MONTHLY UPDATE ON THE INVESTMENT ENVIRONMENT

December 2020

WHITEHELM ADVISERS

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MARKET UPDATE

The past three months reflected a notable tilt in the global economic outlook, with investor optimism buoyed by Democrat Joe Biden's election win, successful vaccine development and global rollout, another round of fiscal stimulus in the US being approved, a last-minute EU-UK trade deal being reached and the continuation of unprecedented monetary and fiscal policy support.

By the end of December, the COVID-19 pandemic has led to 90 million cases and nearly two million deaths. The United States continues to be the epicentre of the crisis; the country accounts for one fifth of the global death count. Renewed lockdown measures have been enforced in many countries over the holiday period in an effort to stem the spread of the virus. In any case, the US, the UK and several European nations continue to face record daily cases and deaths.

The December quarter was an overall strong one for risk assets, despite the worsening of the pandemic. During the month of October, the rise in COVID-19 cases and the uncertainty in the leadup to the US election led to a sell-down in risk assets. However, equity markets rode high following the US election outcome in early November. Furthermore, the approval of a second COVID-19 relief bill in the US and the rollout of vaccines in several countries helped offset concerns of the surging case count in most Northern Hemisphere countries in the depth of their winter. The last-minute Brexit deal struck on 24 December brought a sense of relief to markets after months of worry that a deal would not be made. Fully hedged developed overseas equities returned 11.7% over the quarter, with similarly impressive returns from emerging markets equities and local equities at 11.2% and 13.8% respectively. The strong end to the year meant that global equity markets posted impressive one-year returns, including a double digit return for fully hedged developed overseas equities, an outcome that would have been hard to predict during the February and March sell-offs related to the first wave of COVID-19 globally.

Consistent with the risk market rally, defensive assets sold off over the quarter. US and Australian government bond yields increased; however, overseas fixed interest posted a positive return of 0.8% over the quarter, thanks to the contribution of narrowing credit spreads due to continued policy stimulus. Meanwhile, local bonds, which have a larger skew to government issuers, posted a negative return of -0.1%.

AUSTRALIA

The Australian economy remains insulated from the worst of the pandemic. Australia quickly emerged from its first recession since the early 1990s, posting third quarter GDP growth of 3.3% quarter-on-quarter. The result was driven by a sharp uptick in consumer spending as lockdown restrictions in Victoria were eased. While beating forecasts, the result was not enough to claw back the contraction earlier in the year, with growth down 4.4% over 12 months. The economic recovery continued in the fourth quarter, although the cluster of cases in Greater Sydney just before the holiday period and the resulting containment measures and border closures negatively impacted confidence in the recovery to end the year. Another point of continued concern is the impact of the tariffs and bans the Chinese Government has implemented on several Australian imports. The RBA continued to provide stimulus through its asset purchases and it also reduced the cash rate from 0.25% to 0.1% at its November meeting.

Australian economic data was positive overall. The unemployment rate eased to 6.7%, house prices surged higher in all major cities (bringing the national increase in house prices to 3% for the year), while the nation's trade balance was in surplus thanks in large part to robust commodities demand from a recovering Chinese economy. Australia's retail sales have also shown improvement, with sales in November up 13.3% from a year prior, due to the easing of restrictions in Victoria and the increasing popularity of Black Friday and Cyber Monday.

UNITED STATES

There are growing fears in the US that the surge in COVID-19 cases and renewed restrictions at year-end are stalling the economic recovery. In December, the US recorded its first monthly loss of jobs since April (at 140,000) leading to an unemployment rate of 6.7%. In positive news, the US Congress was finally able to strike a deal on a new COVID-19 fiscal relief package, worth nearly US$900 billion, which includes US$600 stimulus payments to most Americans, an increase of US$300 per week in unemployment benefits, an extension to support for small businesses, among other initiatives.

However, most newsworthy over the quarter was the US election result. The election saw Democrat Joe Biden end the tumultuous and unconventional four-year presidency of Donald Trump. The early January runoff elections in Georgia for two US senate seats led to upset wins for the Democratic Party meaning that President-elect Biden will have a greater chance of implementing his policy initiatives, as he will have the backing of the US Congress and a narrow Democratic majority in the Senate. Further fiscal stimulus to support the economic recovery and a widespread vaccine rollout are expected to be Biden's key priorities post-inauguration.

EUROPE

The European economy faced renewed uncertainty after a resurgence in cases across the region, prompting renewed lockdown restrictions, including nationwide lockdowns in the UK, Italy and Germany. Eurozone unemployment remains high at 8.3% and headline inflation persisted at -0.3% throughout the quarter. The ECB reiterated its commitment to supporting the economic recovery from the pandemic, including through increasing the size of and extending its asset purchase program.

After months of tumultuous negotiations, the UK and the EU struck a last-minute Brexit deal, referred to as the EU-UK Trade and Cooperation Agreement. The deal involves a 'zero tariff and zero quota' guarantee between the two trading partners. However, it is expected to cost exporters as businesses will now face a variety of border checks. The freedom of movement for most UK nationals has also ended.

CHINA

The Chinese economy continues to sharply recover from the pandemic, with exports soaring and commodities demand rising. The recovery has been supported by a large fiscal stimulus plan, focussed on investments in infrastructure and housing.

However, geopolitical tensions have also increased between China and several key trading partners. The Chinese Government has escalated its trade spat with Australia, through the imposition of steep tariffs and full bans on a variety of Australian imports. Following fatal border skirmishes earlier this year, the Indian Government proscribed nearly 50 Chinese smartphone apps in November, taking the total number banned to 200 in a so-called 'digital strike'.

Table: Index Returns to 31 December 2020

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	1.3	13.8	13.7	1.7
S&P/ASX Small Ordinaries Accumulation Index	2.8	13.8	20.3	9.2
International Equities				
MSCI World (ex Australia) Index (hedged A$)	3.4	11.7	18.9	10.6
MSCI World (ex Australia) Index (unhedged A$)	-0.5	5.7	9.7	5.7
MSCI Emerging Markets Index (unhedged A$)	2.5	11.2	17.0	7.8
Property				
S&P/ASX 200 A-REIT Accumulation Index	0.4	13.3	21.2	-4.6
Australian Fixed Interest				
Bloomberg AusBond Composite Index	-0.3	-0.1	0.9	4.5
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	0.1	0.2	0.9	5.9
Barclay's Global Capital Aggregate Bond Index (hedged A$)	0.3	0.8	1.5	5.1
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.0	0.0	0.4
Commodities				
Gold (US$ per ounce)	7.1	0.4	7.0	24.3
Copper (US$ per metric tonne)	2.5	16.4	29.1	25.8
WTI Crude Oil (US$ per barrel)	7.0	20.6	23.6	-20.5
RBA Index of Commodity Prices (A$)	6.1	9.0	9.1	6.6

Table 1: Australian Dollar versus Foreign Currencies to 31 December 2020

AUSTRALIAN DOLLAR VERSUS	AS AT 31 DECEMBER 2020	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.77	4.8	8.7	13.0	10.3
British Pound Sterling	0.57	2.1	2.0	1.3	6.3
Euro	0.63	2.3	3.6	3.1	0.8
Japanese Yen	79.70	3.8	5.9	8.0	4.7