# Australian equity monthly (September 2020)

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## Australian market commentary

The S&P/ASX 200 Accumulation Index returned -3.7% during the month. Australian equities lagged most developed markets during the month, as most markets took a breather in September. In major global developed markets Japan's Nikkei 225 was up 2.3%, the UK's FTSE 100 was down 1.5%, the DJ Euro Stoxx 50 was down 2.3% and the US S&P 500 was down 3.8%.

Cyclical sectors underperformed due to concerns that the global recovery could stall without further stimulus. A surge in COVID-19 cases in Europe and fears of a rising wave in the US also drove risk-off sentiment. Despite value outperforming growth globally, the value style underperformed growth in Australia during September. The underperformance of value in Australia was largely attributable to weakness in the financial and energy sectors.

The Reserve Bank of Australia (RBA) reaffirmed its commitment to support the financial system through a historically low cash rate of 0.25% and yield curve control to keep 3-year bonds at 0.25%. The RBA's Term Funding Facility has been extended in both size and duration. These measures are intended to keep funding costs low and sustain credit availability.

Domestic economic data releases were mixed in September. Employment rose by 111,000 positions in August, exceeding market expectations. The unemployment rate declined to 6.8%, which was also better than expected. Q2 GDP slumped -7.0%, sending Australia into its first recession since 1991. The NAB Survey of Business Conditions fell in August to -6 points, with business confidence remaining weak at -8. Retail sales were up 3.2% in July. National CoreLogic dwelling prices continued to fall in September, ending the month down 0.1%.

Sector returns were mostly negative in September. The best performing sectors were healthcare (0.9%), industrials (-0.3%) and real estate (-1.8%). These were followed by communication services (-2.2%), consumer discretionary (-2.6%), materials (-2.9%) and utilities (-3.3%), which also outperformed the broader market. Sectors that lagged included financials (-6.1%), consumer staples (-6.6%) and information technology (-6.8%). Energy (-11.1%) was the worst performing sector.

Healthcare was the top performing sector, and the only sector to post positive returns, as thoughts start to focus heavily on potential COVID-19 vaccine winners. Sonic Healthcare (5.1%), CSL (0.86%) and Cochlear (3.4%) were the key contributors to performance.

The industrial sector also outperformed during September. Transurban Group (4.8%), Sydney Airport (2.4%) and Qantas were the key drivers of sector performance as these names benefited from the move closer to travel restrictions easing.

The real estate sector also outperformed the broader market, despite the challenges of COVID-19. The key contributor was Mirvac (3.3%).

The consumer staples sector lagged the broader market. It was dragged into negative territory by Woolworths (-7.4%) and the A2 Milk Company (-17.4%), which fell following a profit warning.

The information technology sector ended its recent outperformance, following the lead of global IT stocks. Afterpay (-12.5%) finally ended its stellar run to post negative returns, while Computershare (-8.1%) and Wisetech Global (-8.4%) also underperformed.

The energy sector was the worst performer in September as oil prices fell during the month. Sector heavyweights Origin Energy (-21.4%), Woodside Petroleum (-10.2%) and Santos (-13.9%) were the main detractors.

## Australian market outlook

While the ongoing global COVID-19 situation and ensuing uncertainty makes forecasting difficult, we continue to reassess our earnings estimates. This includes reviewing short-term earnings and implications for dividends and balance sheet risk, as well as long-term earnings, which have implications for valuations. As well as assessing the risks associated with stocks in the portfolio currently, we are also actively assessing opportunities thrown up by any aggressive and, in some instances, indiscriminate sell-offs.

Economic shocks such as the one we are currently experiencing typically result in social and economic adjustments. Ultimately, the impact on long-term earnings estimates and valuations will be a function of the depth, duration and damage inflicted during this period of enforced subdued activity. Some of the more obvious potential transformations include: 1) employees working from home for all or part of the week; 2) potential drop in required office space amid the work from home theme; 3) reduction in the use of public transport and increase in car travel; 4) potential decline in business travel as virtual meetings increase on the back of improving technology; 5) an accelerated shift in market share of e-commerce and omni-channel retail; and 6) surprisingly positive impact of low interest rates and government stimulus on housing, with early signs of increased interest in moving away from the inner CBD suburbs. It is still too early to be confident that these adjustments will be longstanding or perhaps just a one-off. As such, the Nikko AM team continues to invest significant time to identify, and thus appropriately value, any of the structural winners and losers.

The 2020/21 Federal budget delivered out of season in October was, as expected, one of the most stimulatory budgets we've ever seen. Echoing the RBA's explicit statement that reducing unemployment is a "national priority", the budget outlined a commitment to provide continuing extraordinary fiscal support until Australia's unemployment rate is below 6%. The initiative involves a broad strategy of spending to drive economic growth and job creation across many sectors via tax cuts, wage subsidies, infrastructure spending and investment incentives together with a boost to housing and a reboot to manufacturing. The spending was widespread across defence, health, technology, university research, the energy sector and regional areas.

The US election became even stranger, if that was possible, with President Donald Trump contracting COVID-19 along with a number of his key advisors. He was, however, only hospitalised for a short period and is already back in the White House and thus arguably minimising the impact to his campaign. The key risk remains a drawn-out election result, exacerbated by the political parties disputing the outcome through the courts. A clear victory by either party is likely to be viewed positively.

The combination of extreme positioning and valuation differentials that are still evident in the market always provides strong forces when the market reverses. Recessions are typically the catalyst for changes in leadership styles and our expectation is for history to repeat with value outperforming—particularly when the world becomes less sensitive to the COVID-19 situation via a vaccination or a therapeutic solution. Like other large market corrections, it is always difficult to pick the bottom. Therefore, rotating slowly into some of the beaten down value names funded by reducing and exiting the outperformers is an approach that we have found has worked well in these type of markets.

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