Financial market update

Week ending 17 April 2020

Over the past few months we have witnessed some of the most difficult conditions in financial markets since the global financial crisis. Given the extent of the market volatility, we are providing a weekly update.

Financial market volatility

The most important sharemarkets for Australian superannuation investors are Australia and the United States. As at the close of business on Friday 17 April 2020 (note it was a short week because of Easter Monday):

- the Australian sharemarket has risen 2% since its close the previous Thursday (markets were closed Good Friday). The Australian sharemarket is now 23% below its peak recorded on 20 February 2020.
- the US sharemarket has risen 3% since its close the previous Thursday. The US sharemarket is now 15% below its peak recorded on 19 February 2020.
- Movements in currencies impact the returns recorded for international assets. When the Australian dollar falls the value of assets held offshore rises, positively benefiting returns. Alternatively, when the Australian dollar rises this detracts from the value of international assets, negatively impacting returns. During the week the AUD/USD ended close to the previous Thursday's close at around AUD/USD $0.63 and since the share market recorded its peak on the 20 February 2020 the AUD/USD has declined 4%. The decline in currency has to date partly offset the negative portfolio returns recorded on the US sharemarket since the market peak.

Key themes impacting markets

For the week ending Friday 17 April 2020 the main events impacting on investment markets included:

- The continuation of positive market sentiment amidst the release of several poor economic reports:
    - The IMF updated its global growth forecasts with a 3% contraction expected in 2020. This figure contrasts with a contraction of 0.1% recorded as a result of the GFC. Growth in the US is forecast to reach -5.9% in 2020, compared to -2.5% in 2009, similarly in the Euro area growth is forecast at -7.5% this year compared to -4.5% in 2009.
    - China reported GDP growth of -6.8% during the first quarter of 2020. The IMF's Chinese growth forecast for this year is for growth of 1.2% compared with growth of 9.4% in 2009.
    - Poor economic data was also released in the US: a further 5.2 million people claimed initial unemployment benefits during the week ending 11 April, with the four week figure claiming initial unemployment benefits at 22 million; industrial output fell to levels not seen in 70 years in March; while retail sales fell by 8.7% in March.
- On Friday the price of oil fell to levels not seen since the late 1990's, as the demand for oil continues to fall; WTI Crude closed at USD $18.27 a barrel.
- The number of confirmed COVID-19 cases now numbers 2.4 million, with just over 30% of these confirmed cases reported in the US. Countries around the world are using containment measures to reduce the number of new cases recorded each day with the aim of "flattening the curve" to assist health systems cope by reducing the expected peak patient numbers.
- Attention is turning to the process to re-open economies. Small steps are being taken in a number of countries, however a note of caution has been the acceleration of cases in Singapore following these actions.
- Going forward, the rate of growth/decline in the number of new cases of COVID-19 is a very important indicator of business activity and the path to recovery. Economic numbers in the meantime and over coming months are likely to reflect the very poor conditions of the time.

Financial market update

Week ending 17 April 2020

Economic impact of COVID-19

From a financial markets perspective, the pandemic has particularly caused concerns around interrupted supply chains and the negative impact of the virus on global economic growth.

The flow-on effects of the virus to business revenues, employment, income and consumption are being closely watched. While the full effects of the virus are yet to be determined, equity markets are likely to remain volatile.

More actions and announcements from central banks and governments around the world are expected as the impacts of the virus unfold.

Funds SA is constantly monitoring and reviewing the appropriateness of the 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 the 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%.

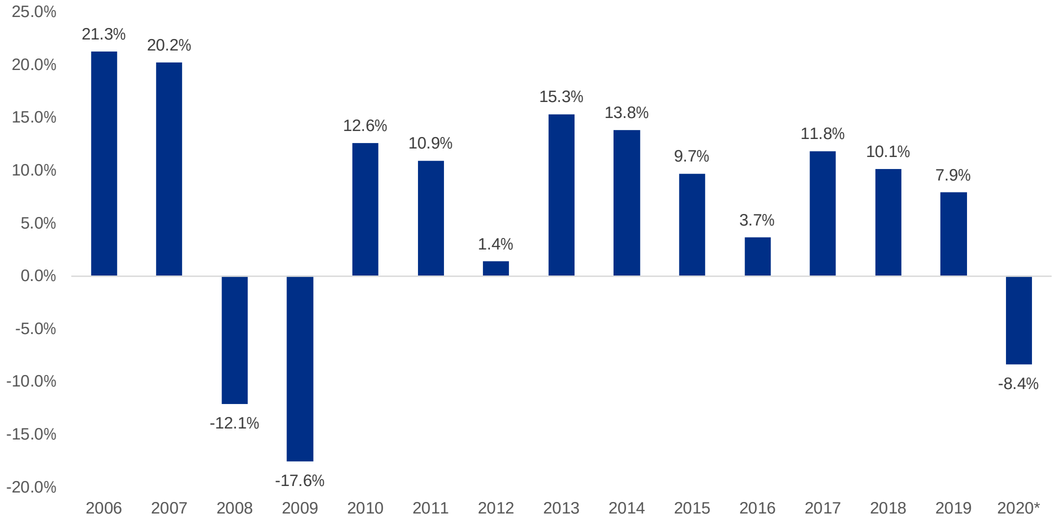
Financial market update

Week ending 17 April 2020

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 March 2020

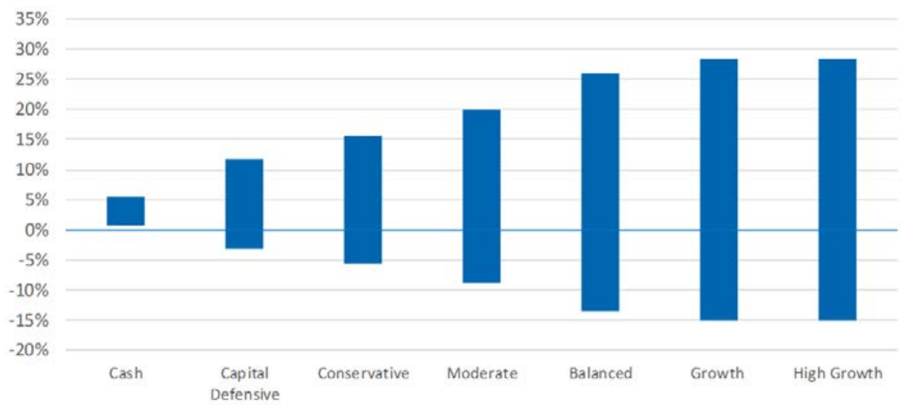
Looking back over the 14-year history of the growth fund, it has recorded a negative return for financial year periods 2 times, with a third bar currently showing for the 2019-20 financial year to date. This experience is broadly in line with expectations (4 to 6 years in 20).

However, the magnitude of loss for the full 2019-20 financial year 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 of the investment options 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.

Financial market update

Week ending 17 April 2020

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.