



## 2021 – a list of lists regarding the macro investment outlook

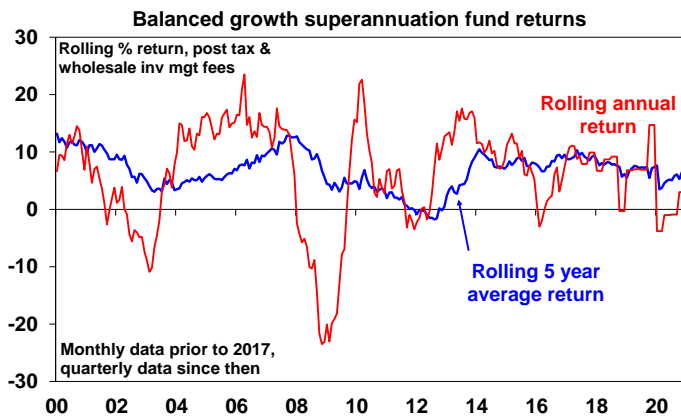
11 JANUARY 2021  
EDITION 1

### Key points

- > 2020 turned out far better for investors than was feared.
- > 2021 is expected to provide solid returns & see a further rotation from pandemic winners to cyclical investments.
- > Watch: coronavirus and vaccines; US politics; China tensions; inflation; & the hit to immigration in Australia.

### Introduction

2020 turned out far better for diversified investors than had been feared when the pandemic hit triggering plunging share markets and deep recessions, with average balanced growth superannuation funds looking like they have returned around 3%. This followed around 15% last year. Balanced growth super funds returns have averaged around 7% p.a. over the last five years which is well above inflation & bank deposit returns.



Source: Mercer Investment Consulting, Morningstar, AMP Capital

But can returns hold up? Here is a summary of key insights and views on the investment outlook in simple point form.

### Six reasons 2020 was better than feared for investors

Despite the pandemic, recession and a 35% plunge in shares into March, 2020 was better than feared for investors as:

- Massive fiscal support shielded businesses, jobs & incomes.
- Debt forbearance schemes headed off defaults.
- Massive monetary stimulus saw interest rates plunge helping borrowers service loans.
- Economies reopened after social distancing helped contain the virus – albeit much better in some countries (eg, Asia, Australia and NZ) than others (eg, the US and Europe).
- The election of Joe Biden as President in the US offered the prospect of less global policy uncertainty & tensions ahead.

- Good news on the effectiveness of vaccines later in the year offered the hope of a return to something more normal.

The first four points contributed to economies bouncing back faster than expected through the second half – even though we are still far from a full recovery and coronavirus continued to wreak havoc. The anticipation of recovery and ultra-low interest rates drove a rebound in many investment markets.

### Five lessons from 2020

- Timing market moves is hard – just as getting out at the share market top in February was hard, getting on board again for the rally from March was even harder given the gloom at the time.
- Don't fight the Fed, ECB, PBOC or RBA – while they could not prevent the plunge in share markets into March, their massive money easing was a key driver of the recovery.
- Investment valuations need to be assessed relative to interest rates – while PEs may be high, once the dust settles in terms of the economic outlook, what matters is the yield offered by shares relative to interest rates. And low rates make shares relatively attractive.
- Depressions can be avoided – 2020 showed that a rapid, large and well targeted economic policy response can protect an economy from a significant shock and enable it to rebound quickly when the threat abates. This is good reason for investors not to panic in the face of economic shocks.
- Turn down the noise – investors were bombarded with information and opinions around what the coronavirus would mean but much of this was just noise. The key is to turn down the noise and stick to a long-term investment strategy.

### Three positive longer-term impacts from the pandemic

The longer term negatives from the pandemic - in terms of: higher unemployment; a further blow to globalisation; tensions with China; increased social tensions; more public debt; the risk of higher inflation long term; disruption for various industries like airlines, retail and office - are well known and have been covered to death. But there are four key longer-term positives:

- Increased productivity – the disruption caused by the pandemic massively accelerated the adoption and efficient use of new technology whether that be in relation to virtual meetings, e-commerce and use of the cloud that can cut costs and boost output.
- A more balanced lifestyle and more affordable housing – with the pandemic showing that it's possible for many to work from home more, this can lead to a more balanced and less stressful lifestyle and allow more disperse living, taking pressure off expensive city property prices.

- The benefits of science and relying on expert advice – the rapid development of vaccines highlighted what science can achieve and the better management of the virus in some countries like Australia with minimal loss of life highlights the benefits of relying on expert advice. Both serve as a rebuke to ignorant populist politicians and offer hope for better management of other issues – like climate change.

#### Four reasons for optimism for 2021

- The deployment of several vaccines with high levels of efficacy in phase 3 testing indicates that there is a good chance that developed countries will reach herd immunity in the second half of the year.
- Fiscal stimulus and easy monetary policy is still working through the system (with the latest \$900bn US stimulus and likely more on the way with Democrat control of the US Senate) and high saving rates indicating significant spending potential as confidence improves.
- The US is moving to more stable, less divisive leadership more reliant on expert advice under Biden, with democratic institutions withstanding an onslaught from Trump.
- The pandemic did not see the world descend into anarchy as doomsters would have predicted.

The first two should support a solid rebound in global growth and profits (beyond near term COVID-19 lockdowns). At a time of significant spare capacity, it should be accompanied by still low inflation and hence interest rates, meaning that we are still in the “sweet spot” of the investment cycle.

#### Key views on markets for 2021

After having run up so hard since early November, shares are vulnerable to a decent short term pull back (say 5 to 15%) and 2021 is likely to see a few rough patches along the way (much like we saw in 2010 after the recovery from the GFC), but looking through the inevitable short term noise, the combination of improving global growth and low interest rates augurs well for growth assets generally in 2021.

- We are likely to see a continuing shift in performance away from investments that benefitted from the pandemic and lockdowns - like US shares, technology and health care stocks & bonds - to investments that benefit from recovery - resources, industrials, tourism stocks and financials.
- Global shares are expected to return around 8%, but expect a rotation away from tech heavy US shares to more cyclical markets in Europe, Japan and emerging countries.
- Australian shares are also likely to be relative outperformers returning around 12% helped by better virus control, enabling a stronger recovery in the near term, stronger stimulus, sectors like resources, industrials and financials benefitting from the rebound in growth and as investors continue to drive a search for yield benefitting the share market as dividends are increased.
- Ultra-low yields & a capital loss from a 0.5-0.75% or so rise in yields are likely to result in negative returns from bonds.
- Unlisted commercial property and infrastructure are ultimately likely to benefit from a resumption of the search for yield but the hit to space demand and hence rents from the virus will continue to weigh on near term returns.
- Australian home prices are likely to rise 5% or so this year being boosted by record low mortgage rates, government home buyer incentives, income support measures and bank payment holidays but the stop to immigration and weak rental markets will likely weigh on inner city areas and units in Melbourne and Sydney. Outer suburbs, houses, smaller cities and regional areas will see stronger gains in 2021.
- Cash and bank deposits are likely to provide very poor returns, given the ultra-low cash rate of just 0.1%.

- The \$A is vulnerable to uncertainty around coronavirus and China tensions and RBA bond buying will keep it lower than otherwise, but expect it to rise to around \$US0.80 helped by rising commodity prices and a cyclical decline in the \$US.

#### Six things to watch

- Coronavirus and vaccines – problems with vaccines or their deployment could result in ongoing waves of new coronavirus cases & slower recovery than we are assuming.
- US politics – the Democrat victory in Georgia’s January 5 US senate elections risks a more leftward tilt under Biden, although conservative Democrat senators will limit this. Social and political tensions remain high even with Trump on the sidelines.
- Tensions between China and the US/Australia – we expect a shift to a diplomatic approach here led by President Biden but there is a risk of misjudgement on either side which could risk slowing Australia’s longer-term growth rate.
- Inflation – we are assuming it remains weak but if it rebounds faster than expected it will mean faster increases in bond yields and downward pressure on asset valuations.
- The hit to immigration in Australia – it’s hard to see 700,000 less immigrants out to mid-2023 having no impact on inner city Sydney and Melbourne property prices.
- Global growth indicators (PMIs) – these have recovered nicely from their first half 2020 lows & need to remain solid.

#### Five reasons Australia is likely to outperform

- It’s done a better job of controlling coronavirus than many.
- It’s seen a stronger policy stimulus than most countries.
- It continues to benefit from a high exposure to China & Asia – with the high iron ore price swamping tensions with China.
- The drag from the mining bust is over.
- The Australian economy and share market are relatively cyclical & so should benefit from a cyclical global recovery.

#### Nine things investors should remember

Yeah – I had these last year, but they are mostly timeless!

- Make the most of the power of compound interest. Saving regularly in growth assets can grow wealth substantially over long periods. Using the “rule of 72”, it will take 144 years to double an asset’s value if it returns 0.5% p.a. (ie, 72/0.5) but only 14 years if the asset returns 5% p.a.
- Don’t get thrown off by the cycle. Falls in asset markets can throw investors out of a well thought out strategy at the wrong time - as some were in March last year.
- Invest for the long term. Given the difficulty in getting short term market moves right, for most it’s best to get a long-term plan that suits your wealth, age & risk tolerance & stick to it.
- Diversify. Don’t put all your eggs in one basket.
- Turn down the noise. As discussed earlier.
- Buy low, sell high. The cheaper you buy an asset, the higher its prospective return will likely be and vice versa.
- Beware the crowd at extremes. Don’t get sucked into the euphoria or doom and gloom around an asset.
- Focus on investments that you understand and that offer sustainable cash flow. If it looks dodgy, hard to understand or has to be justified by odd valuation measures or lots of debt to stack up, then it’s best to stay away.
- Accept it’s a low nominal return world – when inflation is 1.5%, 7% average superannuation returns are pretty good.

**Dr Shane Oliver**

**Head of Investment Strategy and Chief Economist  
AMP Capital**