WHITEHELM ADVISERS

MONTHLY UPDATE ON THE INVESTMENT ENVIRONMENT

September 2020

primesuper

surprisingly straightforward

MARKET UPDATE

The past three months reflected a tilt in global economic outlook as the world continues to grapple with the COVID-19 pandemic. Unprecedented policy stimulus has buoyed investor optimism, however ongoing geopolitical tensions (particularly between China and the US), Brexit uncertainty, an upcoming US election, and the emergence of a second virus wave in Europe have all contributed to concerns.

By the end of September, the COVID-19 pandemic passed a grim milestone, with over one million confirmed deaths globally from the virus. One-fifth of those have come from the US, which continues to have the highest number of active cases despite a tapering in new diagnoses. The impact of the virus has, however, soared significantly across a number of developing regions, such as Latin America and the Indian subcontinent. There now been over 35 million confirmed cases globally.

The September quarter was an overall strong one for risk assets. Equities recorded an excellent quarter amid unprecedented fiscal and monetary stimulus, with indices such as the S&P 500 and Nasdaq Composite recovering fully from their pandemic-era declines to reach new record highs. Despite ongoing concerns about the pandemic, fully hedged developed overseas equities returned 6.4% for the September quarter, while emerging markets equities also recorded strong improvement, rising 5.2% on an unhedged basis. By contrast, Australian equities declined by -0.1% over the three months. The higher weighting of financial stocks (with banks likely to wear higher loan losses in coming months) and commodities and energy (with declining oil prices) both added to broader global concerns. That said, the quarter ended with the rally in equities dissipating amid rising fears of a second pandemic wave in a number of countries, while in the US political uncertainty around fiscal stimulus negotiations in Congress and the looming US elections in November both contributed. The VIX Index, which measures market-implied forward volatility for US equities, traded at elevated levels over September, reaching nearly 34 points – the highest level since June.

Rising risks in September proved beneficial for fixed interest assets, with demand for government bonds driving down sovereign yields. In Australia, the RBA's extension of concessional wholesale bank funding and expectations of further rate cuts provided a relatively strong tailwind. While returns for fixed interest have been relatively robust over the past year, yields have now narrowed to very low levels, providing limited carry and meaning returns will likely be lower in the near-term. Credit spreads, meanwhile, benefitted from policy stimulus and narrowed over the quarter, however nonetheless remain elevated compared to pre-crisis levels.

AUSTRALIA

The Australian economy remained insulated from the worst of the pandemic, buoyed by commodities demand from China and ongoing fiscal and monetary policy support. There was a surge in cases in the state of Victoria in July which triggered stringent lockdowns, however by quarter-end it has become apparent that these measures had been effective in stemming the spread of the virus; albeit at the expense of the economy. The Commonwealth Government budget in early October provided extensive tax cuts for individuals and businesses, and sizeable infrastructure spending; all contributing to a significant forecast fiscal year deficit. The RBA also continued to provide stimulus through its asset purchases as well as an extension in its term funding facility for banks, enabling them to source significant levels of cash funding at a very low cost. While the cash rate remained at 0.25%, expectations are now that a further cut is likely by year-end. The RBA has also noted its commitment to assist states and territories with funding costs.

Australian economic data was positive overall. The unemployment rate eased to 6.8% (its lowest since April), house prices edged downward by only a small margin, while the nation's trade balance was in surplus throughout thanks in large part to robust commodities demand from a recovering Chinese economy. That said, the second quarter GDP print all-but-confirmed that the nation had entered its first recession in nearly three decades.

UNITED STATES

The US economy continued to improve over the quarter. The unemployment rate fell to 7.9% by September – just over half its April level, while inflation also ticked upward (albeit still well below the Federal Reserve's target).

In a significant policy development, the Federal Reserve announced a change in its inflation approach to one of "average inflation targeting", suggesting a more relaxed approach to raising its target rate to allow inflation to run above the 2% target to offset periods of below-target inflation.

Congress was unable to strike a deal on a new fiscal package, however, with negotiations between Republicans and Democrats continuing into October.

Ahead of the Presidential election in early November, polling suggests a close contest between incumbent President Trump and Democrat Joe Biden, with the latter currently favourite. President Trump's positive COVID-19 diagnosis in early October is likely to hinder his ability to campaign (as well as his polling).

EUROPE

The European economy faces renewed uncertainty after a resurgence in cases across the region following the unwinding of lockdown restrictions. Eurozone inflation disappointed, with the headline rate falling to a four-year low of 0.3%. However, a fiscal plan among Eurozone member states was agreed, with €750 billion agreed to stimulate the region's economy.

In the UK, the government announced the end of its furlough scheme at the end of October, to be replaced with a lower-cost wage subsidy plan only for those working at least a set level of reduced hours. Otherwise, Brexit uncertainty continues, with fresh talks between the EU and UK commencing in early October as the 31 December deadline draws closer.

CHINA

The Chinese economy continued to sharply recover from the pandemic, with exports soaring and commodities demand rising. Sentiment indicators are firmly in expansionary territory across both services and manufacturing, while the renminbi appreciated the most against the US dollar in a quarter since the global financial crisis. Second quarter GDP, released in July, revealed that the economy had recouped all of the first quarter's contraction, lifting the annual growth rate to 3.2%

However, geopolitical tensions have also increased, with the US government attempting to ban a number of Chinese smartphone apps for security reasons, a fatal border skirmish between Chinese and Indian soldiers, and tensions with Australia, for whom China is a major trading partner.

Table: Index Returns to 30 September 2020

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	-3.6	-0.1	-0.1	-10.0
S&P/ASX Small Ordinaries Accumulation Index	-2.8	5.7	5.7	-3.3
International Equities				
MSCI World (ex Australia) Index (hedged A$)	-2.9	6.4	6.4	6.4
MSCI World (ex Australia) Index (unhedged A$)	-0.3	3.8	3.8	4.3
MSCI Emerging Markets Index (unhedged A$)	1.5	5.2	5.2	4.0
Property				
S&P/ASX 200 A-REIT Accumulation Index	-1.5	7.0	7.0	-16.6
Australian Fixed Interest				
Bloomberg AusBond Composite Index	1.1	1.0	1.0	3.2
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	0.8	0.7	0.7	3.9
Barclay's Global Capital Aggregate Bond Index (hedged A$)	0.4	0.7	0.7	3.5
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.0	0.0	0.6
Commodities				
Gold (US$ per ounce)	-4.1	6.5	6.5	26.7
Copper (US$ per metric tonne)	0.1	10.9	10.9	16.5
WTI Crude Oil (US$ per barrel)	-5.6	2.4	2.4	-25.6
RBA Index of Commodity Prices (A$)	1.1	-0.2	-0.2	-8.5

Table 1: Australian Dollar versus Foreign Currencies to 30 September 2020

AUSTRALIAN DOLLAR VERSUS	AS AT 30 SEPTEMBER 2020	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.71	-3.2	3.9	3.9	5.4
British Pound Sterling	0.55	0.4	-0.6	-0.6	1.1
Euro	0.61	-1.5	-0.5	-0.5	-1.7
Japanese Yen	75.24	-3.4	2.0	2.0	3.3