Financial market update

Week ending 3 April 2020

Over the past few weeks 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 3 April 2020:

- the Australian sharemarket has risen 5% since its close the previous Friday. The Australian sharemarket is now 29% below its peak recorded on 20 February 2020.
- the US sharemarket has declined 2% since its close the previous Friday. The US sharemarket is now 27% 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 declined 3% and since the share market recorded its peak on the 20 February 2020 the AUD/USD has declined 9%. The declines in currency have to date partly offset the negative portfolio returns recorded on the US sharemarket.

Key themes impacting markets

For the week ending Friday 3 April 2020 the main events impacting on investment markets included:

- Positive reaction, particularly early in the week, to the US Senate passing an historic US$2 trillion fiscal stimulus package and the US central bank introducing extremely large measures to ease the liquidity crunch in the Fixed Interest and Credit markets.
- In Australia, the Federal Government announced a further fiscal stimulus package of $130 billion, in the form of the “JobKeeper Payment”, to provide a wage subsidy for businesses.
- However, around the world, despite measures announced by governments and central banks, due to the imposition of lock-down arrangements to contain the pandemic, businesses are closing or significantly reducing their operations causing mass redundancies. In the US alone, close to 10 million people have filed for unemployment benefits in the last two weeks.
- The oil price recovered a small part of its recent large fall on speculation that Russia and Saudi Arabia will cut oil production.
- The number of confirmed COVID-19 cases now numbers over one million, with just under a quarter of these confirmed cases reported in the US (245,000). 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. At the time of writing the US is yet to flatten the curve.

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.

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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 March 2020

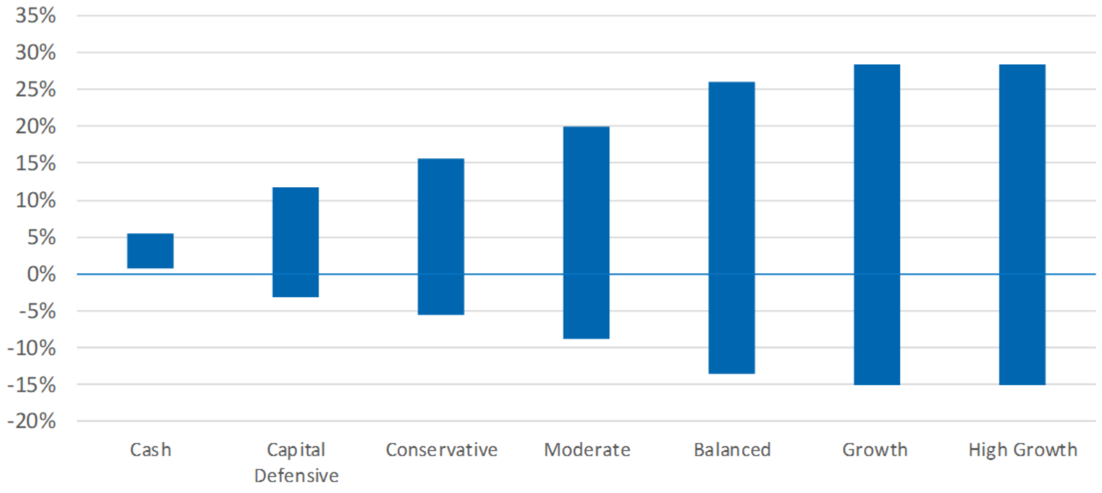
Looking back over the 14-year history of the growth fund, it has recorded a negative return for financial year periods 2 times, with a third negative bar currently showing for the 2019-20 financial year to date. This experience is broadly in line with expectations (4 to 6 years in 20).

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.

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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