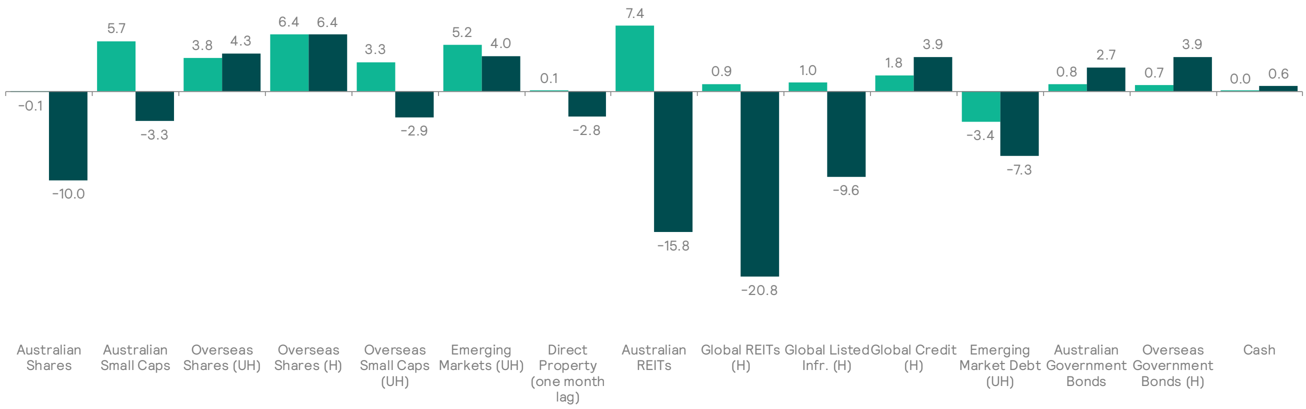
Q3 2020

MARKET AND ECONOMIC CONDITIONS

SELECTED MARKET INDICATORS COMMENTARY

ASSET CLASS RETURNS (%) AS AT SEPTEMBER QUARTER 2020



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

Markets have maintained a broadly positive run since the previous quarter. Investor sentiment was encouraged by the positive economic data that came through over the quarter, with a drop in sentiment towards the end of the quarter as fears of an economic slowdown crept back in. Coronavirus cases are now stable in the US, with strong improvements in Australia and other Asian nations. Whilst the UK, Eurozone and Canada have recently witnessed a resurgence in cases, fatality rates have stabilised to low single-digit levels. Hedged Developed Overseas Shares returned 6.4% for the quarter and Unhedged Developed Overseas Shares returned 3.8%, as the Australian dollar rose 4.1% against the US dollar and 1.2% against the trade-weighted index over the past three months.

Over the quarter, Consumer Discretionary (+11.5%) and Materials (+7.7%) were the top performing sectors within developed overseas shares whilst Real Estate and Energy were the largest detractors, returning -2.3% and -19.4% respectively. Growth stocks continued to outperform value over the quarter.

Australian REITs experienced a particularly strong quarter, returning 7.4%, with majority of this return earnt in August. Compared to hedged global REITS, the Australian REITs index is more heavily weighted towards retail property, which outperformed both office and industrial sectors over August. Although remaining negative at -15.8% over the 12 months to September 2020, the August rebound in AREITs helped claw back some of the significant negative performance since the onset of the pandemic.

MERCER

Yields in fixed interest markets spent the third quarter of 2020 anchoring lower around the levels targeted by their respective Central Banks. Towards the end of the quarter, inflation expectations moved slightly lower as investors priced in a slowdown in the recovery and thus less upwards pressure on inflation in the near term. Following their large sell-off in the prior quarter, Credit markets have continued to rally as yields lowered, returning 1.8% for the three months to September 2020. Returns from domestic and hedged global government bonds have been relatively similar, returning 0.8% and 0.7% respectively over the quarter.

The Australian share market underperformed its hedged overseas counterpart, as the S&P/ASX300 returned -0.1% over the quarter. The S&P/ASX Small Caps was the biggest contributor returning 5.7% over Q3, whilst S&P/ASX 50 was the greatest detractor, returning -1.9%. Information Technology (+13.0%) and Consumer Discretionary (+10.1%) were the strongest performing sectors over the quarter, as domestic investor appetite remains strong in technology and software. In comparison, Energy (-13.5%) and Utilities (-8.2%) were the weakest performing sectors over the quarter.

SIGNIFICANT DEVELOPMENTS

- The Reserve Bank of Australia (RBA) has maintained the cash rate at 0.25% over the third quarter of 2020. Throughout the meetings in Q3, the Board reaffirmed the cash rate and the 3-year yield on Australian government bonds of 25bps, as well as the other elements of the policy package announced in mid-March. RBA Governor, Governor Philip Lowe, noted that the global economy is gradually recovering after a severe contraction due to the COVID-19 pandemic. However, the recovery is uneven and its continuation is dependent on containment of the virus. Financial market volatility is low and the prices of many assets have risen substantially despite the high level of uncertainty about the economic outlook. The Australian economy experienced a sharp contraction in Q2 2020, with output falling by 7%. However, the decline in output was still smaller than most other countries and smaller than expected. A recovery is now underway in most of Australia, although the second-wave outbreak in Victoria has resulted in a further contraction in output. Labour market conditions have improved somewhat over the past few months and the unemployment rate is likely to peak at a lower rate than earlier expected. Even so, unemployment and underemployment are likely to remain high for an extended period. Over the past six months, substantial easing of monetary policy and increased fiscal stimulus has supported the Australian economy. Early in September, the RBA bought a further $2bn of Australian Government Securities (AGS) in support of its 3-year yield target, bringing total purchases of government securities since March to $63bn. The Board has stated that it will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will remain sustainably within the 2–3% target band.
- Australian seasonally adjusted employment increased by 111,000 in August, above the expectations of a fall of 35,000, while July figures were revised to an increase of 119,200. The unemployment rate decreased to 6.8% for August, below expectations for 7.7%. The participation rate increased to 64.8%, above expectations for 64.6%. Part time jobs increased by 74,800 and full time jobs increased by 36,200.
- Australian house prices decreased by 1.8% in the second quarter of 2020, taking it 6.2% higher from a year earlier and below expectations for -1.3% quarter-on-quarter (QoQ) and 6.8% year-on-year (YoY). Building approvals decreased 1.6% month-on-month (MoM) to August, increased from March rate of -4.0%.
- US Non-Farm Payrolls increased by 661,000 in September, below the 1,489,000 increase (revised) recorded for August. The unemployment rate decreased to 7.9% over September, below expectations for 8.2%.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 55.4 in September, below consensus for 56.5, and below the 56.0 recorded in August. Of the 18 manufacturing industries, Paper Products and Wood Products were the industries that reported the highest growth. Apparel, Leather & Allied Products and Printing & Related Support Activities were the largest detractors over the month. The ISM Non-Manufacturing Index recorded 57.8 in September, above consensus for 56.2 and above the 56.9 recorded in August. Of the 18 non-manufacturing industries, the top performers in September were Arts, Entertainment & Recreation and Utilities. Professional, Scientific & Technical Services was the only industry, which reported a decrease over the month.
- US gross domestic product (GDP) third estimate for Q2 2020 is -31.4% quarter on quarter (QoQ) annualised, above expectations for -31.7%.

- US headline consumer price index (CPI) decreased from 0.6% MoM in June to 0.2% (estimated) MoM in September, but increased from 0.6% YoY in June to 1.4% (estimated) YoY in September.
- The Caixin Manufacturing PMI in China recorded 53.0 in September, slightly below expectations for 53.1, as solid improvement in the health of China's manufacturing sector continues.
- Chinese GDP increased 3.2% YoY for Q2 2020, above expectations for 2.4%. Seasonally adjusted GDP increased 11.5% QoQ for Q2 2020, above expectations for 9.6%.
- The preliminary estimate of the European Core Consumer Price Index (CPI) recorded 0.2% over the year to September, below expectations of 0.4%. The unemployment rate increased to 7.7% in September 2020.
- The Eurozone composite PMI decreased to 50.4 in September, above expectations for 50.1. Eurozone operating conditions have deteriorated relative to July.
- The final estimate recorded for Q2 2020 Eurozone seasonally adjusted GDP is -9.7% quarter-on-quarter (QoQ) and -14.7% year-on-year (YoY).

AUSTRALIAN EQUITIES

Australian shares were mixed over Q3 2020 as the S&P/ASX 300 Index returned -0.1% for the period. There was a positive movement in the small cap with the S&P/ASX Small; returning 5.7% for the quarter, while the worst performer was the S&P/ASX 50; returning -1.9%.

The best performing sectors were IT (+13.0%) and Consumer Discretionary (+10.1%), while the weakest performing sectors were Energy (-13.5%) and Utilities (-8.2%). The largest positive contributors to the return of the index were Goodman Group, Afterpay and Fortescue Metals Group with absolute returns of 21.3%, 31.2% and 20.0% respectively. On the other hand, the most significant detractors from performance were CBA, Telstra and Westpac with absolute returns of -7.1%, -10.5% and -5.1% respectively.

GLOBAL EQUITIES

The broad MSCI World ex Australia (NR) increased 6.4% in hedged terms and increased 3.8% in unhedged terms over the quarter, as the AUD appreciated against most major currencies over the period. The strongest performing sectors were Consumer Discretionary (+11.5%) and Materials (+7.7%), while Energy (-19.4%) and Real Estate (-2.3%) were the worst performers. Other global shares were also positive as the Global Small Cap sector increased 3.3% and the Emerging Markets (NR) returned 5.2%, all in AUD terms.

Over the September quarter, the NASDAQ increased 11.0%, the S&P 500 Composite Index increased 8.9% and the Dow Jones Industrial Average increased 8.2%, all in USD terms. Most European markets experienced negative returns, with the FTSE 100 United Kingdom (UK) decreasing 4.0%, the CAC 40 (France) decreasing 2.0%, all in local currency terms. Whilst the DAX 30 (Germany) increased 3.7% over the quarter. Equity returns were positive across most of Asia as the Indian BSE 500 increased 10.5%, the SSE Composite (China) increased 7.8% and the Japanese TOPIX increased 5.2%, all in local currency terms. However, the Hang Seng decreased 2.6%.

REAL ASSETS

Global and Domestic listed property experienced positive results over the September quarter. Unhedged domestic Real Estate Investment Trusts (REITs) were up 7.4%. Whilst global REITs in unhedged terms were negative, the appreciation of the AUD over the quarter led hedged Global REITs increasing to 0.9% (in AUD terms). The Australian unlisted property sector (NAV) increased 0.1% over the quarter on a one month lagged basis and once again, the appreciation of the AUD led to the FTSE Global Core Infrastructure 50/50 index increasing 1.0% for the quarter in hedged AUD terms.

FIXED INTEREST

Global sovereign bonds produced broadly positive returns over the September quarter for hedged Australian investors. Ten-year bond yields decreased in Germany (-2bps to -0.52%) and Japan (-1bp to 0.02%) but increased in the US (+2bps to 0.68%) and the UK (+7bps to 0.19%). Two-year bond yields decreased in the US (-4bps to 0.13%), whilst increased in the UK (+7bps to -0.02%) and Japan (+1bp to -0.14%), and remained flat in Germany (-0.69%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index increased 0.7% and the FTSE World Government Bond (ex-Australia) Index also increased 0.7% over the September quarter, on a fully hedged basis.

Domestically, Australian 10-year bond yields decreased by 4bps to 0.84%, five-year bond yields decreased by 8bps to 0.33% and the two-year bond yields also decreased by 8bps to 0.18%. Bloomberg Ausbond indices were broadly positive over the quarter, with the Bloomberg Ausbond Inflation Index achieving the highest return at 3.5%, and the weakest being the Bloomberg Ausbond Bank Bill Index returning flat.

CURRENCY MARKETS

The Australian Dollar (AUD) appreciated against most major currencies over the September quarter, finishing at US$0.72 with a Trade Weighted Index of 60.7. The AUD appreciated against the USD (+4.1%) and the Japanese Yen (+1.4%) but depreciated against the Pound Sterling (-0.9%) and Euro (-0.9%). On a trade-weighted basis, the local currency appreciated 1.2% over the quarter.

COMMODITIES

The S&P GSCI Commodity Total Return Index increased by 0.5% over the quarter. Gold prices finished the quarter at US$1,899.84 per ounce for a 6.5% increase and Iron Ore prices also increased by 18.2% to US$120.0 per metric tonne over the period. Meanwhile, the oil price decreased by 0.6% to US$41.0 per barrel.

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

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IMPORTANT NOTICES

MARSH & McLENNAN COMPANIES