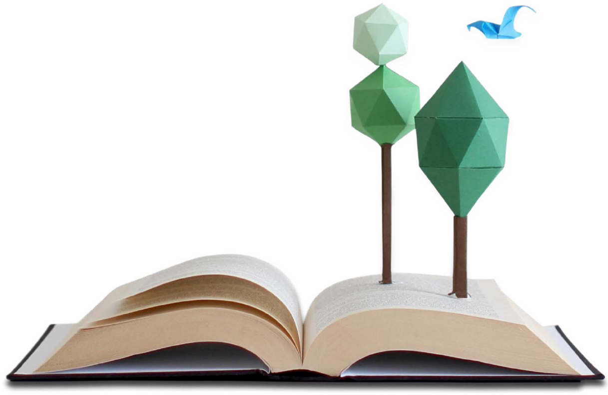
MERCER

welcome to brighter

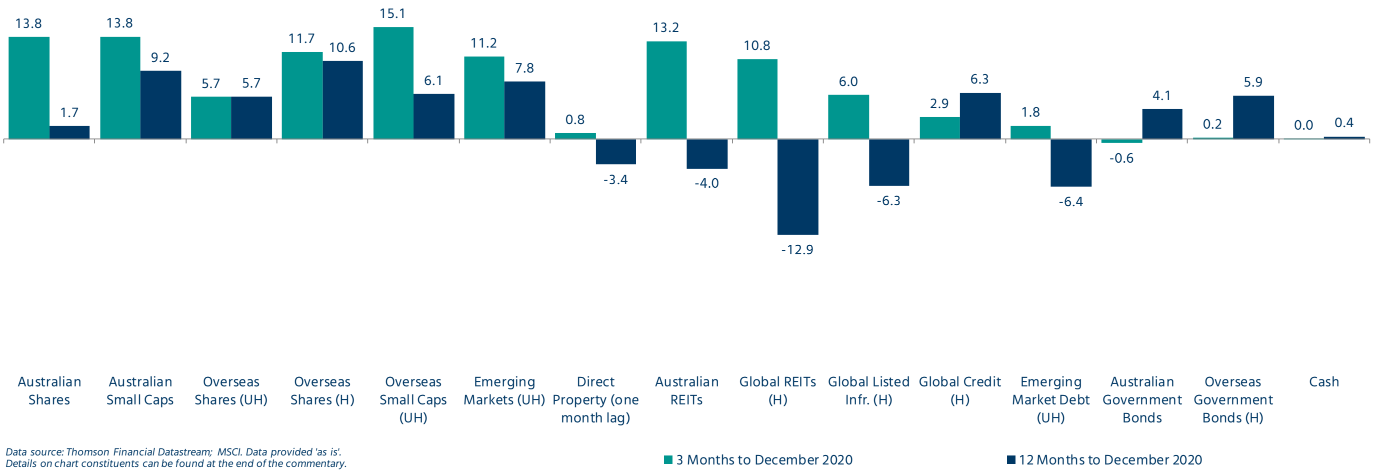
Q4 2020

Market and economic conditions



Selected market indicators commentary

Asset class returns (%) as at December quarter 2020



Markets achieved strong positive returns over the December quarter despite the re-imposition of restrictions as a result of a resurgence in COVID-19 cases and the spread of a new strain. Investor sentiment was encouraged by the US presidential election results, as well as the positive vaccine news and global roll-outs. Hedged Developed Overseas Shares returned 11.7% for the quarter and its Unhedged counterpart returned 5.7%, as the Australian dollar rose 7.7% against the US Dollar and 4.4% against the trade-weighted index over the past three months. Uncertainties surrounding the Brexit negotiations clouded global markets, but were resolved last minute, averting major trade disruptions in early 2021. Over the quarter, global attention focused on the US presidential election, with Joe Biden emerging as the President-elect.

Australian REITs experienced a strong quarter, returning 13.2%, but remained down by -4.0% over the 12 months to December. Similarly, global REITs were up 10.8% over the quarter and down by -12.9% over the year. This indicates investors are still discounting the large degree of uncertainty that the property market is facing after COVID-19 accelerated structural changes, such as increased telecommuting that would have normally materialised at a more gradual pace.

In comparison, defensive sovereign bonds were fairly muted over the December quarter, with Australian Government Bonds and Hedged Overseas Government Bonds returning -0.6% and +0.2% respectively. Upwards pressure on government bond yields in some regions were driven by rising inflation expectations.

Inflation is no longer priced as cheaply as it was earlier in 2020 as investors began to position for an inflationary recovery once pent-up demand can be fully released into a reopened economy. Following on from the prior quarter, global investment grade credit has continued to rally, returning 2.9% for the December quarter.

The Australian share market outperformed its hedged overseas counterpart, as the S&P/ASX300 returned 13.8% over the quarter. The S&P/ASX Mid 50 was the biggest contributor returning 16.9% over Q4, whilst S&P/ASX 50 was the greatest detractor, returning 13.2%. Energy (+26.1%), IT (+22.8%) and Financials (+22.8%) were the strongest performing sectors over the quarter, while Utilities (-5.4%) and Healthcare (-1.0%) were the weakest performing sectors.

Significant Developments

- During the final quarter of 2020, the Reserve Bank of Australia (RBA) decided to adjust its current policy settings, including lowering the target cash rate to 0.10% per annum and lowering the targeted yield on 3-year Australian Government bonds to 0.10%. In late 2020, Governor Philip Lowe noted that in Australia, the economic recovery is under way and recent data have generally been better than expected. This is good news, but the recovery is still expected to be uneven and drawn out, and it remains dependent on significant policy support. In the RBA's central scenario, it will not be until the end of 2021 that the level of GDP reaches the level attained at the end of 2019. In the central scenario, GDP is expected to grow by around 5% in 2021 and 4% over 2022. The extended period of high unemployment and excess capacity is expected to result in subdued increases in wages and prices over coming years. In the September quarter, the Wage Price Index increased by just 0.1%, to be 1.4% higher over the year. In underlying terms, inflation is forecast to be 1.0% in 2021 and 1.5% in 2022.The Board has noted that it will not increase the cash rate until inflation sits sustainably within the 2-3% target range. For this to occur, wage growth will have to be materially higher than it is at present. This will require significant gains in employment and a return to a tight labour market.
- Australian seasonally adjusted employment increased by 90,000 in November, above expectations for an increase of 40,000, while August figures were revised to an increase of 163,400. The unemployment rate remained at 6.8% for November, below expectations for 7.0%. The participation rate increased to 66.1%, above expectations for 65.9%. Part time jobs increased by 5,800 and full time jobs increased by 84,200.
- Australian house prices increased by 0.8% in the third quarter of 2020, taking it 4.5% higher from a year earlier and above expectations for -1.7% quarter-on-quarter (QoQ) and 2.2% year-on-year (YoY). Building approvals increased 2.6% month-on-month (MoM) to November, which was an increase from the August rate of -1.7%.
- US Non-Farm Payrolls decreased by 140,000 in December, below the 711,000 increase (revised) recorded for September. The unemployment rate decreased to 6.7% over December, below expectations for 6.8%.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 60.7 in December, above consensus for 56.8, and above the 57.5 recorded in November. Of the 18 manufacturing industries, Apparel, Leather & Allied Products and Furniture & Related Products were the industries that reported the highest growth. Printing & Related Support Activities and Nonmetallic Mineral Products were the two industries that reported a contraction in December. The ISM Services Index recorded 57.2 in December, above consensus for 54.5 and above the 55.9 recorded in November. Of the 18 services industries, the top performers in December were Management of Companies & Support Services and Wholesale Trade. Arts, Entertainment & Recreation and Accommodation & Food Services were the two industries that reported the highest contractions.
- US gross domestic product (GDP) third estimate for Q3 2020 is 33.4% quarter on quarter (QoQ) annualised, above expectations for 33.1%.
- US headline consumer price index (CPI) remained at 0.2% MoM in November, but decreased from 1.4% YoY in September to 1.2% YoY in November.
- The Caixin Manufacturing PMI in China recorded 53.0 in December, below expectations for 54.7, signalling a softer improvement in manufacturing conditions.
- Chinese GDP increased 4.9% YoY for Q3 2020, below expectations for 5.5%. Seasonally adjusted GDP increased 2.7% QoQ for Q3 2020, below expectations for 3.3%.
- The preliminary estimate of the European Core Consumer Price Index (CPI) recorded 0.2% over the year to December, in line with expectations. The unemployment rate decreased to 7.2% in December 2020.

- The Eurozone composite PMI decreased to 49.1 in December, below expectations for 49.8. The Eurozone private sector economy contracted for a second successive month in December, albeit at a slower rate.
- The final estimate recorded for Q3 2020 Eurozone seasonally adjusted GDP is 12.5% quarter-on-quarter (QoQ) and -4.3% year-on-year (YoY).

Australian Equities

Australian shares were positive over Q4 2020 as the S&P/ASX 300 Index returned 13.8% for the period. There was a positive movement in the small caps space with the S&P/ASX Small Ordinaries returning 13.8% for the quarter, while the worst performer was the S&P/ASX 50 returning 13.2%.

The best performing sectors were Energy (+26.1%), IT (+22.8%) and Financials (+22.8%), while the weakest performing sectors were Utilities (-5.4%) and Healthcare (-1.0%). The largest positive contributors to the return of the index were CBA, Fortescue Metals Group and ANZ with absolute returns of 29.1%, 47.3% and 33.0% respectively. On the other hand, the most significant detractors from performance were CSL, Newcrest Mining and Transurban with absolute returns of -1.1%, -17.2% and -2.4% respectively.

Global Equities

The broad MSCI World ex Australia (NR) increased 11.7% in hedged terms and increased 5.7% in unhedged terms over the quarter, as the AUD appreciated against major currencies over the period. The strongest performing sectors were Energy (+17.5%) and Financials (+14.8%), while Consumer Staples (-1.3%) and Healthcare (-0.7%) were the worst performers. Other global shares were also positive as the MSCI Small Caps (TR) Index increased 15.1% and the MSCI Emerging Markets (NR) Index returned 11.2%, all in AUD terms.

Over the December quarter, the NASDAQ increased 15.4%, the S&P 500 Composite Index increased 12.1% and the Dow Jones Industrial Average increased 10.7%, all in USD terms. Most European markets experienced positive returns, with the FTSE 100 United Kingdom (UK) increasing 10.9%, the CAC 40 (France) increasing 15.8% and the DAX 30 (Germany) increasing 7.5%, all in local currency terms. Equity returns were positive across Asia as the Indian BSE 500 increased 23.2%, the SSE Composite (China) increased 7.9%, the Japanese TOPIX increased 11.2% and the Hang Seng (Hong Kong) increased 16.2%, all in local currency terms.

Real Assets

Global and Domestic listed property experienced positive results over the December quarter. Australian Real Estate Investment Trusts (REITs) were up 13.2% and hedged Global REITs increased 10.8% (in AUD terms). The Australian unlisted property sector (NAV) increased 0.8% over the quarter on a one month lagged basis and the FTSE Global Core Infrastructure 50/50 index increased 6.0% for the quarter in hedged AUD terms.

Fixed Interest

Global sovereign bonds produced mixed returns over the December quarter for hedged Australian investors. Ten-year bond yields decreased in Germany (-5bps to -0.58%), but increased in Japan (+1bp to 0.02%), the US (+23bps to 0.91%) and the UK (+5bps to 0.24%). Two-year bond yields decreased in the UK (-14bps to -0.16%) and Germany (-2bps to -0.71%), remained flat in the US (0.13%) and increased in Japan (+1bp to -0.12%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index increased 0.8% and the FTSE World Government Bond (ex-Australia) Index increased 0.2% over the December quarter, both on a fully hedged basis.

Domestically, Australian 10-year bond yields increased by 15bps to 0.98%, five-year bond yields increased by 2bps to 0.35% and two-year bond yields decreased by 11bps to 0.07%. Bloomberg Ausbond indices returned mixed results over the quarter, with the Bloomberg Ausbond Inflation Index achieving the highest return at 1.7%, and the weakest being the Bloomberg Ausbond Treasury Index returning -0.6%.

Currency Markets

The Australian Dollar (AUD) appreciated against major developed market currencies over the December quarter, finishing at US$0.77 with a Trade Weighted Index of 63.4. The AUD appreciated against the USD (+7.7%), the Japanese Yen (+5.9%), the Pound Sterling (+2.1%) and the Euro (+3.5%). On a trade-weighted basis, the local currency appreciated 4.4% over the quarter.

Commodities

The S&P GSCI Commodity Total Return Index increased by 6.3% over the quarter. Gold prices finished the quarter at US$1,897.8 per ounce for a 0.1% decrease and Iron Ore prices also increased by 32.1% to US$158.5 per metric tonne over the period. Meanwhile, the oil price increased by 26.6% to US$51.9 per barrel.

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Important Notices

Chart Constituents

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Net Index: Total Return (Net Dividends Reinvested).*
- *Total Return: Total Return Index with Gross Dividends.*
- *Where a lag exists, the performance period start and end dates are shifted accordingly.*

Asset class	Benchmark	Data type
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
Overseas Shares (UH)	MSCI World ex Australia	Net Index
Overseas Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
Overseas Small Caps (UH)	MSCI World Small Cap	Total Return
Emerging Markets (UH)	MSCI Emerging Markets	Net Index
Direct Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian REITs	S&P/ASX 300: Industry Group: A-REIT	Total Return
Global REITs (H)	FTSE EPRA/NAREIT Developed Hedged	Total Return
Global Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Total Return
Global Credit (H)	Bloomberg Barclays Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
Overseas Government Bonds (H)	FTSE WGBI Non Australia	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

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