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MANAGED VOLATILITY EQUITIES PORTFOLIO EXCLUDING GLOBAL

PORTFOLIO UPDATE

MANAGED VOLATILITY EQUITIES EXCLUDING GLOBAL PORTFOLIO (MVE EX GLOBAL)

Unless otherwise stated, all figures are as at 17 April 2020. Performance figures are preliminary and gross, based on a representative account.

OVERARCHING THOUGHTS AND SOME OBSERVATIONS

- Where do house prices go? Rental vacancies were up 20% by the end of March. 31% of dwellings in Australia are rented. Initially landlords will be able to defer their interest payments. There are dwellings being built, generally taking 12 months from start to finish, so the pipeline of new supply does not slow quickly. Unemployment is by far the largest cause of defaults on home loans.

- Unemployment is bad, but would be worse without the Federal government's Jobskeeper programme. A new Australian Bureau of Statistics data series on payrolls showing a 6% decline in jobs over the three weeks ending 4 April 2020. Without Jobskeeper it would be much worse.

- Negative oil prices are an interesting headline, but this may not be the capitulation moment in oil, as the move looks more technical than fundamental. The price did not go negative in Brent, negative prices were limited to WTI which is the subject of significant ETF futures trading and storage constraints. It is however a broad indicator that the "deal" done last week by oil suppliers is being overwhelmed.

- Much of the focus has been on higher income countries. Covid-19 cases in middle income countries such as India and Indonesia are beginning to rise. Testing is low, health care systems have less capacity and many workers need to work to ensure they can obtain basic necessities. They may need to choose a different path.

- Money printing and over the top government spending will increase. This, and the government purchasing of assets tends to inflate bubbles. Perhaps one of the more interesting political developments of recent times is the abandonment of fiscal balance policies in the UK and US by the century long traditional holders of those policies, the UK Conservatives and US Republicans. This happened before Covid-19. Covid-19 has pushed on an open door to deficit funded spending and money printing.

HOW HAS MVE (EX GLOBAL) PERFORMED

- Month-to-date (MTD), the portfolio has underperformed a rallying S&P/ASX 300 by (3.6%).

- An underweight to financials, which continues to be the the worst performing sector MTD contributed to performance while an underweight to technology, real estate and energy, the three best performing sectors MTD detracted from performance. We continue to hold 14% in cash as dry powder also detracted from performance amid a MTD strong market rally of 8.3%.

- Stock selection within healthcare and consumer staples sectors detracted from relative returns. Within healthcare, the key detractors have remained not holding CSL, where we believe the risk to blood collections is underappreciated, and our overweights to Sonic Healthcare and Resmed. Coca-Cola also detracted in consumer staples which reported large volume declines as result of Covid-19 lockdown of bars and restaurants. Insurers IAG and Medibank continue to detract amid the cyclical MTD rebound but continued to be positive contributors year-to-date (YTD).

- The key contributors MTD for the portfolio continue to be major Australian banks such as Commonwealth Bank, ANZ, Westpac, NAB and gold mining producers Evolution Mining, Newcrest Mining, and Regis Resources all contributed driven by the recent gold rally. Despite the recent MTD underperformance, the portfolio continues to strongly outperform the S&P/ASX 300 by +5.9% over YTD.

- Strong sector selection with an underweight to financials and overweight to consumer staples as well as holding ~8% on average in cash YTD in falling equity markets contributed to performance. YTD stock selection also contributed positively with key contributors within materials, financials and industrials.

WHAT CHANGES HAVE WE MADE TO MVE'S (EX GLOBAL) PORTFOLIO POSITIONING?

- We have made no material changes from last week where we added a few positions to the portfolio such as APA Group, a firm which operates natural gas and electricity assets and has a solid balance sheet and strong defensive cashflows and Elders, an agribusiness which should benefit from both operating in favourable sector and commodity prices falling.

WHAT IS OUR OUTLOOK FROM HERE?

- Whilst flattening the first wave curve is an undoubted positive and appear to have caused some relief in the market, the challenges that lie ahead are arguably larger.

- We see the major catalysts for a market rerate up to be:

  - Technological: a cure, vaccine or a dramatic increase in accurate testing. Despite much press, a hard headed analysis of the activity here indicates that material improvements from a cure or a vaccine are at best 12 months away. Testing volumes and accuracy are much better than 6 weeks ago, but are optimistically quarters away from being widespread.

  - Fiscal/Monetary: Money printing, deficit spending and the purchasing of assets by governments can inflate asset prices, and if correctly targeted could restart the economy. The correct targeting is the issue. The US Federal reserve now buys junk bonds. Previously unthinkable. However, as Keynes observed animal spirits (a more catchy way of describing consumer confidence) drive the actual economic activity. Without jobs and incomes, inflated asset prices do not turn an economy around. If someone doesn't feel confident about their employment prospects, they won't spend much.

You can access our full suite of coronavirus materials on our [Volatility Insights microsite]

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