

Over the past few months we have witnessed some of the most difficult economic and financial market conditions. Given the extent of the market volatility, we are providing the following update.

Financial market volatility

Sharemarkets fell significantly between 20th February 2020 and 23rd March 2020 (falling over 30% in most global markets) and have since made a meaningful recovery.

The most important sharemarkets for Australian superannuation investors are Australia and the United States.

As at the close of business on Friday 19 June 2020:

- The Australian sharemarket is now 17% below its peak recorded on 20th February 2020 but fell 1% over the past fortnight.
- The US sharemarket is now 8% below its peak recorded on 19th February 2020 but fell 3% over the past fortnight.

Sharemarkets world-wide are likely to remain volatile as each economy manages the social and economic impacts of the coronavirus.

Key themes impacting markets

For the two weeks ending Friday 19 June 2020 the main events impacting on investment markets included:

- Investors remain positive that the fiscal and monetary stimulus being provided will support a rebound in economic growth and corporate earnings whilst researchers work on COVID-19 vaccine candidates. However, sharemarkets fell during the fortnight as investors became wary of the risk of a second wave in the virus as cases increased in Beijing and wait to see if the large numbers of people attending the US protest marches affect the virus situation materially.
- Australia is now firmly focused on re-opening the economy after containing the spread of COVID-19 very well. However, an acceleration of cases in Victoria last week will slow the re-opening in that state and provide a test for the sharemarket this week. The federal Government is facing difficult decisions as it considers paring back stimulus measures as the impact on the economy could be very significant.
- Key data released in Australia included the unemployment rate which rose to 7.1% in May, with the number of jobless now at 927,600 – the most in more than 25 years. The jobless rate, while higher than expected, is distorted by the JobKeeper payments for over three million Australians, as well as by another sizeable fall in the participation rate. The prospects for businesses and jobs when JobKeeper officially ends in September is a watch point for the recovery.
- The US left interest rates at zero to 0.25% and suggested it is unlikely to increase them before 2023 at the earliest. The Chairman of the Federal Reserve, Jerome Powell, noted it would be “a long road to recovery” and promised to use its “full range of tools” to support the US economy in this challenging time.

Funds SA is constantly monitoring and reviewing financial markets and the appropriateness of investment strategies and managers. Changes to the strategy are made to achieve the best outcome for members.

How movements in share markets impact your superannuation option?

Movements in share markets (up and down) impact the unit prices of all investment options, with the exception of Cash. As unit prices change so does the overall value of your superannuation balance.

Although portfolios are not immune to the volatility stemming from share markets, the asset mix, including high quality bonds, property, private equity and other unlisted assets, have helped to lessen the gyrations and deliver a smoother return profile for members.

Notwithstanding short-term fluctuations in share markets, the best long run guide to the investment outcomes of the options is their investment objectives. For example, the Growth option is targeting a return averaging 4% above the inflation rate when measured over long-term periods (of at least 10 years).

The expectation of negative returns

One of the most important concepts to consider when making an investment decision is that of risk and return. All investments, including super, have some level of risk.

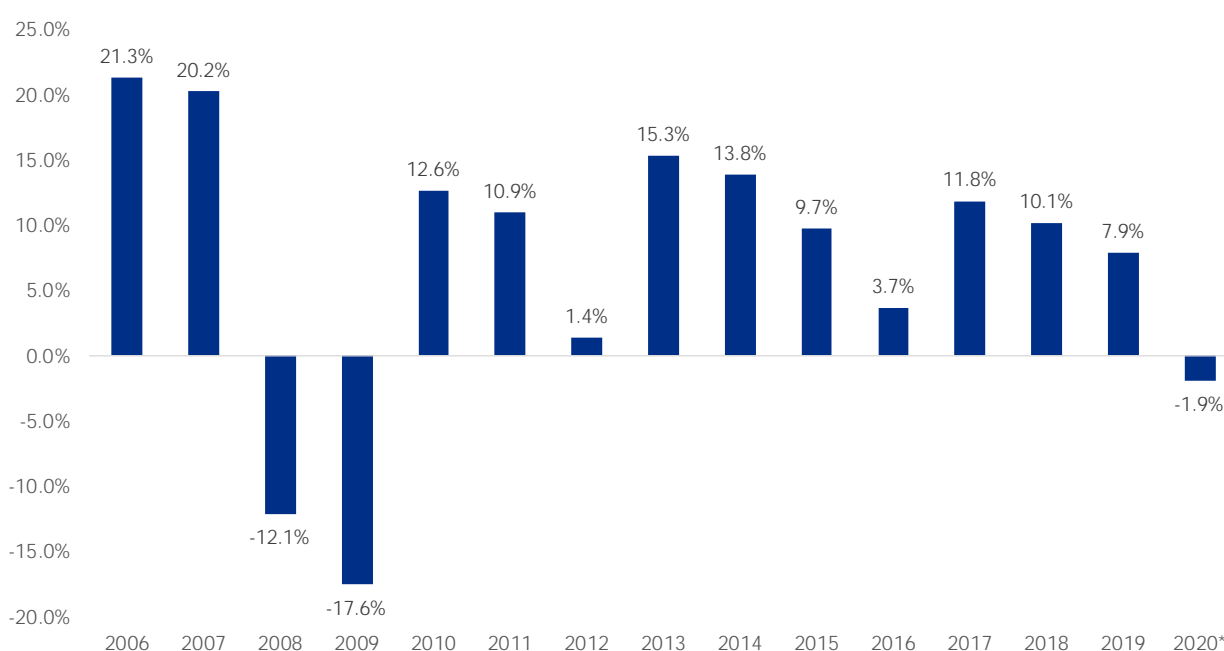
Members should be aware that capital losses are possible, depending on the investment option(s) chosen and their performance over time. Fluctuations in investment markets will have on-going impacts on performance. This volatility is a normal part of investing and can occur with money you may have in other super funds, the share market and other types of investment.

Each option's investment objective provides an indication of risk by stating the number of negative annual returns likely to be experienced over any 20-year period. For example, for the Growth option it is expected that the investment strategy will result in between four to six negative annual returns over any 20-year period. This means that the risk of a negative return in any single year is between 20% and 30%.

The Chart below illustrates the annual returns of the Growth option since inception in 2005.

Chart 1: Growth option annual returns to 30 June*

Returns net of fees and gross of tax



* 2020 FYTD ending 31 May 2020

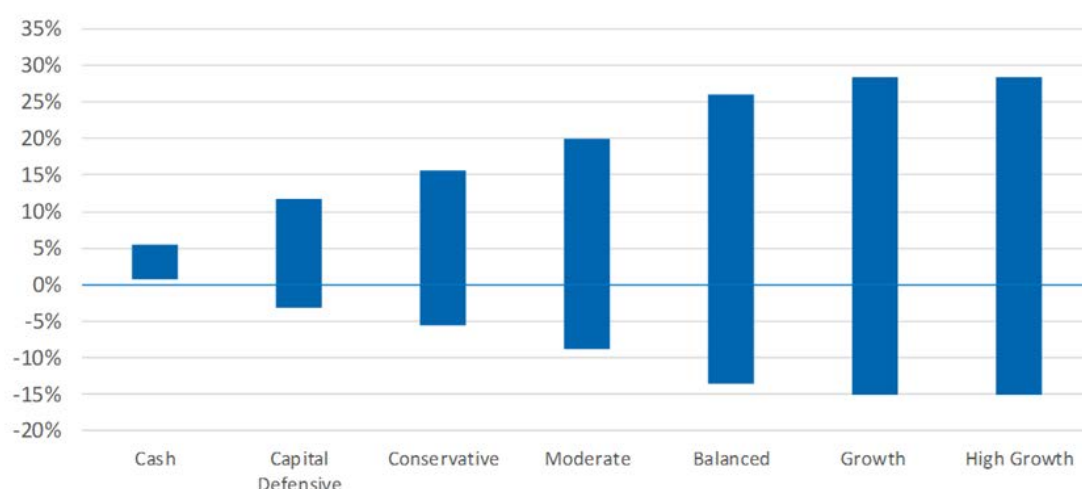
Looking back over the 14-year history of the growth fund, it has recorded a negative return for financial year periods 2 times, with a third bar currently showing for the 2019-20 financial year to date. This experience is broadly in line with expectations (4 to 6 years in 20).

However, the full 2019-20 financial year result is yet to be known and won't be determined until after 30 June 2020.

The expected range of annual return outcomes also provides an indication of risk. This varies between the options. Generally, the options that offer the highest potential long-term returns also come with the widest range of returns including the possibility of negative returns. Options that offer the lowest potential long-term returns come with the narrowest range of returns and greatest likelihood of positive returns.

Each investment option has a different level of risk and return, as shown in the graph below.

Chart 2 Expected range of returns over a 1-year period*



* Note there is approximately a 5% chance that the return could lie outside of this range.

Understanding your attitude to risk is important. Note that this may change over time. You may wish to periodically review your investment strategy to make sure it still meets your needs.

Switching your investment option is an important decision

It's not easy to time entry to, or exits from, markets. Selling out of more risky options (i.e. those options with larger allocations to assets such as shares and property) and switching into less risky options (such as cash and options with higher allocations to fixed interest) can be costly over the longer term as it effectively locks in the losses which result from poor investment markets. As well, it is possible to miss out on future growth by being out of the market when it recovers.

We understand that you may be concerned about the impact of market movement on your super. We encourage you to think about your super as a long-term investment generating a return over multiple years. We suggest that you don't focus narrowly on short-term results.

Many members seek professional financial advice, especially those members approaching or in retirement.

There are a number of investment options offered to suit members with differing risk appetites and time horizons.

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