RETIREWELL
WEALTH MANAGEMENT SOLUTIONS

eNewsletter
Exclusive Client Email Newsletter
21 December 2020

# Year 2020 – Not What We Expected

The year 2020 will be remembered as the year of the Coronavirus pandemic. But in the midst of global gloom and despair, there is always room for hope and optimism. Consider the following, which happened in 2020:

- Africa was declared free of polio by the World Health Organisation in August, with no new cases since 2016.
- For the first time around the world, there was a rush to adopt pets and countries such as the Netherlands reported they had no unadopted dogs across the entire country.
- Books such as "How to be Antiracist" topped global best-selling lists.
- Because of less pollution this year, both Aurora Borealis and Aurora Australis are more visible than ever.
- Home-schooling taught millions of parents how hard teaching their children really is, and that teachers are all heroes.
- Venice became beautiful again, where marine life returned to the canals and the water returned to a more natural blue/green colour.
- With reduced human activity, wildlife has prospered with animals such as elephants in India, deer in Japan, pandas in Hong Kong, dolphins in Turkey, turtles in Australia and many more returning or moving closer to human occupied lands, *en masse*.
- Many 'green' energy supplies became cheaper than conventional 'brown' supplies, even without government subsidies. This creates the momentum where green energy becomes economically as well as socially viable.

## Summary

- *2020 was dominated by the coronavirus pandemic but despite high volatility, shares saw reasonable returns on the back of policy stimulus and vaccine optimism – resulting in constrained but positive returns for balanced and growth super funds.*
- *For 2021, the combination of massive policy stimulus and the prospect of vaccines allowing a return to something more normal by end 2021/early 2022 should see a decent rebound in economic growth.*
- *This plus lower interest rates is likely to see solid returns from share markets but poor returns from bonds. Australian shares are likely to be relative outperformers.*
- *The main things to keep an eye on are: coronavirus and vaccines; China tensions; inflation; as well as the hit to immigration in Australia and its impact on home prices.*

2020 didn't exactly turn out the way we expected a year ago. For Australia, the year started badly as severe drought gave way to the worst bushfires on record. But just as the bushfires were receding, it gave way to the Coronavirus pandemic. Every year usually has a big surprise - or what Economists call Factor X - but they don't usually have such a profound impact as the Coronavirus pandemic has.

- It caused a massive health crisis claiming 1.65 million lives, with many countries seeing at least two waves.
- It kept many confined to their homes and shut down big chunks of economies, driving the biggest fall in economic activity since the end of World War II, if not the Great Depression, with major economies seeing peak to trough falls in GDP of 10% to 20% and the Australian economy contracting by 7.3%. This saw unemployment surge and inflation plunge.
- Share markets had 35% or so plunges in February/March, commodity prices collapsed with the oil price going negative at one point, as investors sought out safe havens like bonds.
- And it, or rather the poor management of it, lost President Trump the US election (even though he has not yet truly conceded defeat).

The pandemic also increased tensions with China. It is likely to leave a longer term mark with a further set back to globalisation, more social tensions, bigger government and public debt and the risk that massive money printing will eventually result in higher inflation. It has brought about faster structural change due to an accelerated embrace of technology, more consumer caution and a lower population in Australia due to the hit to immigration.

However, while 2020 is a year many of us would prefer to forget and coronavirus continues to wreak havoc in much of the world, the end result for economies hasn't been as bad as had been feared back in March and April. This reflected a combination of:

- An unprecedented and rapid fiscal stimulus that protected businesses, jobs and incomes;
- Debt forbearance schemes that headed off defaults;
- Massive monetary stimulus that saw interest rates plunge;
- Social distancing which has helped contain the virus enabling some reopening – albeit better in some countries (e.g., Australia and New Zealand and some Asian nations) than others.

This enabled economic activity to bounce back faster than expected through the second half as restrictions eased, even though it wasn't always smooth (e.g., in Victoria, Europe and the US) and we still have a way to go to full recovery. As a result, investment markets also performed far better than feared.

**Investment returns for major asset classes**

| Total return %, pre fees and tax | 2019 actual | 2020* actual | 2021 forecast |
|---|---|---|---|
| Global shares (in Aust dollars) | 28.0 | 6.3 | 4.0 |
| Global shares (in local currency) | 27.4 | 9.9 | 8.0 |
| Asian shares (in local currency) | 18.8 | 16.3 | 12.0 |
| Emerging mkt shares (local currency) | 18.1 | 12.3 | 12.0 |
| Australian shares | 23.4 | 0.2 | 12.0 |
| Global bonds (hedged into $A) | 7.2 | 4.8 | -2.0 |
| Australian bonds | 7.3 | 4.8 | -2.0 |
| Global real estate investment trusts | 22.1 | -15.9 | 10.0 |
| Aust real estate investment trusts | 19.4 | -5.0 | 10.0 |
| Unlisted non-res property, estimate | 6.0 | -3.5 | 4.0 |
| Unlisted infrastructure, estimate | 11.0 | -3.0 | 5.0 |
| Aust residential property, estimate | 5.6 | 2.5 | 5.0 |
| Cash | 1.5 | 0.4 | 0.1 |
| **Avg balanced super fund**, ex fees & tax | **14.7** | **3.0** | **6.0** |

* Yr to date to Nov.

*Source: Thomson Reuters, Morningstar, REIA, AMP Capital*

- While share markets plunged in March during the early stages of the pandemic, they then rebounded thanks to massive fiscal stimulus and reopening, low interest rates and bond yields that made shares cheap as well as good news on vaccines that enabled investors to look forward to further recovery in 2021.
- This all drove solid returns in global shares with Asian and US shares (which were boosted by a relatively a high exposure to IT and initially health care stocks which benefitted from the pandemic) outperforming. The more cyclical Japanese and European markets underperformed.
- Australian shares also underperformed due to the greater cyclical exposure of the Australian share market.
- Government bonds had reasonable returns as yields fell in response to central bank rate cuts and bond buying along with safe haven demand – which drove capital growth.
- Real estate investment trusts had negative returns as a result of a hit to property space demand and rents.
- It was the same story for unlisted commercial property and infrastructure, although industrial property did well.
- Home prices fell 3% around mid-year but then started to recover as low interest rates, government support measures and reopening swamped the hit to immigration, weak rental markets and higher unemployment. Houses, outer suburbs & regions benefitted from “escape from the city.”
- Cash and bank term deposit returns were poor as the RBA cut the cash rate to just 0.1%.
- After a pandemic driven plunge to $US0.55 in March the $A rose reflecting higher commodity prices and a falling $US.
- Due to reasonable share returns but weak property and infrastructure returns balanced super funds have so far seen low but positive returns – but this followed a strong 2019.

## 2021 – Recovery and Reasons for Optimism

Just as 2020 was dominated by the pandemic and this determined the relative performance of investment markets and stocks, 2021 is likely to be dominated by the recovery. This in turn will have a profound effect on investment markets. There are four reasons for optimism:

**First**, massive fiscal and monetary stimulus is still feeding through economies with very high saving rates indicating pent up demand that can be spent once confidence improves, which will also help offset the wind-down of some support measures like JobKeeper in Australia.

**Second**, the news on vaccines is positive. While uncertainties remain, by end 2021 or early 2022 there is a good chance the world will be approaching a degree of herd immunity.

**Third**, a new US president in Joe Biden should usher in a period of more stable and expert-based policy making in what is still the world's biggest economy. In particular, it will likely head off a return to trade wars that could have wreaked havoc in 2021. A more diplomatic US approach to resolving differences with China could also help Australia move down a path to resolving its own differences with China.

**Finally**, Australia along with NZ has navigated 2020 remarkably well, controlling Coronavirus far better than most comparable countries and seeing its politicians and institutions work well together. It also led to structural reforms that may help future growth (eg, property tax reform in NSW, and some Industrial Relations reform nationally). The combination of vaccines, policy stimulus and pent up demand is expected to see a supercharged cyclical rebound in global GDP of around 5.2% and 4.5% in Australia in 2021. This is likely to see strong double-digit rebounds in profit growth. Inflation is likely to remain weak, reflecting still high levels of spare capacity which in turn means interest rates will remain low. While this is not good for those relying on bank interest, it benefits the household sector as a whole (with debt exceeding bank deposits) and corporates, eases the servicing of high public debt levels and makes shares cheap.
So, in a way we remain in the sweet spot of the investment cycle with improving growth but low rates. In Australia, the cash rate is expected to end 2021 at 0.1% with a likelihood of more quantitative easing.

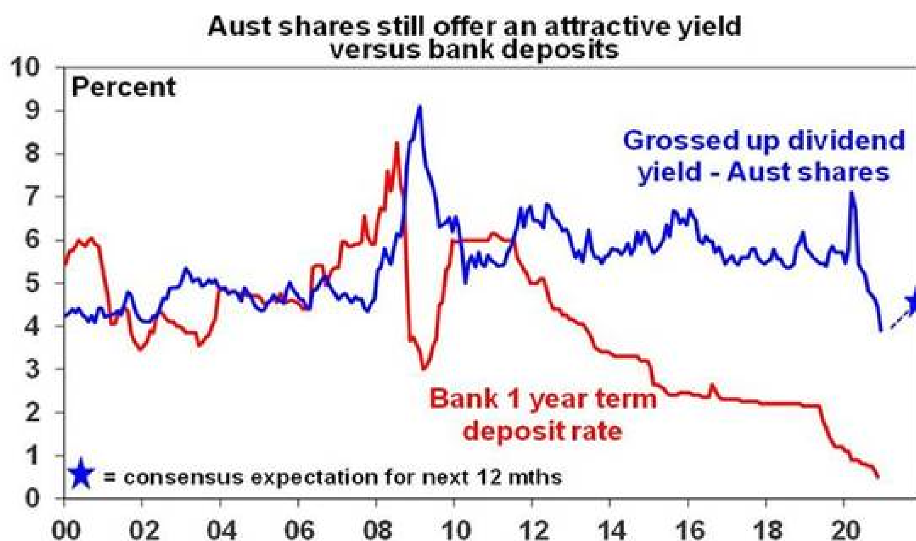
### Implications for investors

Shares are at risk of a short term correction after having run up so hard recently 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.

In particular, we could see a shift in performance away from investments that benefitted from the pandemic and lockdowns - like US shares, technology and health care stocks and bonds – more towards investments that will benefit from recovery - like resources, industrials, tourism stocks and financials.

1. Global shares are expected to return around 8%, but there could be a rotation to some extent from growth heavy US shares to more cyclical markets in Europe, Japan and emerging countries.

2. Australian shares are also likely to be relative outperformers 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 our share market as dividends are increased, resulting in a 4.4% grossed up dividend yield. Unforeseen calamities aside, expect the ASX 200 to end 2021 back around 7200.




*Source: Bloomberg, AMP Capital*

3. Ultra-low yields and a capital loss from a 0.5 - 0.75% or so rise in yields are likely to result in negative returns from bonds.
4. 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.
5. Australian home prices are being boosted by record low mortgage rates, government home buyer incentives, income support measures and bank payment holidays. However, high unemployment, a 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.
6. Cash and bank deposits are likely to provide very poor returns, given the ultra-low cash rate of just 0.1%.
7. Although the $A is vulnerable to bouts of uncertainty about coronavirus and China tensions and RBA bond buying will keep it lower than otherwise, a rising trend could still drive our dollar to around $US0.80 over the next 12 months, helped by rising commodity prices and a cyclical decline in the US dollar.

## What to Watch?

The main things to keep an eye on in 2021, are as follows:

1. **Coronavirus and vaccines** – problems with vaccines or their deployment could result in ongoing waves of new coronavirus cases and slower recovery than we are assuming.
2. **US politics** – a Democrat victory in Georgia’s January 5 US Senate elections would risk more of a leftward tilt under Biden, although conservative Democrat senators will limit this.

3. **China tensions** – we expect a shift to a diplomatic approach here, but there is a risk of misjudgement on either side which could start to slow our longer-term economic growth rate.
4. **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 i.e. shares and property.
5. **Low immigration** in Australia – it's hard to see 700,000 fewer immigrants out to mid-2023 having no impact on inner city Sydney and Melbourne property prices.

***Acknowledgement:*** *Primary source of information for this Report acknowledged to Dr Shane Oliver, Head of Investment Strategy and Economics and Chief Economist at AMP Capital, from Investment Insight Report dated 9 December 2020, supported by input from Retirewell internal research.*