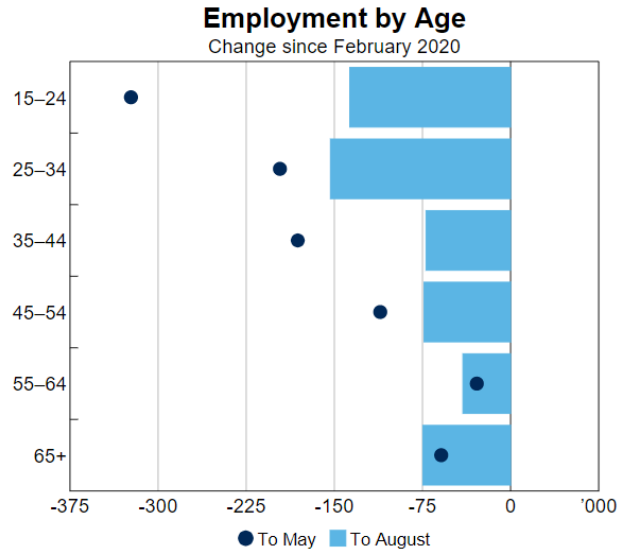
The transition to the new leadership of Prime Minister Suga has been very orderly, and the market has welcomed the stability and the continuation of the policies established under his predecessor Shinzo Abe. These policies, which came to be known as Abenomics, "went a long way toward strengthening Japan's limping economy, not least by spurring major employment gains."[3] Whilst they were not immune to spot outbreaks in virus cases in the aftermath of the initial containment efforts, Japan is among the nations to have best handled the pandemic.

The Japanese share market has seen a relatively strong if incomplete recovery, with growth from an initial plunge of 30% not yet enough to fully regain the earlier 2020 peak. Looking back a little further, and the benchmark Topix index still trades nearly 15% below the peak it set in 2018. The same challenges to recovery need to be navigated, but we expect that the policy measures will continue from the Suga administration, with important support on monetary policy initiatives from the Bank of Japan. "In Japan - where inflation is negligible and interest rates are lower than the rate of GDP growth – deficit spending can be beneficial, not only today, but also for future generations."[3]

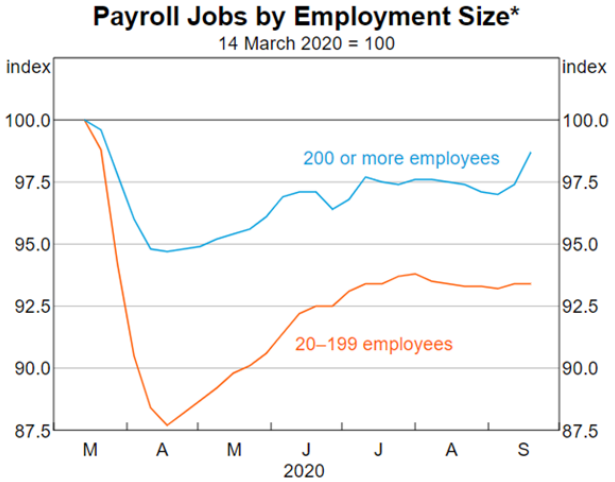
**Australia**

Echoing such sentiments and policy imperatives, our own Reserve Bank Governor Philip Lowe recently provided more context to our crisis response, but more importantly was especially clear about what the future will hold from the bank's perspective on continuing policy support. His speech contained a shift in language from building a bridge across the gap in economic activity, to now being focused on the need "to construct a road to recovery as the economy opens up."[4]

Just as there has been divergences in the impact and recovery from the virus between countries, so too has there been substantial differences in how parts of our economy and labour market have fared. These charts from the governor's speech reinforce the concept that we spoke of earlier, that share market performance is normally not representative of the broader economy. In this current crisis, young people and smaller businesses have been hit much harder than other areas.




Sources: ABS; RBA




* Excludes a small number of businesses reporting through single-touch payroll (STP) where employment size information was unavailable; excludes businesses not reporting through STP and self-employed persons

Source: ABS

The positives we can look forward to though, again, as our restrictions ease and our borders re-open, are quite substantial. The latest national accounts data showed that our savings were at a record high, and we have seen strong demand for housing credit, particularly amongst first home buyers. A range of ongoing supportive measures were announced in the recent federal budget, and the RBA has been unequivocal that they will not move to increase interest rates any time soon.

"The Board will not be increasing the cash rate until actual inflation is sustainably within the target range. It is not enough for inflation to be forecast to be in the target range. While inflation can move up and down for a range of temporary reasons, achieving inflation consistent with the target is likely to require a return to a tight labour market. On our current outlook for the economy – which we will update in early November – this is still some years away. So we do not expect to be increasing the cash rate for at least three years."

If we can continue to handle the recovery from the health crisis well, and people and businesses have enough confidence about their outlook to draw on their savings for spending and investment, then our recovery can still surprise to the upside.

Kind regards,
**Asset Allocation & Investment Committee**

# Asset Class Tipping Points

Markets have generally remained relatively stable though the last month or so, and as such we have seen little change in the relativities between risky asset classes shown below. We do see support here for the continued move from Asia-Pacific to Japan, and we are still considering a shift to increase the target on Listed Property as more clarity on the office and retail sector emerges. We remain comfortable with an overweight stance to Australia, and within that to the Financials sector, where we see improving prospects and the coming restoration of dividend payout ratios.

## Asset Class Tipping Points - October 2020

**Australian Equities**

| All Ords | 10 Year Forecast | Valuation | 09-Oct |
|---|---|---|---|
| 10,700 | 1.1% | Overpriced | |
| 10,300 | 1.6% | Overpriced | |
| 9,900 | 2.1% | Fully Priced | |
| 9,500 | 2.6% | Fully Priced | |
| 9,100 | 3.1% | Fully Priced | |
| 8,700 | 3.7% | Fully Priced | |
| 8,300 | 4.3% | Fully Priced | |
| 7,900 | 5.0% | Fair Value | |
| 7,500 | 5.7% | Fair Value | |
| 7,100 | 6.4% | Fair Value | |
| 6,700 | 7.2% | Cheap | |
| 6,300 | 8.1% | Cheap | Aust 8.1% |
| 5,900 | 9.1% | Cheap | |
| 5,500 | 10.1% | Cheap | Fin'l 9.4% |
| 5,100 | 11.3% | Cheap | |
| 4,700 | 12.6% | Cheap | |
| 4,300 | 14.1% | Cheap | |

| | | |
|---|---|---|
| Income | 4.5% | p.a. |
| Earnings | 4.9% | p.a. |
| Valuation | -1.4% | p.a. |
| **Forecast** | **8.1%** | **p.a.** |

**International Equities - Developed**

| World ExAust | 10 Year Forecast | Valuation | 09-Oct |
|---|---|---|---|
| 3,200 | 1.6% | Overpriced | USA 0.8% |
| 3,100 | 1.9% | Overpriced | |
| 3,000 | 2.3% | Fully Priced | |
| 2,900 | 2.7% | Fully Priced | |
| 2,800 | 3.1% | Fully Priced | |
| 2,700 | 3.5% | Fully Priced | |
| 2,600 | 3.9% | Fully Priced | |
| 2,500 | 4.4% | Fully Priced | |
| 2,400 | 4.9% | Fair Value | Dev 4.6% |
| 2,300 | 5.4% | Fair Value | |
| 2,200 | 5.9% | Fair Value | |
| 2,100 | 6.5% | Fair Value | |
| 2,000 | 7.1% | Cheap | Euro 6.9% Japan 7.3% |
| 1,900 | 7.7% | Cheap | |
| 1,800 | 8.4% | Cheap | |
| 1,700 | 9.1% | Cheap | |
| 1,600 | 9.9% | Cheap | |

| | | |
|---|---|---|
| Income* | 2.5% | p.a. |
| Earnings | 4.8% | p.a. |
| Valuation | -2.7% | p.a. |
| **Forecast** | **4.6%** | **p.a.** |

**International Equities - Emerging**

| Emerging Markets | 10 Year Forecast | Valuation | 09-Oct |
|---|---|---|---|
| 1,500 | 1.3% | Overpriced | |
| 1,450 | 1.7% | Overpriced | |
| 1,400 | 2.1% | Fully Priced | |
| 1,350 | 2.5% | Fully Priced | |
| 1,300 | 2.9% | Fully Priced | |
| 1,250 | 3.3% | Fully Priced | |
| 1,200 | 3.8% | Fully Priced | |
| 1,150 | 4.3% | Fully Priced | |
| 1,100 | 4.8% | Fair Value | EM 4.6% |
| 1,050 | 5.4% | Fair Value | Asia 5.4% |
| 1,000 | 6.0% | Fair Value | |
| 950 | 6.6% | Fair Value | |
| 900 | 7.3% | Cheap | |
| 850 | 8.0% | Cheap | |
| 800 | 8.8% | Cheap | |
| 750 | 9.7% | Cheap | |
| 700 | 10.6% | Cheap | |

| | | |
|---|---|---|
| Income* | -1.0% | p.a. |
| Earnings | 7.3% | p.a. |
| Valuation | -1.6% | p.a. |
| **Forecast** | **4.6%** | **p.a.** |

**Listed Property**

| ASX200 Property | 10 Year Forecast | Valuation | 09-Oct |
|---|---|---|---|
| 2,275 | 1.4% | Overpriced | |
| 2,200 | 1.8% | Overpriced | |
| 2,125 | 2.3% | Fully Priced | |
| 2,050 | 2.7% | Fully Priced | |
| 1,975 | 3.2% | Fully Priced | |
| 1,900 | 3.7% | Fully Priced | |
| 1,825 | 4.3% | Fully Priced | |
| 1,750 | 4.8% | Fair Value | |
| 1,675 | 5.4% | Fair Value | |
| 1,600 | 6.1% | Fair Value | |
| 1,525 | 6.7% | Fair Value | |
| 1,450 | 7.5% | Cheap | A-REITs 7.5% |
| 1,375 | 8.2% | Cheap | |
| 1,300 | 9.1% | Cheap | |
| 1,225 | 10.0% | Cheap | |
| 1,150 | 11.0% | Cheap | |
| 1,075 | 12.0% | Cheap | |

| | | |
|---|---|---|
| Income | 4.8% | p.a. |
| Dist Grwth | 2.5% | p.a. |
| Valuation | 0.2% | p.a. |
| **Forecast** | **7.5%** | **p.a.** |

** Income for International Equities includes dividends and forecast currency impact.*

*Sources*


1. *The New York Times, The Upshot on Today's Polls. nytimes.com. 19-Oct-20.*
2. *Chang Shu, "Soft GDP Still Set for Final Mile of Recovery" – Bloomberg. 19-Oct-20.*
3. *Koichi Hamada, "The Making of Suganomics" – Project Syndicate. 13-Oct-20.*
4. *Philip Lowe, "The Recovery from a Very Uneven Recession" – Reserve Bank of Australia. 15-Oct-20.*

***NOTE:*** *It is important to note that each portfolio is managed to its own mandate, which can mean that activity mentioned above is not reflected in your own portfolio. This may be because it is more beneficial to your portfolios after tax performance to complete the trading at a different time, or may be due to individual customisation that you have requested. This flexibility is an integral part of the investment process. If you would like to discuss the tailoring of your portfolio, please contact your Adviser.*