Market Outlook

September 2020

At a glance

- Our diversified funds have performed well over the coronavirus period. Capital deployment and market-timing decisions have added additional value.
- We increased allocations to equities over March, and to both currency and energy exposures in May, decisions that have so far worked out well.
- We've now come to something of an inflection point. US fiscal stimulus is on pause, the generous but also desperately needed unemployment benefits expired in late June, and the Payroll Protection Plan is all but finished.
- Monetary policy has also tightened over the past month, with the monetary base shrinking. To note, it's "at the margin," with policy having clearly been stimulatory in the months' prior. But the virus is not gone, nor is its economic overhang, so the time for monetary and fiscal intervention has not passed either.
- As such, we're comfortable monetising much of the initial March capital deployment. Given our desire to move our Fixed Income exposures from "long duration" to neutral or short duration, we're comfortable leaving the rebalancing proceeds in cash.

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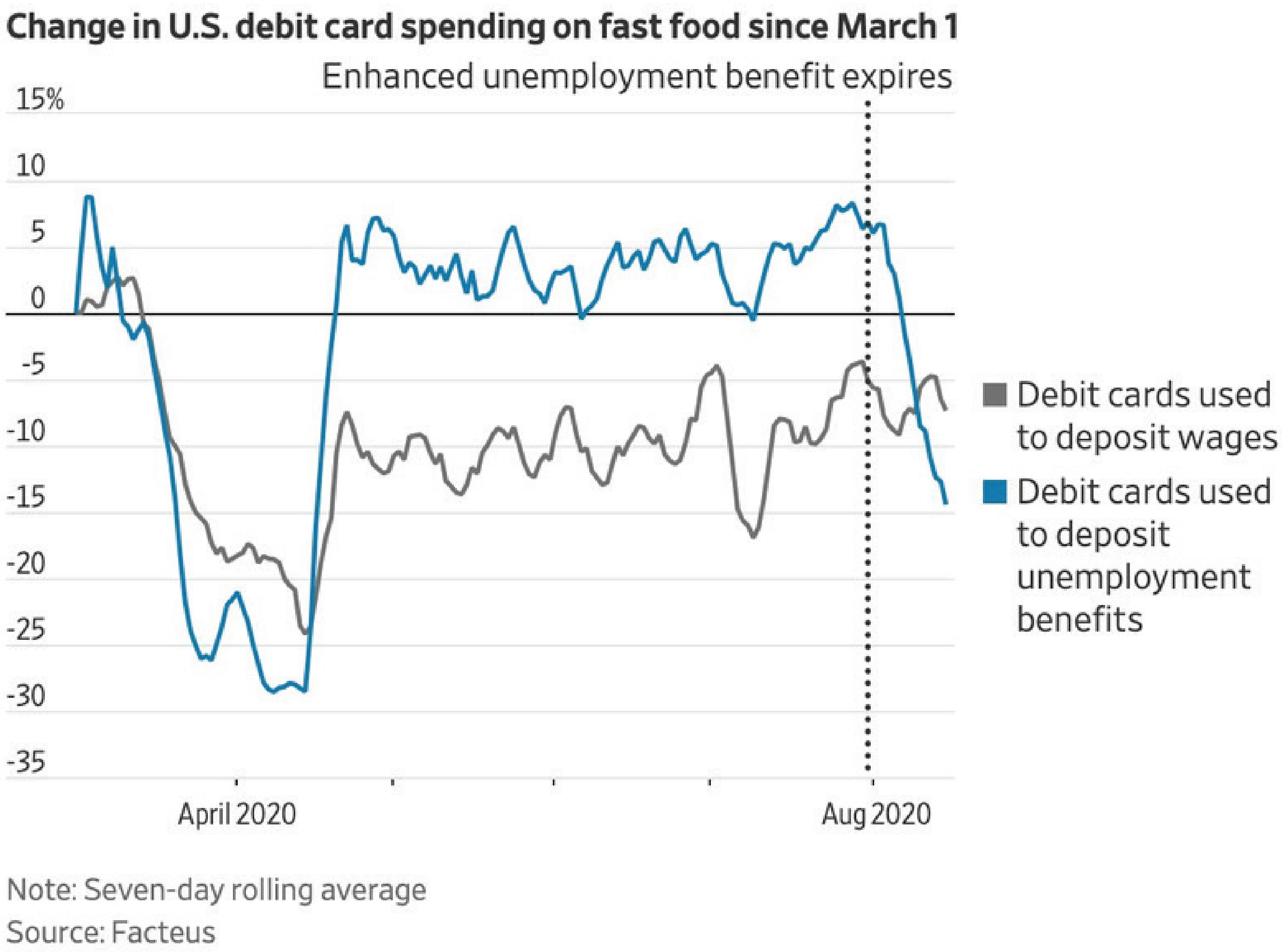
The second wave

Months ago, we discussed the key threats to the "then underway" economic and financial market recovery that began in April. The first threat was the dreaded second wave. And that threat has materialised. New Zealand, France, Germany, Japan, and locally, Victoria, are all affected, and it shows that flare ups and disruptions are something we'll have to live with until a vaccine arrives.

The stimulus

Second waves might not be so bad if the stimulus required to shore-up the economy in the face of sustained drops in output and income were offset with additional expenditure. But, having done a superlative job in the first instance, US stimulus remains unpassed (a bill was passed by house democrats back in late May, but not supported by the GOP).

The predictable consequence has been a collapse in spending by the households that received the benefits, visible in the graph below.



And here's the rub. "COVID time" is much faster than normal economic time. We usually look at monthly economic aggregates (like retail sales) and even then only really put weight on the quarterly time series. Anything shorter has too much statistical noise. But with coronavirus, things changed at such a fast pace that we had to look to much higher frequency data; the iconic example being daily restaurant bookings through Open Door, and Google app data. However, in high frequency credit card data, the drop in spending hasn't been visible. The secret has been that the credit card data does not take into account the largely pre-paid nature of the unemployment benefits. So, it's not where everyone is looking.

The market

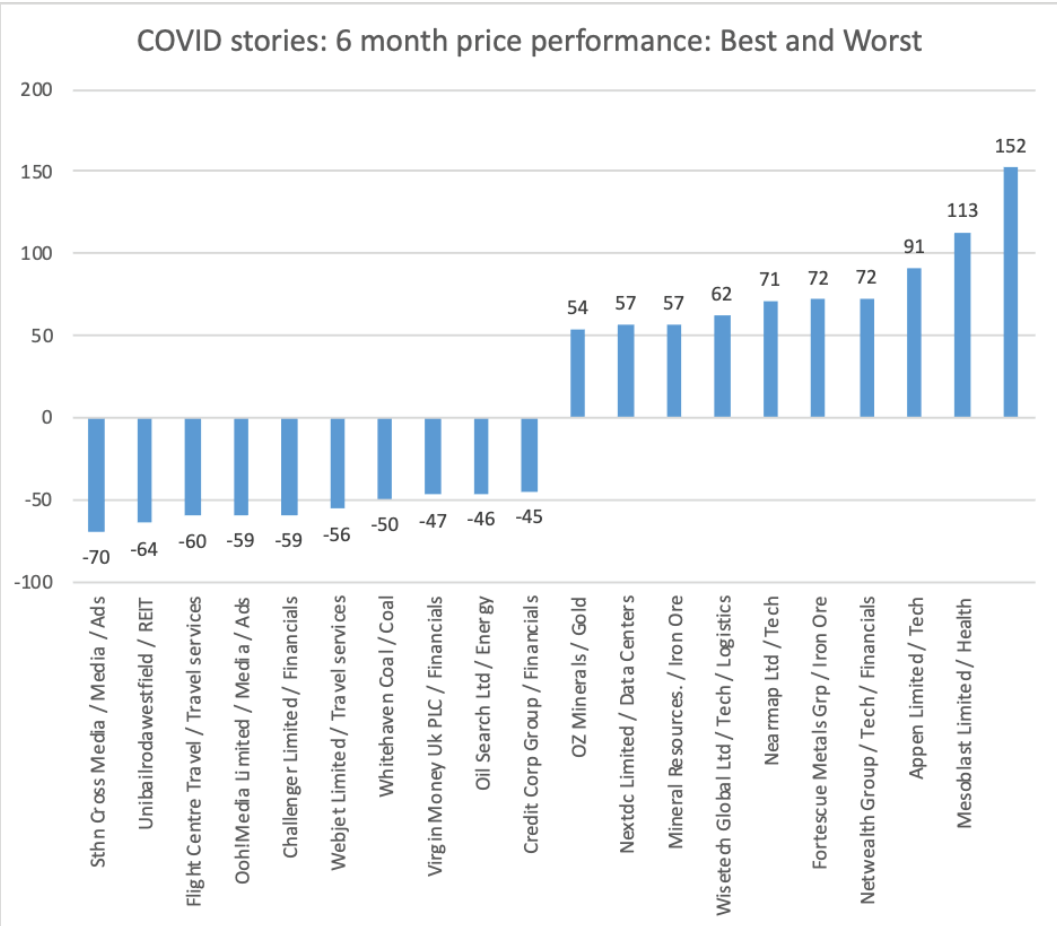
All of that would be fine if the market wasn't breaking new highs. We all know why that's happened. The original stimulus. The virus coming under control. The fact the major companies that make up the S&P 500 are general beneficiaries of the accelerated trends that coronavirus and work-from-home brings. Think of the online activity that benefits Amazon, Facebook, Google, Apple, Microsoft, Netflix et al. The fact that the companies that survive will have fewer competitors. The fact that low bond yields raise the net-present-value of future income. All of these things are well understood; we used the same arguments to support buying the markets back in March.

But with these new developments, the risks have become somewhat asymmetric. It also gives us time to play the "better or worse" game. Since things look worse now than they did in February (before we knew about coronavirus), and yet the market is higher than it was in February, we're forced to decide if either the market was cheap then, or is overvalued now.

A more distinct navel gazing activity concerns the US elections. A Biden presidency points to some modest redress to the US Tax Cuts and Jobs Act, which is something of an issue for the level of the market. The alternative, is also not without consideration, including a president who has stated he is inclined to disregard the outcome of the election. In any case, monetising some of the gains made over the past few months are of great appeal to us.

The local market

Given our desire to keep these market updates short and punchy, we'll hold off discussing the Australian equities reporting season for now. But, we'll quickly showcase some of the key stock and sector best and worst performers over the past six months, noting that similar to the US, the winners are the coronavirus beneficiaries, and the laggards those impacted.



Source: IRESS, Author's calculations, 27 August, 2020

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