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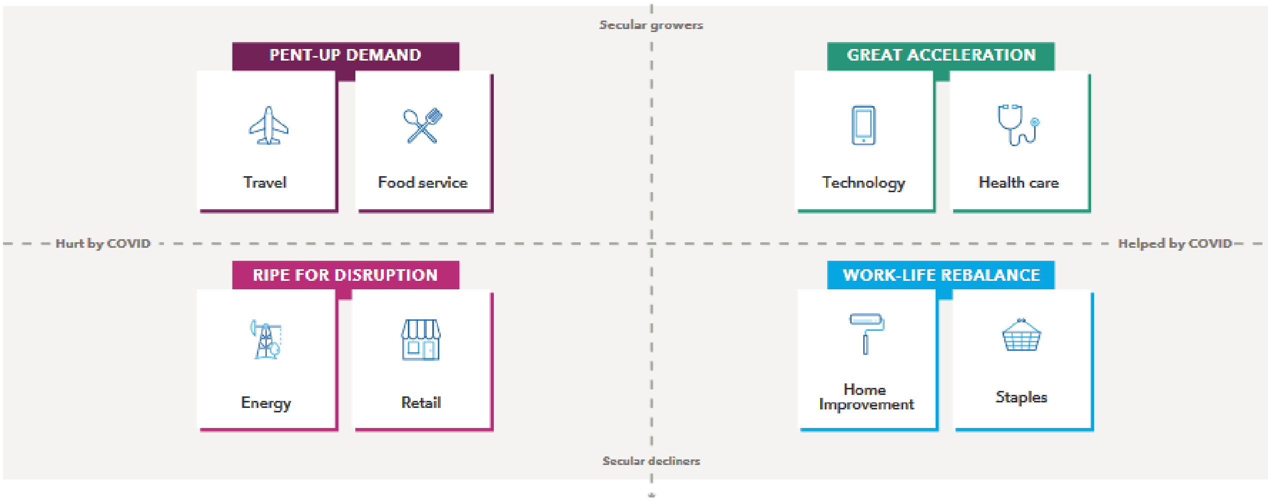
Investment Outlook

2020 was a year of alphabetical symbols

Capital Group economist Jared Franz says, "On the other end of the spectrum, the stay-at-home era has been a boon for e-commerce, cloud computing, video streaming, digital payment processors and home improvement stores. As the recovery grinds along, separating the long-term winners from the losers will be the No. 1 job for investors who value fundamental, bottom-up research and highly selective investing. The post-pandemic economy is going to look very different than the one we had in February 2020."



(source: Capital Group)

So, what happened in 2020?

• At the onset of COVID 19, the govts globally pumped money into the economy which shielded businesses, jobs & incomes.
• Restructuring bankruptcy laws gave business breathing space to implement new re-strategies.
• Interest rates fell to an all-time low making it easier for businesses to service their loans.
• After the initial disruption, certain economies reopened after social distancing helped contain the virus.
• The defeat of Donald Trump and the election of Joe Biden as President in the US could mean more stability, both internally and in foreign affairs.

According to Dr Shane Oliver from AMP Capital:

Four reasons for optimism for 2021

• The deployment of several vaccines with high levels of efficacy in phase 3 testing indicates that there is a good chance that developed countries will reach herd immunity in the second half of the year.
• Fiscal stimulus and easy monetary policy is still working through the system (with the latest $900bn US stimulus and likely more on the way with Democrat control of the US Senate) and high saving rates indicating significant spending potential as confidence improves.
• The US is moving to more stable, less divisive leadership more reliant on expert advice under Biden, with democratic institutions withstanding an onslaught from Trump.
• The pandemic did not see the world descend into anarchy as doomsters would have predicted.

The first two should support a solid rebound in global growth and profits (beyond near term COVID-19 lockdowns). At a time of significant spare capacity, it should be accompanied by still low inflation and hence interest rates, meaning that we are still in the "sweet spot" of the investment cycle.

Key views on markets for 2021

After having run up so hard since early November, shares are vulnerable to a decent short term pull back (say 5 to 15%) and 2021 is likely to see a few rough patches along the way (much like we saw in 2010 after the recovery from the GFC), but looking through the inevitable short term noise, the combination of improving global growth and low interest rates augurs well for growth assets generally in 2021.

We are likely to see a continuing shift in performance away from investments that benefitted from the pandemic and lockdowns - like US shares, technology and health care stocks & bonds - to investments that benefit from recovery - resources, industrials, tourism stocks and financials.

Global shares are expected to return around 8%, but expect a rotation away from tech heavy US shares to more cyclical markets in Europe, Japan and emerging countries.

Australian shares are also likely to be relative outperformers returning around 12% helped by better virus control, enabling a stronger recovery in the near term, stronger stimulus, sectors like resources, industrials and financials benefitting from the rebound in growth and as investors continue to drive a search for yield benefitting the share market as dividends are increased.

Ultra-low yields & a capital loss from a 0.5-0.75% or so rise in yields are likely to result in negative returns from bonds.

Unlisted commercial property and infrastructure are ultimately likely to benefit from a resumption of the search for yield but the hit to space demand and hence rents from the virus will continue to weigh on near term returns.

Australian home prices are likely to rise 5% or so this year being boosted by record low mortgage rates, government home buyer incentives, income support measures and bank payment holidays but the stop to immigration and weak rental markets will likely weigh on inner city areas and units in Melbourne and Sydney. Outer suburbs, houses, smaller cities and regional areas will see stronger gains in 2021.

Cash and bank deposits are likely to provide very poor returns, given the ultra-low cash rate of just 0.1%.

The $A is vulnerable to uncertainty around coronavirus and China tensions and RBA bond buying will keep it lower than otherwise, but expect it to rise to around $US0.80 helped by rising commodity prices and a cyclical decline in the $US.

Six things to watch

Coronavirus and vaccines – problems with vaccines or their deployment could result in ongoing waves of new coronavirus cases & slower recovery than we are assuming.

US politics – the Democrat victory in Georgia's January 5 US senate elections risks a more leftward tilt under Biden, although conservative Democrat senators will limit this. Social and political tensions remain high even with Trump on the sidelines.

Tensions between China and the US/Australia – we expect a shift to a diplomatic approach here led by President Biden but there is a risk of misjudgement on either side which could risk slowing Australia's longer-term growth rate.

Inflation – we are assuming it remains weak but if it rebounds faster than expected it will mean faster increases in bond yields and downward pressure on asset valuations.

The hit to immigration in Australia – it's hard to see 700,000 less immigrants out to mid-2023 having no impact on inner city Sydney and Melbourne property prices.

Global growth indicators (PMIs) – these have recovered nicely from their first half 2020 lows & need to remain solid.

Five reasons Australia is likely to outperform

• It's done a better job of controlling coronavirus than many.

• It's seen a stronger policy stimulus than most countries.

• It continues to benefit from a high exposure to China & Asia – with the high iron ore price swamping tensions with China.

• The drag from the mining bust is over.

• The Australian economy and share market are relatively cyclical & so should benefit from a cyclical global recovery.

Nine things investors should remember - timeless gems!

• Make the most of the power of compound interest. Saving regularly in growth assets can grow wealth substantially over long periods. Using the "rule of 72", it will take 144 years to double an asset's value if it returns 0.5% p.a. (ie, 72/0.5) but only 14 years if the asset returns 5% p.a.

• Don't get thrown off by the cycle. Falls in asset markets can throw investors out of a well thought out strategy at the wrong time - as some were in March last year.

• Invest for the long term. Given the difficulty in getting short term market moves right, for most it's best to get a long-term plan that suits your wealth, age & risk tolerance & stick to it.

• Diversify. Don't put all your eggs in one basket.

• Turn down the noise. As discussed earlier.

• Buy low, sell high. The cheaper you buy an asset, the higher its prospective return will likely be and vice versa.

• Beware the crowd at extremes. Don't get sucked into the euphoria or doom and gloom around an asset.

• Focus on investments that you understand and that offer sustainable cash flow. If it looks dodgy, hard to understand or has to be justified by odd valuation measures or lots of debt to stack up, then it's best to stay away.

• Accept it's a low nominal return world – when inflation is 1.5%, 7% average superannuation returns are pretty good.

And keep your friends close, but your financial adviser closer in these uncertain times.