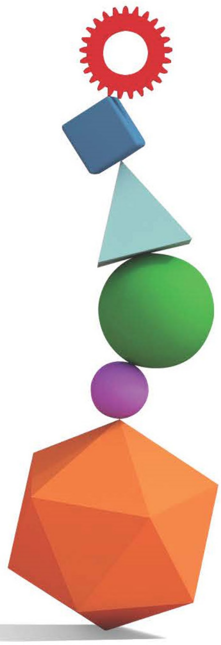
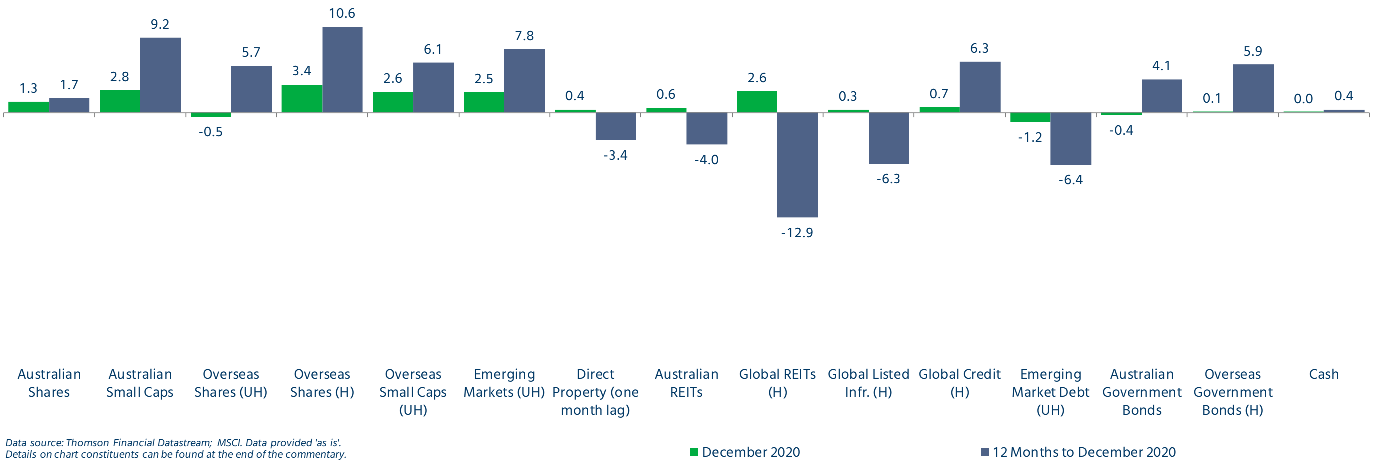
December 2020

Australian monthly market review

Selected market indicators commentary



Asset class returns as at 31 December 2020



Data source: Thomson Financial Datastream; MSCI. Data provided 'as is'. Details on chart constituents can be found at the end of the commentary.

Over the month of December, markets broadly achieved positive returns as vaccine roll-outs and another fiscal stimulus package in the US offset bad news on the virus front. Restrictions tightened in many countries as new COVID-19 cases across the developed world surged, as a new more infectious COVID-19 strain began to spread globally. However, vaccination programs have given markets hope that economies will fully reopen over the next year. Emerging markets enjoyed another strong month, returning 2.5% in unhedged terms, mainly driven by commodity exporters, such as Brazil and Russia, but also a strong rebound in India. Growth reverted back to outperforming value, mirroring the technology versus old economy narrative, which unfolded during the pandemic. Major political tail risks have receded for now with Brexit having been resolved in an orderly manner. However, the political situation within the US has recently been at the forefront of global news.

The US dollar (USD) weakened against currencies of major developed countries and plummeted against currencies of commodity exporters, as investors kept positioning for commodity reflation. Consequently, the Australian dollar (AUD) rose 4.7% relative to the USD over the month. Gold outperformed global equities due to worries about the debasement of currencies in a year where governments have monetised more debt than ever before.

Major central banks also reassured markets about their willingness to offer a backstop should any short term obstacles to the recovery begin to emerge. The US Federal Reserve committed to maintaining the pace of its asset purchase programs, while the European Central Bank increased its asset purchase program. China's central bank implied a fair balance between slowing credit growth without tightening prematurely.

Overseas government bonds remained relatively flat as yields moved sideways for most developed nations, while the Bloomberg Ausbond Treasury Index returned -0.4%.

Australian shares were positive in December, with the S&P/ASX300 returning 1.3% and S&P/ASX Small Ordinaries returning 2.8%, as markets continued to price in the recovery, which drove up commodity prices. Materials (+8.8%) and IT (+8.6%) were the best performing sectors, while the weakest performing sectors were Utilities (-5.4%) and Healthcare (-4.7%).

Significant Developments

- During its early December 2020 meeting, the Reserve Bank of Australia (RBA) decided to maintain its current policy settings, including the target cash rate at 0.10% per annum and the targeted yield on 3-year Australian Government bonds at 0.10%. 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 October figures were revised to an increase of 180,400. The unemployment rate decreased to 6.8% for November, below expectations for 7.0%. The participation rate increased to 66.1%, above expectations of 65.9%. Part time jobs increased by 5,800 and full time jobs increased by 84,200.
- Australian building approvals increased 2.6% month-on-month to November, compared to the previous level of 3.3% (revised) for period ending October.
- 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 over the month.
- US Non-Farm Payrolls decreased by 140,000 in December, below the 336,000 increase (revised) recorded for November. The unemployment rate remained at 6.7% over December, below expectations for 6.8%.
- US GDP third estimate for Q3 2020 is 33.4% quarter on quarter (QoQ) annualised, above expectations for 33.1%.
- The Caixin Manufacturing PMI in China recorded 53.0 in December, below expectations for 54.7, signalling a softer improvement in manufacturing conditions.
- The preliminary estimate of the European Core CPI recorded 0.2% over the year to December, in line with expectations.
- The Eurozone composite PMI increased to 49.1 in December, below expectations for 49.8.
- The final estimate recorded for Q3 2020 Eurozone seasonally adjusted GDP is 12.5% QoQ and -4.3% YoY.

Australian Equities

The Australian share market underperformed its hedged overseas counterpart over the month, as the S&P/ASX 300 Index returned 1.3%. The S&P/ASX Mid 50 was the strongest relative performer, increasing 3.4%, while the S&P/ASX 50 was the weakest, returning 0.7% over the month.

The best performing sectors were Materials (+8.8%) and IT (+8.6%), while the weakest performing sectors were Utilities (-5.4%) and Healthcare (-4.7%). The largest positive stock contributors to the index return were BHP, Fortescue and Afterpay with absolute returns of 11.9%, 29.4% and 24.2% respectively. In contrast, the most significant detractors were CSL, Westpac and QBE Insurance with absolute returns of -4.7%, -3.6% and -14.3%, respectively.

Global Equities

The broad MSCI World ex Australia (NR) Index decreased 0.5% in unhedged terms and increased 3.4% in hedged terms over the month, as the Australian dollar (AUD) appreciated against all major developed market currencies. In AUD terms, the strongest performing sectors were IT (+0.9%) and Consumer Discretionary (+0.7%), while Utilities (-2.7%) and Real Estate (-2.5%) were the weakest performers. In AUD terms, the MSCI Small Caps (TR) Index was up 2.6% and MSCI Emerging Markets (NR) Index was also up 2.5% over December.

Over December, the NASDAQ increased 5.7%, the S&P 500 Composite Index increased 3.8% and the Dow Jones Industrial Average increased 3.4%, all in USD terms. In local currency terms, major European share markets experienced positive returns as the CAC 40 (France) increased 0.8%, FTSE 100 (UK) increased 3.3% and the DAX 30 (Germany) increased 3.2%. In Asia, the Indian S&P BSE 500 (+7.7%), Hong Kong Hang Seng (+3.4%), Chinese SSE Composite (+2.4%) and Japanese TOPIX (+3.0%) had solid positive returns.

Real Assets

The Real Assets sector achieved broadly positive returns over December. The Global Real Estate Investment Trusts (REITs) Index increased by 2.6% over the month and the FTSE Global Core Infrastructure 50/50 Index returned 0.3% (both in AUD hedged terms). Domestic REITs increased 0.6% over December, whilst the Australian Direct Property (NAV) returned 0.4% on a one-month lagged basis.

Fixed Interest

Global bond markets were broadly positive over December, with the Barclays Capital Global Aggregate Bond Index (Hedged) returning 0.3% and the FTSE World Government Bond (ex-Australia) Index (Hedged) returning 0.1%. Ten-year bond yields decreased in most markets including UK (-10bps to 0.24%), Germany (-1bp to -0.58%) and Japan (-1bp to 0.02%), whilst the US yield increased (+8bps to 0.91%). Two-year bond yields were mixed over the month, decreasing in the US (-2bps to 0.13%) and the UK (-14bps to -0.16%), remaining flat in Japan (-0.12%) and increasing in Germany (+4bps to -0.71%).

Returns for Australian bondholders were mixed over December, with 10-year (+9bps to 0.98%) and five-year (+5bps to 0.35%) bond yields increasing, and two-year bond yields decreasing (-3bps to 0.07%). Of the Bloomberg Ausbond indices, the Bloomberg Ausbond Inflation Index produced the highest return, increasing 1.2% over the month.

Currency Markets

The AUD Trade Weighted Index increased to 63.4 over December, up by 3.1% from November. The AUD appreciated against all major developed market currencies, including the US Dollar (+4.7%), Japanese Yen (+3.5%), Euro (+1.5%) and Pound Sterling (+2.1%).

Commodities

Iron Ore increased by 21.5%, finishing the month at US$158.5 per metric tonne. The S&P GSCI Commodity Total Return Index increased 1.2% over the month. Gold prices increased from November finishing the month at US$1,897.8 per ounce and the oil price increased 8.8% to US$51.9 per barrel over December.

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

Contact: Mercer >IS<

Tel: 1800 512 947

Email: merceris@mercer.com

Important Notices

‘MERCER’ is a registered trademark of Mercer (Australia) Pty Ltd ABN 32 005 315 917.

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.

This contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity, without Mercer’s prior written permission.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed. Past performance does not guarantee future results. Mercer’s ratings do not constitute individualised investment advice.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages), for any error, omission or inaccuracy in the data supplied by any third party.

This does not constitute an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products or constitute a solicitation on behalf of any of the investment managers, their affiliates, products or strategies that Mercer may evaluate or recommend.

For the most recent approved ratings of an investment strategy, and a fuller explanation of their meanings, contact your Mercer representative.

For Mercer Investments conflict of interest disclosures, contact your Mercer representative or see www.mercer.com/conflictsofinterest.

Mercer universes: Mercer’s universes are intended to provide collective samples of strategies that best allow for robust peer group comparisons over a chosen timeframe. Mercer does not assert that the peer groups are wholly representative of and applicable to all strategies available to investors.

The value of your investments can go down as well as up, and you may not get back the amount you have invested. Investments denominated in a foreign currency will fluctuate with the value of the currency. Certain investments carry additional risks that should be considered before choosing an investment manager or making an investment decision.

This document is not for distribution to retail investors.

This document has been prepared by Mercer Investments (Australia) Limited (MIAL) ABN 66 008 612 397, Australian Financial Services Licence #244385.