Quarterly Economic Wrap

December 2020

Summary

- Share markets rose strongly during the December quarter with a combination of coronavirus vaccine rollouts, a Brexit deal and a Democrat President helping spur the rally.
- Coronavirus cases escalated towards year-end most notably within several European countries such as the UK and Germany which saw tighter lockdowns imposed.
- A new mutant variant of the coronavirus was also identified in the UK (B117 strain) with some estimates suggesting it could be up to 70% more infectious than Covid-19 and has led several countries to ban any travellers from the UK as concerns rise that this new variant may prove too difficult to contain in quarantine.
- Joe Biden, the Democrat nominee defeated incumbent President Trump in the US Presidential Election. Elections for Congress saw the Democrats victorious paving the way for President Biden's policy agenda and further fiscal stimulus

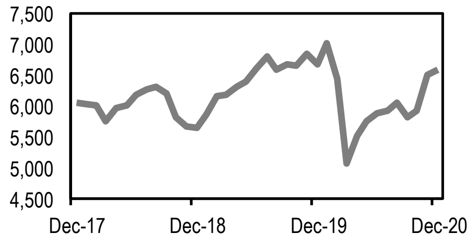
Markets

- Risk assets were positive with the vaccine news triggering a broad rally especially amongst riskier exposures such as small cap stocks (see page 14).
- Australian equities outperformed vs global peers (see Chart 2) while value stocks clawed back much of their relative performance against growth names (see Chart 3). Emerging market strength continued its uptrend since May (see Chart 4) even following poor performance from heavyweights such as China's Alibaba.

Key economic news

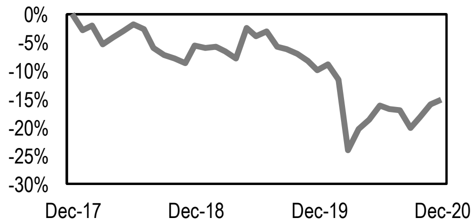
- The RBA launched a new series of measures to promote growth and weaken the Australian dollar.
- The UK and EU agreed to a deal for the former's exit from the union, removing a risk of a disruptive economic shock.

1. S&P/ASX 200 Price Index



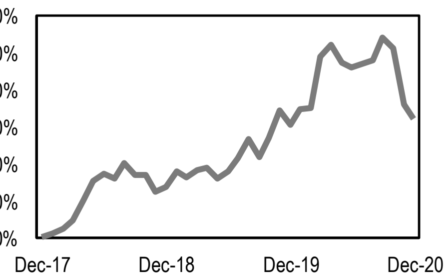
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



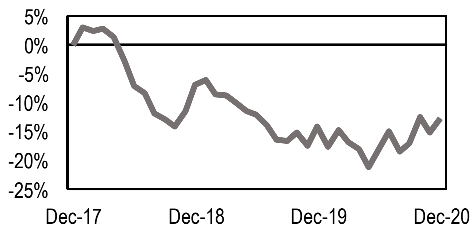
Source: Bloomberg, IOOF

3. Australia – Growth vs Value stocks



Source: Bloomberg, IOOF

4. Emerging markets vs Developed Markets, (In USD)



Sources: Bloomberg, MSCI, S&P, IOOF

Key company news

Vaccine news defined the top and bottom performers for the quarter. Please refer to pages 11-13 for more detail

Sector and stock returns

ASX/S&P 200 Sectors (GICS)				
	Monthly	**% ∆**	**Quarterly**	**% ∆**
▲	Consumer Discretionary	0.92	Consumer Discretionary	10.93
▲	Consumer Staples	2.17	Consumer Staples	6.25
▼	Energy	-0.88	Energy	26.17
▼	Financials ex Property	-0.52	Financials ex Property	21.82
▼	Financials	-0.53	Financials	21.82
▼	Health Care	-4.87	Health Care	-1.14
▼	Industrials	-2.99	Industrials	4.59
▲	IT	9.44	IT	24.72
▲	Materials	8.80	Materials	15.25
▼	Property Trusts	-0.89	Property Trusts	11.82
▼	Telecommunications	-0.63	Telecommunications	12.29
▼	Utilities	-6.79	Utilities	-7.12

Source: Bloomberg, IOOF

Best and Worst S&P/ASX 200 Performers			
Top five stocks		**Bottom five stocks**	
Monthly			
IGO Ltd	+37.4%	Mesoblast Ltd	-45.9%
Fortescue Metals Group Ltd	+28.5%	Appen Ltd	-21.7%
Credit Corp Group Ltd	+24.9%	Service Stream Ltd	-20.1%
Afterpay Ltd	+24.2%	IDP Education Ltd	-18.9%
Whitehaven Coal Ltd	+24.2%	A2 Milk Co Ltd	-17.1%
Quarterly			
Unibail-Rodamco-Westfield CDI	+110.7%	Mesoblast Ltd	-55.7%
Virgin Money UK Plc – CDI	+83.0%	Appen Ltd	-27.6%
Sims Ltd	+77.4%	Regis Resources Ltd	-25.3%
Polynovo Ltd	+75.6%	Silver Lake Resources Ltd	-22.5%
Credit Corp Group Ltd	+75.3%	St Barbara Ltd	-20.8%

Source: Bloomberg, IOOF

Share Markets, December 2020

Australian Indices		Dec-20 Price	1M return (%)	Sep-20 Price	3M return (%)
▲	S&P/ASX 200	6587	1.06	5816	13.26
▲	All Ordinaries	6851	1.61	6009	14.00
▲	Small Ordinaries	3090	2.45	2727	13.29
US Indices					
▲	S&P 500	3756	3.71	3363	11.69
▲	Dow Jones	30606	3.27	27782	10.17
▲	Nasdaq	12888	5.65	11168	15.41
Asia Pacific Indices					
▲	Hang Seng	27231	3.38	23459	16.08
▲	Nikkei 225	27444	3.82	23185	18.37
UK & Europe Indices					
▲	FTSE 100	6461	3.10	5866	10.13
▲	CAC40	5551	0.60	4803	15.57
▲	DAX Index	13719	3.22	12761	7.51

Sources: Bloomberg, MSCI, FTSE, S&P, IOOF

Note: return is reported on a price basis and in local currency terms e.g. S&P500 performance is in US dollars and excluding dividends

Global equity markets

Asian equities were the strongest performers in the December quarter led by the Nikkei rise of 18.4%. Strength was broad-based with all major markets in the green. Key drivers were:

- Vaccine rollouts globally under emergency provisions with Moderna and Pfizer-led options the first to be rolled out. Subsequently the AstraZeneca option (the most cost-effective of the three) also received more limited approval in the UK and India.
- In the US uncertainty over the presidential election was alleviated with a Biden victory. At the time of writing it appears the Democrats will also have control of both Houses allowing them to pursue their policy agenda.
- In China, antitrust scrutiny saw certain large cap names such as Alibaba and Tencent underperform after leading the emerging market index for much of the year. The pulled IPO of Alibaba subsidiary Ant Financial following tighter regulatory scrutiny was another factor weighing on sentiment.

At a regional level, exposure to emerging markets added to client returns with 2.1% outperformance over developed markets in 2020.

	1-mth	3-mth	6-mth	1-yr
MSCI World Index	-0.5%	5.9%	9.7%	5.6%
Value	-1.0%	7.9%	7.6%	-9.8%
Value-Weighted	-0.2%	11.4%	10.9%	-4.1%
Momentum	-0.3%	3.0%	10.1%	17.1%
Growth	0.3%	4.9%	12.6%	22.2%
Quality	-0.9%	2.9%	8.0%	11.6%
Low volatility	-2.3%	0.1%	0.3%	-6.2%
Equal weight	0.6%	14.1%	14.5%	1.8%
Small caps	2.7%	15.4%	19.2%	5.9%

Source: Bloomberg, IOOF, MSCI

At a style level, the December quarter saw a rotation-trade away from Growth and Quality towards both value and small caps which vastly outperformed. Former market darlings such as Zoom (a video conferencing software provider) saw its share price fall over 28% as investors anticipated a more normal environment where its tool would be less relied upon. Managers with a value bias or exposure to small cap stocks will have likely outperformed in these conditions but may still be behind for the full year.

Australian equity markets

The Australian market also performed strongly with a 13.6% rise for the benchmark S&P/ASX 200 Price Index. At a sector level, the benchmark was driven higher by the financials (up 26.2%) and energy sectors (up 21.8%).

	1-mth	3-mth	6-mth	1-yr
MSCI Australia Index	1.3%	14.2%	12.8%	-0.8%
Value	2.6%	23.0%	18.7%	-1.2%
Value-Weighted	0.9%	19.7%	15.2%	-3.0%
Momentum	2.3%	6.8%	11.6%	8.2%
Growth	0.4%	4.9%	12.8%	23.1%
Quality	-1.1%	2.5%	7.2%	11.0%
Low volatility	-0.1%	9.2%	7.1%	-5.2%
Equal weight	0.6%	14.1%	14.5%	1.8%
Small caps	2.8%	13.8%	20.3%	9.2%

Source: Bloomberg, IOOF, MSCI

At a style level, the Australian market only saw outperformance from value stocks during the quarter with quality and growth stocks notably lagging these and the broader market. The prospect of economies normalising saw a sharp rally in oil prices and in turn energy stocks. It also benefitted financials such as the major banks which also reported improvement in deferred mortgage balances, reducing the risk of non-performing loans and APRA approval for dividend payments, supporting the value style.

Fixed Income

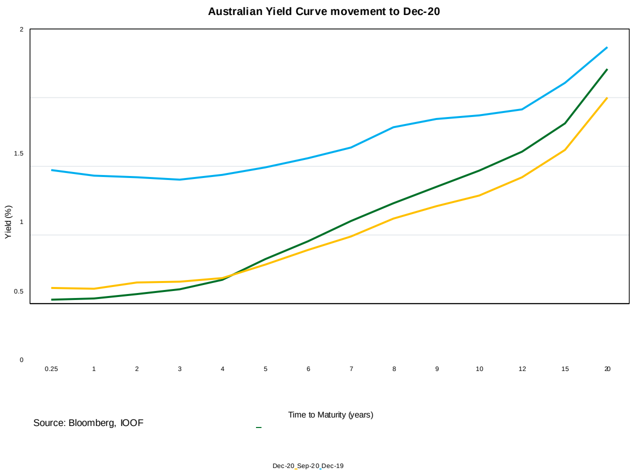
	Fixed Income	Dec-20 yield	1M mvt (bps)	Sep-20 yield	3M mvt (bps)
	Australian Cash rate	0.10	--	0.25	-0.15
▲	10-year Bond Yield	0.97	0.07	0.79	0.18
▼	3-year Bond Yield	0.11	-0.01	0.16	-0.05
	90 Day Bank Bill Yield	0.02	--	0.09	-0.07
▲	US 10-year Bond Yield	0.91	0.07	0.68	0.23
▼	US 3-year Bond Yield	0.16	-0.02	0.16	0.01
▼	US Investment Grade spread	1.09	-0.10	1.52	-0.43
▼	US High Yield spread	3.27	-0.58	5.08	-1.81

Source: Bloomberg, IOOF

Australian bond market

The Australian yield curve steepened during the quarter as investors expected stronger growth while at shorter-term maturities, yields fell further in line with the RBA yield curve targeting policy.

5. Australian yield curve changes to Dec-20



The RBA rate cut of 15bps on 3 November, taking the cash rate from 0.25% to 0.10%. The RBA announced additional bond purchases to the tune of $100bn to lower longer-term borrowing costs and separately purchases would be made to maintain its (now) lower target for the 3-year bond yield of 0.1%.

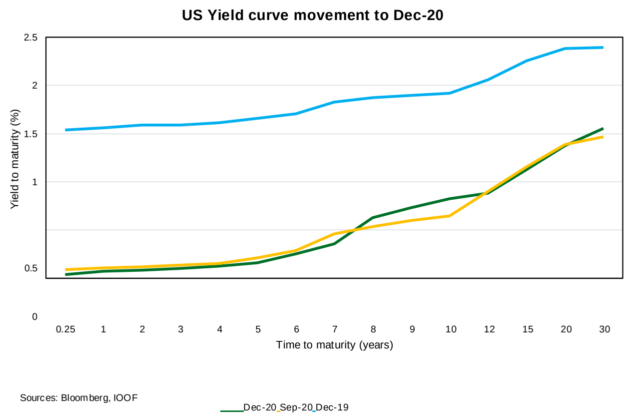
The shift in risk sentiment dwarfed these moves particularly where the RBA policy to constrain yields has less impact. The RBA focus is on shorter-term term yields, particularly around the 3-year mark whereas longer-term bonds have more scope to trade freely. The vaccine rollout suggested a normalising global economy and saw investors adjust upwards their economic growth expectations with longer-term bond yields rising accordingly. It also saw corporate bonds in the Australian market rally further, rising 1.4% compared to a 0.3% fall for government bonds (see page 14).

Managers with more exposure to riskier segments of the market such as credit likely outperformed while those with lower duration than the benchmark including defensive alternative managers will have benefitted from the rise in domestic bond yields.

US bond market

US Treasury yields rose over the quarter particularly for longer-dated bonds. Vaccine rollouts in the US and the elsewhere in the world drove stronger expectations of normalising economic activity and yields rose in anticipation of higher interest rates.

6. US yield curve movement to Dec-20



US credit spreads contracted further during the quarter reflecting the strength seen in equity markets. The vaccine news spurred a surge particularly in riskier, lower-rated business debt with firms exposed to travel or tourism such as hospitality or hotel businesses seeing a strong rally on expectations that

the world would be going "back to normal" sooner.

Global managers with greater credit or emerging market exposure (see page 14) will have also outperformed for the quarter, benefitting from the tightening of spreads while those with more exposure to sovereign bonds will have underperformed.

Outlook

Bond expected returns remain extremely low relative to history. The contraction in spreads suggests less favourable returns for riskier debt such as high yield bonds. Government bonds at current prices suggest negative after-inflation returns over the next 10 years.

Currencies

Currencies	Dec-20 Price	1M return (%)	Sep-20 Price	3M return (%)
▲ $A vs $US	76.94	4.77	71.62	7.43
▲ $A vs GBP	56.29	2.12	55.44	1.54
▲ $A vs YEN	79.47	3.74	75.54	5.20
▲ $A vs EUR	62.98	2.27	61.11	3.06
▲ $A vs $NZ	107.09	2.29	108.26	-1.08
▲ $A TWI	63.40	3.09	60.70	4.45
▼ $US vs EUR	81.86	-2.37	85.32	-4.06
▼ $US vs CNY	6.53	-0.79	6.79	-3.88
▼ $US vs GBP	73.18	-2.49	77.38	-5.43
▼ $US vs JPY	103.25	-1.02	105.48	-2.11
▼ $US vs CHF	88.52	-2.61	92.09	-3.88
▼ US Dollar Index	89.94	-2.10	93.89	-4.21
▲ JPM EM Currency Index	57.92	2.77	54.52	6.25

Source: Bloomberg, IOOF

The Australian dollar (AUD) rose 7.4% against the US Dollar (USD) during the December quarter, from USD 0.7162 to USD 0.7694. Drivers included:

- The beginning of coronavirus vaccine rollouts globally. Two joint ventures led by Moderna and Pfizer respectively reported strong trial results for their respective options. They were subsequently being administered under emergency authorisation. This stoked investor sentiment for a nearer term end to the pandemic which is seen as good for economic growth and hence demand for Australian resource exports, supporting the AUD's rise.
- While the RBA did cut rates which would, ordinarily, put downward pressure on the AUD, this was swamped by the shift in investor sentiment.
- Stronger jobs growth, Westpac consumer confidence and NAB business surveys boosted sentiment towards the economic recovery.

Conversely the US Dollar saw a sharp reversal with the DXY Index falling 4.2%. The vaccine drove outperformance of currencies seen as benefitting from stronger global growth. In addition, a Biden win saw anticipation of more liberal trade policy, a support for more trade-sensitive currencies such as the Euro.

Commodities

Commodities	Dec-20 Price	1M return (%)	Sep-20 Price	3M return (%)
▼ Aluminium	1979	-3.18	1770	11.84
▲ Copper	352	2.36	304	15.79
▲ Nickel	16567	3.45	14531	14.01
▼ Zinc	2733	-1.82	2408	13.51
▲ Crude Oil – Brent	51.80	8.85	40.95	26.50
▼ Natural Gas	2.54	-11.90	2.53	0.47
Metallurgical Coal	129	--	130	-1.07
▲ Thermal Coal	88	24.03	58	51.14
▲ Iron Ore	155.84	25.05	123.98	25.70
▲ Gold	1895	6.41	1903	-0.39
▲ Silver	26	16.90	24	11.79

Source: Bloomberg, IOOF

Most commodities rallied strongly over the December quarter across the energy and base metals spectrum. Notable exceptions were natural gas and gold.

The catalyst for the strong rise was the news of successful vaccine trials and subsequent rollouts from the likes of Moderna and Pfizer. These promised a closer end to the pandemic and recovery in commodity demand as economic activity normalises. A resumption of air travel for example would be a strong support for oil demand, helping spark a sharp uptick in oil prices. Despite elevated coronavirus cases in the likes of the US and Europe, manufacturing production continued to track strongly with the Global Manufacturing PMI rising to 53.8, signalling expansion for a sixth-consecutive month.

Natural Gas (an important Australian export) prices were flat with milder weather than previously forecast for the northern hemisphere winter dragging on demand while supply had also been built up to 8% over last year's levels with the resulting surplus dragging on prices.

Gold struggled against a stronger real yield (bond yield after inflation) environment following rising government bond yields. There has also been a sentiment reversal with more speculative investors chasing Bitcoin as a gold alternative following strong recent price action.

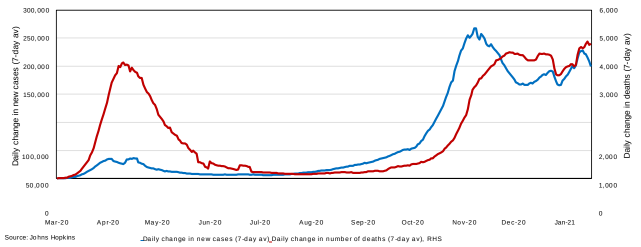
Coronavirus update

The coronavirus pandemic accelerated to new highs across the world over the quarter and into January led by the US notably with tighter lockdown restrictions that will drag on economic activity in the near term. Vaccine rollout has begun with some countries such as Israel particular standouts. They give cause for optimism this year, but we note logistical and cost challenges make it unlikely that the vast majority of the world will be inoculated by the end of 2021, suggesting the coronavirus will still linger as a policy issue.

Global case trends

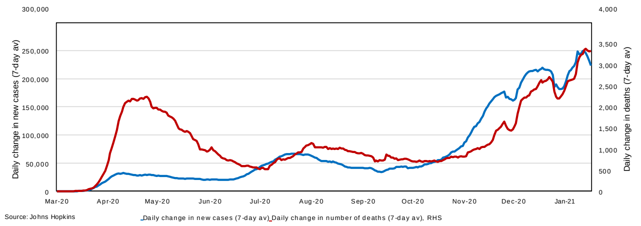
European case growth moderated substantially from its Nov-20 high of ~267k cases on average before climbing substantially into 2021 and now beginning to recede. The surge was led by the UK's new B117 strain while coronavirus-related deaths saw new highs in January. The B117 strain is more infectious and crippling UK health infrastructure before lockdowns appear to be taking affect with average cases falling from a peak of 59.5k to 48.7k as of 16 January.

7. Europe coronavirus case vs fatality growth



The US situation grew more severe over the quarter and into early January. Case growth and coronavirus deaths have intensified after falling in mid-November.

8. US coronavirus case vs fatality growth



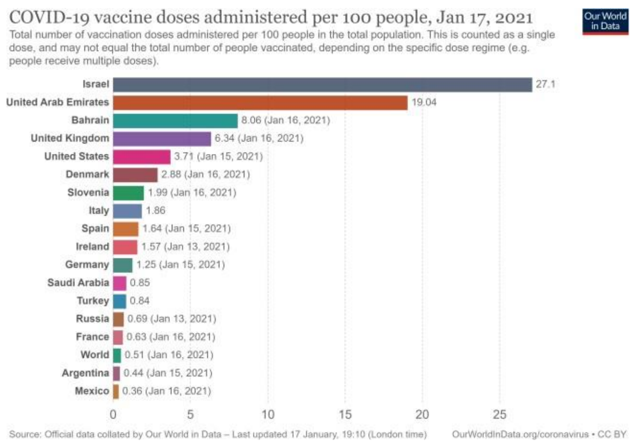
Lastly Australia was on a path to normalisation that became derailed towards quarter-end following a new clusters in New South Wales and case of the mutant B117 strain in Brisbane. This saw border shutdowns enacted at short notice and the imposition of mask-wearing in the Greater Sydney region. Currently, case growth appears muted and suggests some restrictions may be removed in the weeks ahead.

Vaccine progress

Different countries have negotiated vaccine supply from a range of sources. In Western countries, Moderna and Pfizer-led vaccines have been more prevalent followed by the AstraZeneca option (the latter slightly derailed by issues with its interim trials).

Under emergency authorisations we have seen *en masse* programs begin with Israel one of the standout performers with 27.1 doses per 100 people already administered. Importantly this stat does not necessarily mean 27.1% of the population has been inoculated as some vaccines such as Pfizer's option require two doses to be completely effective.

10. Vaccination rollout as at 17 January 2021



The US has now moved towards getting as many initial doses administered as possible. This followed an initial plan to hold back second doses to ensure vulnerable citizens were completely vaccinated first. However, delays in administering the vaccine and soaring case counts have seen authorities move to release more of the vaccine sooner and administer the second dose as these become available.

The Australian plan will involve a mix of both the Pfizer and AstraZeneca vaccines. The Pfizer vaccines will be deployed from March targeting vulnerable people such as aged care residents as well as frontline healthcare workers. Only 5 million doses have been secured which given the need for two doses to be effective implies only 2.5m people to be vaccinated in this fashion. The AstraZeneca option is being produced domestically at CSL facilities and has the benefit of being easier to transport (the Pfizer options requires more extreme sub-zero temperatures) as well as having supply secured.

Australia

The bounce back in economic activity following the Victorian lockdown continued over the December quarter. Outbreaks in Sydney and Brisbane disrupted the resumption of inter-state travel. Measures taken to counteract these have not had a material effect on the economy to date with momentum remaining positive into 2021.

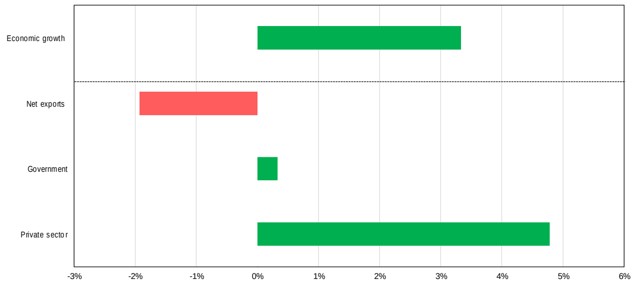
Policy

The Federal government extended its Jobseeker supplement of $150/week for another three months until March 2021 and increased funding for coronavirus vaccination rollout with a population-wide program projected to be in place by late 2021 according to its Dec-20 MYEFO outlook. We also saw notable budget deficits at a State level with both NSW and Victoria committing to sizeable spending and asset sales to support their economies. Tax reform also featured with the NSW government announcing plans to give taxpayers the option between paying stamp duty and a smaller, annual property tax. In addition to stamp duty relief, Victoria also launched a $250m wage subsidy program to encourage women and young workers to re-join the workforce.

Economic growth

The September quarter marked the end of the technical recession with economic growth bouncing back led by strong household consumption. Government spending contributed to this recovery bounce which saw real GDP grow 3.3% (consensus: 2.5%) while net exports dragged with international travel bans limiting tourism spending and import demand recovering as lockdown restrictions lifted.

11. Sep-20 Quarterly growth and its contributors



Source: ABS, IOOF

Growth outlook

The Westpac-Melbourne Institute Leading Index rose to 3.25% in October, up from -0.48% in September. This marked the first above trend growth result since November 2018 and suggests that there will be continued growth momentum as the economy recovers from the lockdown shock earlier this year. Vaccine rollouts and coronavirus case containment promise to support growth momentum. Longer-term, structural challenges remain as current policy support unwinds, and immigration levels remain low (adding more people tends to boost economic activity and overall growth in aggregate).

Consumer spending

November continued to shift the retail sales dynamic with 7.1% monthly growth as the reopening of the Victorian economy and Black Friday sales drove consumer spending higher. Annual retail sales growth was at a 19-year high of 13.1% led by growth in household goods such as furniture, Clothing and accessories was the strongest category for November with 26.7% growth on October sales.

Labour market

The unemployment rate fell to 6.8% in November with participation also rising 0.3% to 66.1% as more people re-joined the workforce looking for work. Both are welcome results with the labour participation rate now above its level prior to the pandemic emerging. Jobs growth was also surprisingly strong at 90k (consensus: 40k) led by full-time roles (+84k).

In addition to this welcome result we also saw job vacancies continue to recover with a 1.4% rise in online jobs ads during December according to the National Skills Commission. This saw total ads rise to 171,500 nationally, 11.1% above the level we saw in December 2019 (pre-coronavirus). Rising vacancy rates points to increased demand for labour and should act as a tailwind for the current jobs recovery.

China trade tensions

Chinese retaliation against Australia was a notable theme for the quarter with punitive tariffs against Australian wine producers and de facto bans on coal and other commodity exports. Australian authorities have stood their ground on Chinese demands and appear to be retaliating by blocking Chinese acquisitions in Australia. Affected exports are relatively small in the context of our overall trade relationship, less than 15% of the annual total. We expect this *détente* period to persist with further escalation limited to goods that can be substituted elsewhere e.g. lamb and timber.

United States

The coronavirus pandemic has continued to worsen in the US and seen lockdown restrictions tighten while economic data has remained mixed. The Democrat victories in November (and now January) elections is paving the way for sizeable fiscal stimulus that should support growth in 2021 and counteract the pandemic's worst impacts.

US Elections

Democrat Nominee Joe Biden defeated incumbent President Trump to become the 46th President of the United States. The legal battles by the Trump campaign were met with widespread defeat and repudiation in the courts and legislature.

In addition, Biden's Democrat Party successfully retained control of the House and was able to win the Senate after claiming two seats in Georgian runoff elections on 5 January. This gives more scope for President Biden to promote his legislative agenda with fiscal stimulus to counteract the economic damage of the pandemic a key priority.

Policy

Negotiations for additional fiscal stimulus were partially successful by quarter-end. Additional $600 payouts to US householders were ultimately approved after being thrown into doubt by President Trump. The President had threatened to veto the bill if the payments were not increased to $2,000 but ultimately acquiesced to the bill under pressure from both parties. The incoming Biden administration has signalled a planned $1.9 trillion stimulus program that will include

- Additional direct payments of $1,400 per person
- $350bn in support to state and local governments
- $190bn for coronavirus vaccinations

Following the 20 January inauguration, we will also likely see greater national coordination in combating the pandemic. Some measures such as contact tracing are impractical given the scale of infections but others such as broader mask wearing could make a difference in helping halt the pandemic sooner.

Growth outlook

Leading indicators including the Conference Board Leading Economic Index and the ECRI Weekly Leading Index improved further during the quarter suggesting positive growth in the near term. The Weekly Economic Index from the NY Fed suggests the December quarter should show a continued uptick in growth. This may however be moderated by the more subdued consumption outlook and the policy stimulus set to be terminated in upcoming months unless bipartisan efforts succeed. The increase in lockdown restrictions will also pose a near-term headwind. Successful FDA approval of the vaccine options under consideration may assist in accelerating the recovery but given the challenge sin delivery it will take several months before enough of the population can be immunised to help contain transmission.

Business sentiment

The US manufacturing PMI continued to rise in December, defying coronavirus disruptions with a reading of 57.1, up from 53.4 in October. New orders continued to climb with a welcome uptick in foreign demand. Coronavirus restrictions saw input costs rise potentially a source of inflation if it persists. Consumer good demand faltered while machinery demand remained strong suggesting weaker consumer spending and stronger investment spending by businesses and optimism for the year ahead remains elevated but slightly lower due to rising coronavirus case growth.

The Services PMI moderated a fall to 54.8 in December, down from its intra-quarter high of 58.4 in November. Difficulties for consumer businesses following more coronavirus cases and new social distancing restrictions saw a slowdown in domestic new business orders and the first outright contraction in new export orders since May given greater travel restrictions. The overall combination saw the Composite PMI rise to 55.3 in December, up from 54.4 in September but well below its intra-quarter high of 58.6 in November. Confidence in the near-term has faltered particularly for the services sector with coronavirus case growth a key downside risk.

Consumer confidence

The Michigan consumer sentiment index rose to 80.7 in December (consensus: 81), up from 76.9 in November but down from its preliminary December reading of 81.4. The Conference Board Consumer Confidence also fell to 88.6, down from 92.9 in November. Weaker confidence would typically weigh on consumer spending, but current and potential fiscal stimulus should counteract this.

China

Business surveys suggest continued improvement into December although geopolitical risks with US relations remain a feature, clouding the outlook potentially. Deceleration of credit growth may pose a headwind into 2021 although offset by an anticipated global economic recovery.

Business activity and sentiment

Chinese economic activity continued to strengthen in November with the Services PMI rising to 56.3, up from 54.8 in September. Confidence amongst services firms rose to its highest since April 2011 with expectations of a further recovery in global economic conditions. This saw services firms continue to expand their staff as well as being willing to pass on costs to end clients with output prices growing at their quickest rate since January 2008. New business order growth slowed, driven by weaker foreign demand which moderated from November highs as rising coronavirus cases overseas weighed on sales activity.

The Manufacturing PMI held steady at 53 in December (53 in September also), falling slightly from a high of 54.9 in November. New orders slowed, due in part to more subdued overseas demand. Firms remain cautious about hiring new staff with new hiring broadly flat and outstanding work backlogs continuing to grow. Greater raw material costs particularly in metals weighed on profit margins and saw firms exercise caution on any increases in costs e.g. new worker hires. While an overall positive backdrop, the weaker manufacturing job market continued to weigh on the near-term outlook.

Credit growth and policy

Broad M2 money supply grew 10.7% in the year to November (consensus: 10.5%) and total social financing, a broader credit measure rose 13.6% to 2.13 trillion yuan (consensus: 2.075 trillion yuan). This has contributed to further leveraging of the Chinese economy. In early January we saw Reuters cite policy sources stating that the People's Bank of China will reduce its current support to the economy in a bid to cool credit growth. It was also suggested that the PBOC was unlikely tighten given the risk of derailing the current recovery and sparking debt defaults. Economists at Nomura anticipate total social financing to slow to 11.5% annual growth by December 2021, down from 13.6% in November 2020.

Any signs of slowing credit growth will be watched for closely as it may bode poorly for key Australian exports such as iron ore and other commodities as it signals less willingness to lend to fringe projects to create economic activity.

The existing fiscal setting is also believed to be less stimulative in 2021 with a 3% budget deficit targeted, down from its 2020 target of 3.6%. Taken together this suggests some potential for Chinese demand to soften in 2021.

Inflation

Inflationary pressures increased with headline CPI rising 0.2% for the year to December and producer price inflation falling 0.4%, both increases on November. The CPI numbers reflect base effects with annual inflation cycling out of a period of very high pork prices. The core inflation rate (stripping out volatile price effects) fell slightly to 0.4% (down from 0.5%). As with other countries, deflationary pressures remain the near-term concern although recent improvement and rising PMI inflation indicators suggests inflationary pressures are returning with the broader economic recovery.

Geopolitics

US-China relations soured further over the quarter with the Trump Administration escalating in its last few months in office. These included:

- Sanctions against Chinese officials over increasing assertiveness in the South China Sea.
- Threatened delisting of several Chinese firms with ties to the Chinese government that are listed on US exchanges.
- Banning US firms from business with a number of Chinese companies including telecommunications giant Huawei and state oil company, the China National Offshore Oil Corporation.
- Banning agricultural exports from Xinjiang over forced labour concerns regarding the province's Uighur minority.

The incoming Biden administration is not expected to be as adversarial but nor is it expected to retreat fully to a pre-Trump policy setting with a number of tariffs likely to remain in place. These more recent measures will delay any process of rapprochement in the near term.

Europe

The coronavirus pandemic remains elevated, but case growth is still below peak levels and lockdown restrictions beginning to be lifted in select countries such as France. Successful Brexit negotiations removed a key geopolitical downside risk for the regional outlook which has improved over the quarter.

United Kingdom

Brexit negotiations were successfully concluded ahead of the 31 December deadline. This was in line with our comments in mid-December where we expressed our belief that compromise would ultimately be reached given the cost of the alternative for both the UK and EU.

Remarks of a UK "victory" at the negotiations should be tempered by an acknowledgement of what has been lost. There is more scope for regulatory and other bureaucratic challenges to hinder trade with the EU. In addition, there is a "baked-in" renegotiation set for 4 years' time that may prompt further geopolitical volatility. The agreement has provisions for either the UK or EU to potentially retaliate with tariffs and other measures should either be deemed to have moved away from the common standards set by the agreement.

In addition, the agreement was arguably incomplete in several key areas including recognition of professional qualifications and services more broadly. These will require "equivalence" decisions on the part of the EU to ensure current practices can continue. The overall picture is a tougher, less favourable relationship with the EU as a result.

By quarter-end a new mutant strain of the coronavirus, B117, was identified in the UK. It is considerably more infectious with case growth growing considerably faster in the UK relative to other European nations. This prompted new lockdown measures across the UK, centred particularly on London and will drag on economic activity with the UK Composite PMI in fractionally positive territory at 50.4 thanks in part to manufacturing strength with the services sector contracting during the quarter. Administration of the Pfizer vaccines and other options should help curb the worst of this latest surge, but it will take considerable time before herd immunity is reached notwithstanding any further mutations that might impair vaccine effectiveness.

Business activity and sentiment

The Eurozone Manufacturing PMI rose to 55.2, up from 53.7 in September. The improvement was broad based with most countries at near-term highs and some such as Germany, multi-year highs with the Dec-20 result of 58.3 its highest since February 2018. By subsector, business facing producers fared best with investment goods the strongest followed by intermediate goods while conditions for consumer-facing producers were more subdued. New exports orders notably improved with confidence for the year ahead at its highest level in almost three years. Points of concern persist in high input cost inflation due to coronavirus related restrictions as well as a subdued jobs markets with a number of countries reporting job losses. However as noted by Markit economists, recovery in employment tends to lag the bounce in productions and should the latter be sustained we should see manufacturing employment recover from current levels.

Coronavirus restrictions weighted on the Services sector with the PMI falling to 46.4 in December, marking further contraction from September's 48 print. Weakness was widespread amongst major countries with new orders declining for a fifth successive month both domestic and international suggesting a troubled demand backdrop and reflecting the difficulties in services trade given the lockdowns. The current downturn appears to be less severe than that seen in the June quarter with the expansion in manufacturing a welcome feature as is the less severe nature of current lockdown measures. A contraction in growth for the December quarter still appears to be a likely outcome and continued restrictions into 2021 may increase the prospect of a technical recession but looking forward vaccine developments are fuelling optimism for a "return to normal" in 2021. This is especially important for the more challenged Southern states that have a greater reliance on tourism exports with businesses increasingly embattled given the collapse of global travel this year.

Policy

The European Central Bank is introduced additional monetary stimulus in December with extensions to its Pandemic Emergency Purchase Program (PEPP) and Targeted Long-Term Refinancing Operations (TLROs). Later in 2021 we also see the European Recovery Fund raise and begin distributing up to $2.2trillion in capital to EU member states.

Company news - best and worst performers during December 2020 quarter

Unibail-Rodamco-Westfield CDI (URW, +110.7%)

URW was expected to conduct a dilutive capital raising heading into November which contributed to rising short interest in the stock. The play there was that the capital raising would go ahead and send the share price lower, with short sellers participating in the raise and locking in their profits. The locked down state of much of Europe where URW has a considerable retail property footprint also contributed to higher short interest. However, said capital raise did not occur with activist French investors able to sway enough investors to cancel the raise and the business instead able to access the necessary capital via a long-term debt issue. This helped reduce near-term solvency concerns and avoided sizeable dilution in the stock. In addition to the vaccine news, these factors saw a “short-squeeze” result where short-sellers have to buy on the market to exit the stock and prevent excessive losses with other short-sellers having to follow suit creating a reinforcing loop of demand driving the stock price higher.

Virgin Money UK - Plc (+83%)

Virgin Money UK (VUK) benefitted from an aggressive cost cutting program that aimed to reduce 400 roles and planned workforce by 16% as part of a restructuring process to increase efficiencies within the bank. The former NAB subsidiary (Clydesdale Bank, which was rebranded Virgin Money UK after a successful takeover) also benefitted from a string of positive vaccine trial results from Pfizer and Morderna as the UK struggled to combat a resurgent COVID-19 outbreak (third wave). VUK is likely to continue to undergo a period of restructuring as its new owner seeks to produce an estimated £200m in cost savings by 2022 and turn around the underperforming bank.

Sims Ltd (+77.4%)

Sims Ltd (SGM) recovered from a difficult FY20 off the back of a strong iron ore price, increasing the value and demand for alternatives like scrap metal. The iron ore price has rallied from c.$100-$170 USD/tonne over the past 6 months and has fuelled SGM’s depressed share price. Shareholders have also been supportive of the National Waste and Recycling Industry Council’s submission to the federal government calling for used metal offshore processing to be banned – although Australia recycles close to 90% of metals (~5 tonnes), about half of the scrap metal is sent off shore for processing, where impurities are removed. A ban on offshore processing would significantly benefit SGM as Australia’s largest scrap metal recycler.

Mesoblast (-55.7%)

Mesoblast (MSB) served a string of consecutive disappointments in the December quarter which saw its share price continue to tumble. The vaccine hopeful, after grabbing the attention and imagination of shareholders with seemingly positive test results, had its application for FDA approval for its vaccine Remestemcel-L drug declined, with the FDA demanding further randomised controlled studies in adults and children to further provide evidence of effectiveness. MSB capped off a difficult quarter by revealing that its COVID-19 trial would be wound up because of unexpectedly poor clinical data and that Remestemcel-L was not likely to meet its primary objective. The disappointment further fuelled speculation that a potential US$75m capital injection to stay afloat.

Appen Ltd (-27.6%)

Appen (APX) shareholders were disappointed after the company released a trading update stating that FY20 underlying EBITDA will likely drop to $106-109m after initially forecasting $125-130m in April 2020. The onset of the pandemic saw a slowdown in digital ad spending, a reduction in IT/digital spending, and a meaningful number of cancellations of services from Appen’s smallest customers, which faced interrupts to global hardware supply chains with COVID-19.

Regis Resources (-25.3%)

Regis Resources (RRL) declined on the back of positive vaccine news, a strengthening $A, and a decline in the gold price as investors put risk-on and shifted out of safe haven assets after Pfizer and Morderna announced positive trial results and first batches of vaccine to be distributed Q1-2 CY21. Regis Resources produced a strong

FY20 result and guided for a positive FY21 outlook, increasing gold production c.8% to 350,000-380,000 oz with an AISC of A$1,230-1,300/Oz.

Sources: ASX company announcements, Bloomberg, Fund manager disclosures, Australian Financial Review, Sydney Morning Herald

Movers and Shakers for quarter of December 2020

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month price return (%)	Quarter ago close ($)	Quarter Price return (%)	Year ago, close ($)	Annual Price Return (%)
URW	Unibail-Rodamco-Westfield CDI	5.10	5.02	1.6	2.42	110.7	11.19	-54.4
VUK	Virgin Money UK Plc – CDI	2.37	2.31	2.6	1.30	83.0	3.49	-32.1
SGM	Sims Ltd	13.45	11.34	18.6	7.58	77.4	10.67	26.1
PNV	Polynovo Ltd	3.88	3.21	20.9	2.21	75.6	1.97	97.0
CCP	Credit Corp Group Ltd	29.70	23.77	24.9	16.94	75.3	30.84	-3.7
LYC	Lynas Rare Earths Ltd	3.98	3.78	5.3	2.32	71.6	2.30	73.2
CGF	Challenger Ltd	6.44	5.75	12.0	3.83	68.1	8.09	-20.4
WHC	Whitehaven Coal Ltd	1.65	1.33	24.2	1.05	57.4	2.64	-37.7
IGO	IGO Ltd	6.38	4.64	37.4	4.12	54.9	6.18	3.3
BEN	Bendigo And Adelaide Bank	9.32	8.90	4.7	6.04	54.3	9.78	-4.7

Source: Bloomberg, IOOF

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month price return (%)	Quarter ago close ($)	Quarter Price return (%)	Year ago, close ($)	Annual Price Return (%)
MSB	Mesoblast Ltd	2.25	4.16	-45.9	5.08	-55.7	2.08	8.2
APX	Appen Ltd	24.69	31.55	-21.7	34.08	-27.6	22.46	9.9
RRL	Regis Resources Ltd	3.74	3.69	1.4	5.01	-25.3	4.34	-13.8
SLR	Silver Lake Resources Ltd	1.79	1.77	1.1	2.31	-22.5	1.34	33.6
SBM	St Barbara Ltd	2.36	2.45	-3.7	2.98	-20.8	2.72	-13.2
RMS	Ramelius Resources Ltd	1.69	1.69	0.0	2.07	-18.6	1.24	36.4
ASB	Austal Ltd	2.67	2.92	-8.6	3.28	-18.6	3.82	-30.1
A2M	A2 Milk Co Ltd	11.45	13.82	-17.1	14.05	-18.5	14.30	-19.9
NCM	Newcrest Mining Ltd	25.78	26.93	-4.3	31.24	-17.5	30.25	-14.8
RSG	Resolute Mining Ltd	0.80	0.76	4.6	0.93	-14.5	1.26	-36.9

Source: Bloomberg, IOOF

Asset class performance to December 2020 (Total returns in AUD)

					Annualised					
Asset class	**1-mth**	**3-mth**	**6-mth**	**1-yr**	**3-yr**	**5-yr**	**7-yr**	**10-yr**	**15-yr**	**20-yr**
Australian equities (S&P/ASX 200)	1.2%	13.7%	13.2%	1.4%	6.7%	8.7%	7.4%	7.8%	6.7%	8.1%
Australian equities - Mid caps	3.4%	16.9%	22.9%	17.0%	9.7%	13.7%	13.3%	10.2%	7.5%	10.9%
Australian equities - Small caps	2.8%	13.8%	20.3%	9.2%	6.6%	10.5%	8.3%	3.8%	4.4%	6.5%
Australian equities - Micro caps	2.6%	17.4%	42.4%	27.1%	10.0%	14.3%	10.0%	1.7%	4.9%	#N/A
International equities	-0.5%	5.7%	9.7%	5.7%	11.2%	10.9%	11.6%	13.2%	7.0%	4.2%
International equities (Hedged)	3.4%	11.7%	18.9%	10.6%	9.0%	11.4%	10.5%	11.9%	8.4%	#N/A
International equities - Small caps	2.7%	15.4%	19.2%	5.9%	8.6%	10.6%	10.8%	12.8%	7.6%	7.6%
Emerging Markets equities	2.5%	11.2%	17.0%	7.8%	6.7%	11.5%	8.4%	6.6%	6.2%	7.8%
Australian REITs	0.4%	13.3%	21.2%	-4.6%	5.4%	7.0%	10.7%	11.1%	3.7%	6.6%
Global REITs	-1.2%	5.2%	3.2%	-17.1%	2.0%	2.5%	6.8%	8.5%	4.0%	#N/A
Global REITs (Hedged)	2.5%	10.6%	11.3%	-13.7%	0.1%	2.9%	5.7%	7.2%	4.9%	#N/A
Global Infrastructure	-3.2%	0.8%	-1.3%	-12.6%	5.3%	7.4%	9.2%	11.2%	6.2%	#N/A
Global Infrastructure (Hedged)	0.3%	5.8%	6.6%	-7.0%	4.2%	7.9%	8.3%	10.3%	9.2%	#N/A
Trend following (USD)	3.4%	5.1%	4.6%	6.2%	1.0%	-1.1%	2.4%	1.0%	3.4%	5.5%
Australian bonds	-0.3%	-0.1%	0.9%	4.5%	5.4%	4.6%	5.0%	5.6%	5.6%	5.7%
Australian bonds - government	-0.3%	-0.3%	0.6%	4.5%	5.6%	4.6%	5.1%	5.6%	5.6%	5.7%
Australian bonds – corporate	0.0%	1.4%	2.9%	5.3%	5.4%	5.0%	5.2%	5.9%	6.0%	6.1%
Australian bonds - floating rate	0.0%	0.5%	1.1%	1.8%	2.3%	2.7%	2.9%	3.6%	4.3%	4.6%
Global bonds (Hedged)	0.3%	0.8%	1.5%	5.1%	4.6%	4.6%	5.2%	5.9%	6.4%	6.9%
Global bonds - government (Hedged)	0.2%	0.2%	0.7%	4.9%	4.6%	4.4%	5.2%	5.8%	6.3%	6.7%
Global bonds - corporate (Hedged)	0.5%	2.6%	4.3%	7.0%	5.6%	6.1%	6.1%	6.9%	7.0%	7.5%
Global bonds - High Yield (Hedged)	1.9%	6.5%	10.0%	3.5%	4.0%	7.4%	6.1%	8.1%	8.8%	#N/A
Emerging Market bonds (Hedged)	1.8%	5.8%	8.0%	3.7%	3.9%	6.7%	6.6%	7.3%	8.1%	10.1%
Cash (AUD)	0.0%	0.0%	0.0%	0.4%	1.3%	1.5%	1.8%	2.4%	3.5%	3.9%

Sources: Bloomberg, IOOF calculations

* AUD total returns as at Dec-20 assuming reinvestment of dividends unless otherwise specified

** Returns reflect index performance excluding any fees; Actual ETF/managed fund performance will vary due to both fees and tracking error.

Appendix – Index sources

Asset class	Index
Australian equities (S&P/ASX 200)	S&P/ASX 200 Accumulation Index
Australian equities - Mid caps	S&P/ASX Accumulation Midcap 50 Index
Australian equities - Small caps	S&P/ASX Accumulation Small Cap Ordinaries Index
Australian equities - Micro caps	S&P/ASX Emerging Companies Total Return Index
International equities	MSCI World ex Australia Net Total Return (in AUD)
International equities (Hedged)	MSCI World ex Australia Hedged AUD Net Total Return Index
International equities - Small caps	MSCI World Small Cap Net Total Return USD Index (in AUD)
Emerging Markets equities	MSCI Emerging Markets EM Net Total Return AUD Index
Australian REITs	S&P/ASX 200 A-REIT Accumulation Index
Global REITs	FTSE EPRA/NAREIT Developed Index Net Total Return (in AUD)
Global REITs (Hedged)	FTSE EPRA/NAREIT Developed Index Net Total Return (Hedged to AUD)
Global Infrastructure	FTSE Global Core Infrastructure 50/50 Net Total Return in AUD
Global Infrastructure (Hedged)	FTSE Global Core Infrastructure 50/50 100% Hedged to AUD Net Tax Index
Trend following	SGI Cross Asset Trend Following Index (USD)
Australian bonds	Bloomberg AusBond Composite 0+ Yr Index
Australian bonds - government	Bloomberg AusBond Govt 0+ Yr Index
Australian bonds – corporate	Bloomberg AusBond Credit 0+ Yr Index
Australian bonds - floating rate	Bloomberg AusBond Credit FRN 0+ Yr Index
Global bonds (Hedged)	Bloomberg Barclays Global Aggregate Total Return Index Value Hedged AUD
Global bonds - government (Hedged)	Bloomberg Barclays Global Aggregate Treasuries Total Return Index Hedged AUD
Global bonds - corporate (Hedged)	Bloomberg Barclays Global Aggregate Corporate Total Return Index Hedged AUD
Global bonds - High Yield (Hedged)	Bloomberg Barclays Global High Yield Total Return Index Hedged AUD
Emerging Market bonds (Hedged)	J.P. Morgan EMBI Global Core Hedged Index Level AUD
Cash (AUD)	Bloomberg AusBond Bank Bill Index

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