Quarterly Economic Wrap

September 2020

Summary

- Coronavirus case growth globally slowed over the quarter but a marked "second wave" of cases in Europe saw cases there rise above early April highs. In some countries such as Israel we have seen lockdowns resume whilst elsewhere in Europe varying restrictions have begun to be implemented once again.
- In addition to the pandemic we have seen geopolitical risks loom with US Presidential and Senate races and, UK-EU negotiations all on the horizon in the near term.
- A global manufacturing resurgence remains in place, but continued coronavirus cases has slowed momentum for the services sector. It is not our base case however to see a return to March lows.

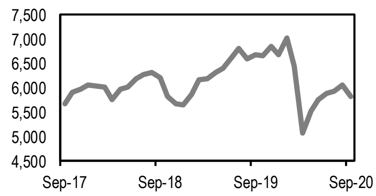
Markets – **Strong performance continued for "risk on" assets (see p 11).**

- Equities and other risky assets performed strongly over the quarter with some exceptions. A sell-off in September triggered by an uptick in coronavirus cases leading to new restrictions in Europe supported defensive assets such as government bonds.
- Australian equities lagged vs global peers (see chart 2) after a period of outperformance following the March quarter with the banking sector a point of weakness. A similar experience impacted Value names vs growth stocks (see chart 3), with the latter led by our local tech sector and healthcare names. Emerging markets bounced back partly due to stronger currencies as coronavirus infections began to decline across most of these economies.

Key economic news –

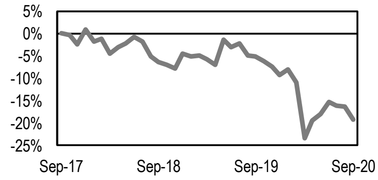
- While the quarter saw official confirmation of the first Australian recession in several decades, attention has shifted towards hastening the recovery underway. The FY21 Federal Budget is a key part of this with the government hoping to spark a business-led investment spending boom thanks to generous tax deductions.
- Leading indicators did not turn down materially lower suggesting recovery remains on foot in the US and elsewhere including China.
- The Federal Reserve shifted to an average inflation policy target. This suggests more willingness to leave interest rates on hold even if inflation rises above the 2% target in the short run.

1. S&P/ASX 200 Price Index



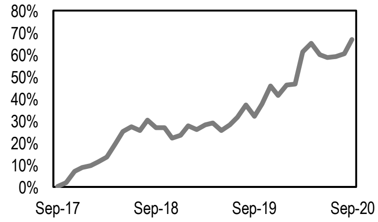
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



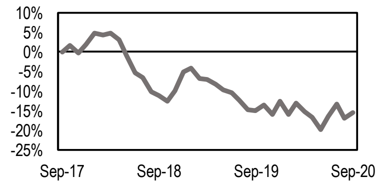
Source: Bloomberg, IOOF

3. MSCI Australia Growth relative to MSCI Australia Value



Source: Bloomberg, IOOF

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



Sources: Bloomberg, MSCI, S&P, IOOF

Sector and stock returns

	S&P/ASX 200 Sectors (GICS)				Best and Worst S&P/ASX 200 Performers			
	Monthly	%Δ	Quarterly	%Δ	Top five stocks		Bottom five stocks	
					Monthly			
▼	Consumer Discretionary	-2.64	Consumer Discretionary	7.73				
▼	Consumer Staples	-7.23	Consumer Staples	-4.92	Skycity Entertainment Group	+21.1%	Zip Co Ltd	-32.6%
▼	Energy	-11.56	Energy	-15.15	CSR Ltd	+16.7%	IOOF Holdings Ltd	-27.8%
▼	Financials ex Property	-6.21	Financials ex Property	-6.89	Boral Ltd	+13.7%	Unibail-Rodamco Wstfld	-26.9%
▼	Financials	-6.21	Financials	-6.89	Whitehaven Coal Ltd	+12.4%	Virgin Money UK Plc	-24.9%
▲	Health Care	0.44	Health Care	0.32	Washing. H. Soul Pattinson	+12.3%	Origin Energy Ltd	-23.2%
▼	Industrials	-0.70	Industrials	-0.22	Quarterly			
▼	IT	-6.91	IT	12.28	CorpTravel management	+83.0%	Unibail-Rodamco-Wstfld	-40.1%
▼	Materials	-3.69	Materials	2.19	Netwealth Group Ltd	+69.2%	IOOF Holdings Ltd	-32.0%
▼	Property Trusts	-1.57	Property Trusts	6.68	Mesoblast Ltd	+56.3%	AMP Ltd	-29.6%
▼	Telecommunications	-2.44	Comm Services	-4.29	Arb Corp Ltd	+54.0%	Whitehaven Coal Ltd	-26.9%
▼	Utilities	-3.71	Utilities	-9.51	ALS Ltd	+40.4%	Origin Energy Ltd	-26.4%

Source: Bloomberg, IOOF

Equity review

Major Market Performance, September 2020

	Australian Indices	Sep-20 Price	1M return (%)	Jun-20 Price	3M return (%)
▼	S&P/ASX 200	5816	-4.03	5898	-1.39
▼	All Ordinaries	6009	-3.79	6001	0.13
▼	Small Ordinaries	2727	-3.30	2599	4.92
	US Indices				
▼	S&P 500	3363	-3.92	3100	8.47
▼	Dow Jones	27782	-2.28	25813	7.63
▼	Nasdaq	11168	-5.16	10059	11.02
	Asia Pacific Indices				
▼	Hang Seng	23459	-6.82	24427	-3.96
▲	Nikkei 225	23185	0.20	22288	4.02
	UK & Europe Indices				
▼	FTSE 100	5866	-1.63	6170	-4.92
▼	CAC40	4803	-2.91	4936	-2.69
▼	DAX Index	12761	-1.43	12311	3.65

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

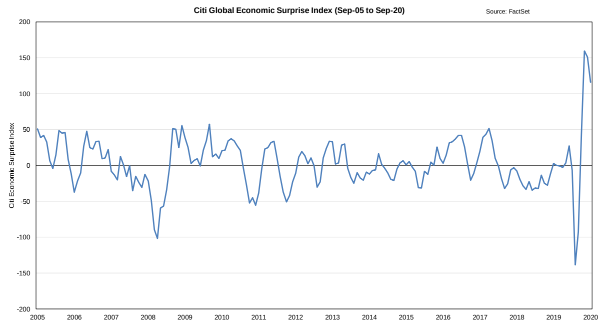
Note: return is reported on a price basis and in local currency terms e.g. S&P500 performance is in US dollars and excluding dividends.

Global equity markets

Global equity markets saw a correction late in the September quarter that clawed back most (or all) of the returns made in July and August. Notable drivers included:

- A surge in coronavirus cases in Europe continued to climb over the quarter before triggering new lockdown restrictions in the UK, Netherlands and more. While it was not accompanied by a material climb in fatalities (these remain well below the previous peak) there was enough concern to impose limited restrictions by European governments. This will likely constrain economic activity and corporate earnings.
- Deadlocked negotiations in the US saw the prospects of new fiscal stimulus fade after bonus emergency unemployment benefits concluded from July. Stimulus payments have been a large support to corporate earnings. To the extent that more stimulus was "priced in", continued deadlock is negative news.
- Partial unwinding of the options trades highlighted in the previous update may have also contributed.
- Another factor that has faded has been the economic data surprises with actual results underwhelming against market expectations globally. This can be seen below in Chart 5 with the downward trajectory a potential warning sign for global earnings growth. Typically, these are correlated with swings in underlying economic strength with the fall since early August suggesting headwinds for global earnings growth.

5. Citi Global Economic Surprise Index



Looking ahead the December quarter has several geopolitical events that may trigger market volatility. These include the US Presidential and Senates races and, the UK negotiations with the EU to settle the terms of the UK-EU relationship going forward.

Australian equity market

The S&P/ASX 200 index fell -1.4% on a price basis during the September quarter with Information Technology the top performer (up 12.3%) followed by the Consumer Discretionary (up 7.7%) and Property (up 6.7%) sectors. Gradual reduction of lockdown measures across most of Australia (excluding Victoria) and beating downbeat expectations in reporting season were notable drivers for the consumer discretionary and property sectors. Notable names with ties to home improvement e.g. Nick Scali and Beacon Lighting saw strong growth rewarded by investors.

Most sectors ended in the red with Energy (down -15.2%), Utilities (down -9.5%) and Financials (down -6.9%) the worst performers. The Utilities sector fell on the headwinds of lower electricity prices following the rise of alternative energy sources and lower electricity usage. Energy stocks were impacted by the weakness in oil prices on concerns of weaker oil demand following a surge of coronavirus cases in Europe. For Financials increased speculation of another RBA rate cut by 10bps was a headwind as was the need for lockdowns in Victoria during July which will act as a drag on economic growth and pose challenges to the health of bank mortgage books.

Style-wise we saw smaller companies outperform substantially with the Small Ordinaries up 5.7% and microcaps up 21.3% on a total return basis for the quarter. On a trailing 1-year basis to September, both small and micro caps have outperformed the S&P/ASX 200 by 6.9% and 14.9% respectively. This is consistent with history where these market segments tend to sell off more forcefully during corrections but subsequently bounce back more strongly than larger companies.

Fixed Income

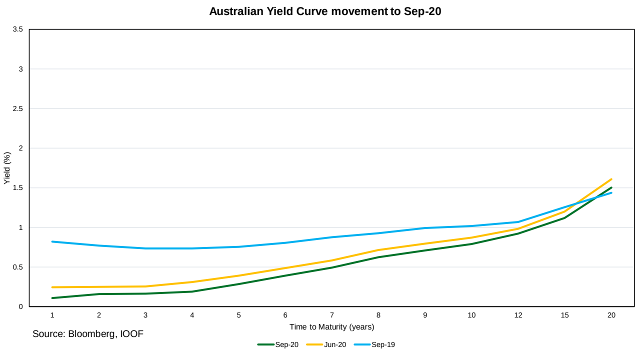
	Fixed Income	Sep-20 yield/ spread	1M mvt (bps)	Jun-20 yield/ Spread	3M mvt (bps)
	Australian Cash rate	0.25	--	0.25	--
▼	10-year Bond Yield	0.79	-0.20	0.87	-0.08
▼	3-year Bond Yield	0.16	-0.10	0.25	-0.09
	90 Day Bank Accepted Bills SFE-Day	0.09	--	0.11	-0.02
▼	US 10-year Bond Yield	0.68	-0.02	0.66	0.03
▲	US 3-year Bond Yield	0.16	0.01	0.17	-0.02
▲	US Investment Grade spread	1.52	0.07	1.73	-0.21
▲	US High Yield spread	5.08	0.45	6.19	-1.11

Source: Bloomberg, IOOF

Australian bond market

The Australian yield curve fell over the quarter with the decline in the 3-year yield by 9bps more notable as speculation of another RBA rate cut intensified. This is not expected to be the full 25bp cut seen earlier this year but rather in the range of 10-15bps with two goals. It may also extend its bond purchasing program to that end. First to ease borrowing costs and second to reduce the carry appeal of our dollar. By carry we refer to the extra return a speculator could earn from holding Australian dollars relative to our developed economy currencies because of the higher cash rate on offer. A rate cut reduces the spread between our cash rate and that of other currencies and should reduce pressure on the Australian dollar. The RBA concern is that speculative buying can reduce the competitiveness of our exports, slowing the recovery.

6. Australian yield curve movements to September 2020



Admittedly we confess to some surprise that the RBA may be embarking on this course of action. There are limited signs that the cost of credit is a material problem or hindrance in our economy today. This suggests consistent with market consensus that the exchange rate strength seen since hitting USD 0.55 in late March has become an increasing concern. Adding support to that thinking has been remarks during the quarter by RBA officials expressing their concern at the strength of the exchange rate.

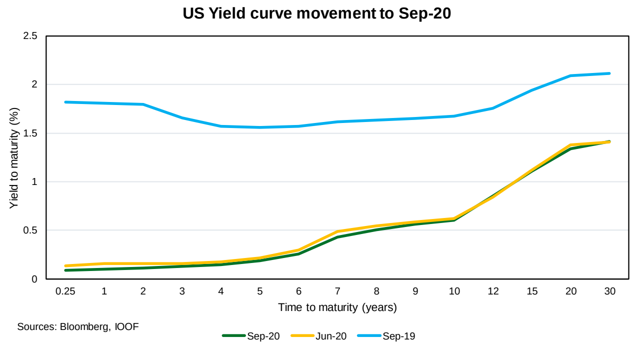
Credit markets

Credit spreads continued to contract over the September quarter. This saw corporate bonds outperform both domestically and internationally favouring managers overweight credit exposure while those positioned more defensively in government bonds will have lagged. The continuation of government support favoured a stronger outlook for this debt and saw investors continue to favour a “risk-on” trade. The concerns of a surge in coronavirus cases and the flow-on economic impact in September was dwarfed by the strength seen earlier in the quarter. After quarter-end we note that US High Yield spreads (the difference in yield between US government bonds and the riskiest types of corporate bonds) has recovered substantially to August levels.

US bond market

US Treasury yields were largely unchanged over the quarter. After rising in July and August, yields subsequently retreated slightly in September following declines in equity markets and concerns over President Trump’s coronavirus infection.

7. US yield curve movements to September 2020



One highlight of the quarter was the shift in Federal Reserve policy to an average inflation target of 2%. This was well-telegraphed and has implications longer-term for US monetary policy. It suggests that rate hikes will take more time to occur and implicitly acknowledges, we believe, that the Fed made a mistake in hiking too much over the 2017-18 period. We may see further news on policy shifts when the European Central Bank delivers on the policy review currently underway. This follows years of failing to hit its own inflation target and confronting deflation currently (headline deflation has been recorded for August and September).

In previous updates we had remarked on the possibility of central banks keeping rates suppressed more than ordinarily would have. We suggested the value of inflation protection. Inflation break-evens have since converged with inflation expectations for the next 10 years rising from their March low of 0.5% p.a. to 1.7% in early October.

Currencies

	Currencies	Sep-20 Price	1M return (%)	Jun-20 Price	3M return (%)
▼	$A vs $US	71.62	-2.90	69.03	3.75
▲	$A vs GBP	55.44	0.48	55.67	-0.42
▼	$A vs YEN	75.54	-3.30	74.51	1.39
▼	$A vs EUR	61.11	-1.10	61.45	-0.55
▼	$A vs $NZ	108.26	-1.17	106.95	1.22
▼	$A TWI	60.70	-3.04	60.00	1.17
▲	$US vs EUR	85.32	1.84	89.02	-4.16
▼	$US vs CNY	6.79	-0.84	7.06	-3.87
▲	$US vs GBP	77.38	3.45	80.64	-4.04
▼	$US vs JPY	105.48	-0.41	107.93	-2.27
▲	$US vs CHF	92.09	1.90	94.73	-2.79
▲	US Dollar Index	93.89	1.89	97.39	-3.60
▼	JPM EM Currency Index	54.52	-1.68	54.29	0.41

Source: Bloomberg, IOOF

The Australian dollar (AUD) rose 3.75% against the US Dollar (USD) during the quarter, up from USD 0.6903 to USD 0.7162.

Relative economic strength was not as pronounced a factor in the quarter with the Services sector slipping into slight contraction and August retail sales disappointed. However, strength in commodity prices, most notably iron ore and thermal coal, supported a strong bid in the **AUD**. Another factor was portfolio flows with investors attracted by the stronger bond yields on offer here relative to other countries. RBA officials have commented the strength of the AUD and its unhelpfulness for the economic recovery underway (because it makes out export sectors less competitive). Later in the quarter market expectations for another rate cut (more to prevent further currency appreciation) intensified led by Westpac Chief Economist Bill Evans. This has seen consensus price in a potential 15bps cut (to the bottom of the RBA floor for exchange settlement balances). It exacerbated the decline later in the quarter for the AUD but not enough to offset other factors driving AUD higher

Ongoing weakness in the **US Dollar** was a notable feature with a decline of -3.6% over the quarter. While it did rise 1.9% during September this was more than offset by the depreciation earlier in the quarter. Investor focus had supported a recovering global growth story (making other currencies more attractive) while USD demand and emergency provision in the form of swap lines had faded.

We also saw emerging market currencies rise slightly vs the US Dollar, up 0.4% as a number appear to be overcoming their own substantial coronavirus pandemics such as Brazil or South Africa.

Commodities

	Commodities	Sep-20 Price	1M return (%)	Jun-20 Price	3M return (%)
▼	Aluminium	1740	-2.67	1626	7.00
▼	Copper	303	-0.95	274	10.57
▼	Nickel	14487	-5.66	12819	13.01
▼	Zinc	2391	-4.67	2049	16.69
▼	Crude Oil – Brent	40.95	-9.56	41.15	-0.49
▼	Natural Gas	2.53	-3.92	1.75	44.32
	Metallurgical Coal	130	--	143	-9.16
▲	Thermal Coal	58	17.58	50	15.54
▲	Iron Ore	123.98	1.18	102.95	20.43
▼	Gold	1896	-4.20	1820	4.13
▼	Silver	23	-17.84	19	24.95

Source: Bloomberg, IOOF

Oil prices were flat during the September quarter with the bulk of the decline seen in the month of September, falling 9.6% alone. Signs of stronger global growth including slowing coronavirus cases in the US played an important role for energy demand. These faltered later in the quarter triggered by concerns over the path of global growth with the impost of new restrictions within Europe and concerns over the continued deadlock preventing further US fiscal stimulus. Another factor was a decline in commercial flights in the northern hemisphere with the end of summer reducing jetliner fuel demand and putting pressure on prices. **Natural gas** prices soared by over 44% on the back of supply disruptions with expectations of a colder winter than past years also a factor heading into the northern hemisphere's winter months.

Precious metals saw mixed performance by contrast with gold rising 4% whilst silver saw a strong surge, up almost 25%. This was arguably a case of mean reversion with silver trading at a substantial discount to gold earlier in the year. In addition, improving global growth benefits silver given its usage in industrial applications.

Iron ore prices saw strong support from Chinese demand even as Brazilian supply has recovered.

Thermal coal prices rose 15.5% over the quarter with two main drivers. First, increased buying from Chinese businesses with domestic Chinese production more limited in the face of curbs on illegal mining. Second, recovery in electricity production by key importers such as Japan and India has also been a supportive tailwind. We also note reports of Chinese import curbs on coal production from Australia. These have happened in the past and been temporary. We will monitor to see if it is a more extreme disruption this time.

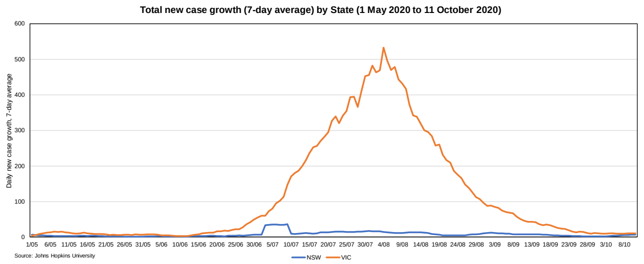
Australia

Victorian lockdown restrictions have eased, and inter-State travel is resuming as coronavirus infections have declined substantially. The 2020-21 Federal Budget is targeting a supply-led recovery with its focus on business investment spending. Tax cuts will also be an important support as the country exits its emergency settings (e.g. JobKeeper) from March next year.

Coronavirus pandemic

The September quarter was marred by a second wave of coronavirus infections centred around Victoria. This spilled over into NSW as well but never escalated to the degree of the Victorian experience. That wave saw Premier Andrews impose tight lockdown restrictions in Victoria. This was successful in containing the surge in cases with the Victorian 7-day average for new cases falling from 533 a day in early August to 11 per day as at 11 October.

7. Daily case growth (7-day av) in select States (May-20 to Oct-20)



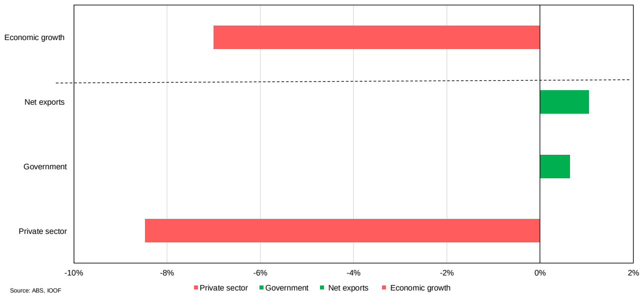
It did come at a substantial economic cost with Victoria lagging other states in job growth, consumer spending and general economic activity. This decline has seen lockdown restrictions begin to ease with the Victorian activity expected to improve from here. We have also begun to see borders reopen and other restrictions ease with NSW moving towards larger-scale public events from October and a return to larger-turnout sporting events for instance. This should support the ailing hospitality and tourism sectors although we note the continued closure of international borders may prompt some additional government intervention in this area given the scale of employment contribution.

Policy

On the policy front the Federal Budget brought forward the FY22 tax cuts in line with expectations to take affect from FY20. This helps all taxpayers with proportionately more gains for lower-paid workers (in terms of the percentage of tax being paid). In addition, the government committed to a sizeable program of tax allowances to encourage investment spending (both on new investment and improvements to existing machinery and property). This is to counter the weakness expected in business investment spending following the decline in demand from the coronavirus lockdowns. As we noted in a recent client article there are some concerns as to how forthcoming this business spending will be if demand is not sufficiently strong to induce it. NAB Business Surveys suggest limited investment intentions ahead of the Budget and we will be monitoring future releases closely to see if the scale of the government intervention is sufficient incentive.

Economic growth

10. Quarterly economic growth to June 2020 split by contribution



Australian economic growth disappointed expectations, falling -7% (consensus: -6.2%) during the June quarter. At a high level, the impact of lockdowns saw private sector consumer and investment spending fall, contributing over 8% to this decline. Net exports and government spending were positive offsets but unable to counter the full decline.

The Westpac-MI Leading Index continues to improve rising substantially to -2.56% in August, up from -4.44% in June. In the next update this will have cycled through the weakness seen in March-April and likely see a resumption of growth with a stronger consumer outlook and improving business conditions potential drivers.

Consumer and Business Sentiment

The NAB Monthly Business Survey for September improved in terms of both business conditions and business confidence. Stronger trading and profitability results were the drivers of higher business conditions with the employment subindex still lagging suggesting challenges in hiring conditions remain. Victorian confidence and conditions remain challenged consistent with the lockdown restrictions disrupting many businesses. This survey was prior to the FY21 Budget and we will be monitoring to see how this incentivises new spending and business activity.

The Westpac-MI Index of Consumer Sentiment saw a sharp bounce back in October, rising by 11.2 points from 93.8 to 105.0. Improving confidence of household finances tied to the FY21 Budget was a key driver that saw the index at its highest level since July 2018. This should be a tailwind for consumer spending in the near term.

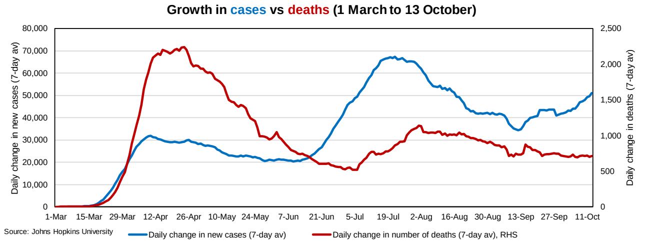
United States of America

Policy deadlock in Washington continued over the quarter with emergency unemployment benefits expiring. Pleasingly however, leading indicators

continued to support economic recovery in the US albeit at a moderated pace. Attention is focusing increasingly on the upcoming Presidential and Senate races with Democrat candidate Joe Biden ahead of President Trump in the polls and the Democrats slight favourites to claim the Senate.

Coronavirus pandemic update

11. Total US case growth by region, 7-day average (Mar-20 to Sep-20)



Daily new case growth (in blue) peaked early in the quarter before declining and then beginning to resume in September. We also saw President Trump become infected and subsequently recover. Unlike the case for Europe (see later in this report) we have seen deaths continue to decline. In addition, the unwind of lockdown restrictions in US States has been providing a tailwind for growth and allowing for a return to normal business settings within the US with unemployment still at elevated levels but gradually falling. We note that continued claims (people still receiving unemployment benefits) have steadily fallen over the quarter from 17.8m to 11m at the end of September. This is good progress with more required given the jobs growth challenge still ahead. For context it took until 2014 to reach pre-GFC levels from a peak of 6.6m continued claims.

Policy update

Additional fiscal stimulus remains in a deadlock between the Democrat and Republic parties. It now appears highly unlikely for this to happen prior to the November Elections. That will leave a challenge for the victor in the Presidential race to address with much hinging on how the Senate race transpires as well, specifically whether the President's party will control both Houses of government and be able to pass legislation without lengthy negotiation efforts. As highlighted in the August update, both parties came to a compromise to prevent a government shutdown with a stopgap funding bill passing to avoid the October 1 deadline.

US Elections

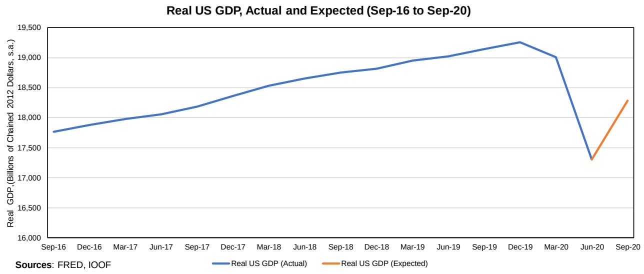
Relying on polling aggregation and analysis from FiveThirtyEight suggests that both a Joe Biden Presidency and a Democrat-led Senate are the likely outcomes in the November Elections. While there are concerns with the polling after the surprise win of President Trump in 2016, we believe they still make a viable base case. We note also that FiveThirtyEight was one of the few forecasters to give Trump a meaningful chance of victory in 2016 (~29%). Current forecasts only assign a 13% chance to the President. The Senate race is narrower but also appears to be favouring a Democrat victory. Regardless of who is President the outcome will provide more certainty to markets and there are pros and cons for both to consider. While the Biden campaign has some "anti-stock market" policies such as higher corporate taxes it also appears to be in favour of further fiscal support which is important given the large job creation challenge still ahead of the US.

Economic growth

Leading indicators continue to improve for the US with the ECRI Weekly Leading Economic Index and the Conference Board's Leading Economic both recovering further over the quarter. This suggests a low risk of a second trough in economic activity in the short run.

If we examine how growth "now"-casts are forecasting the below shows a sharp bounce back expected for the September quarter with a 24.6% annualised bounce expected vs the -31.4% annualised decline in the June quarter. This is based on the Fed's Weekly Economic Index drawn from several leading economic indicators including retail sales.

10. Real US GDP growth



Continued strength in housing starts and new business formation are other near-term indicators strengthening our convictions at present that US growth will continue to improve from here. An additional fiscal stimulus following the Presidential election would also add to this viewpoint.

Sentiment

The IHS Markit Composite PMI improved to 54.4 in September, up from 47.9 in June. Recovery has been broad-based with strong growth across both services and manufacturing sectors. Both saw improvement in new orders (a sign of stronger demand) including from overseas.

China

The Chinese economy recovery continued over the September quarter driven largely as a supply-led response to government stimulus encouraging infrastructure and construction spending. While domestic activity is getting back to normality, the weaker global economy continues posing challenges for China's exporting industries. On a positive note, growth in retail sales suggests

Chinese consumers may be regaining confidence, an important growth driver.

Business activity and sentiment

The Caixin China Services PMI fell to 54.8 in September, down from 58.4 in June, a sign of continued recovery albeit at a slower pace. New orders increased but were stymied by a weaker export outlook which continued to see contraction. The recovery in services sector demand remains domestic-led and pleasingly saw a recovery in employment demand for the first time since January to meet the new order requirements. Services firms continue to remain confident on the economic outlook but remains challenged by the external outlook and the impact of the pandemic on growth.

The Caixin China Manufacturing PMI picked up further, rising from 51.2 in June to 53 in September. The notable driver was again new business growth, rising at its fastest rate since January 2011, supported by a notable rebound in export sales, itself at its fastest pace since August 2017. Business confidence for the year ahead rose to a three-month high with the employment index hitting expansionary territory for the first time this year, ending an eight-month contraction. Uncertainties persist over the continuation over the pandemic overseas as well as the US presidential election.

Economic growth

Chinese retail sales rose 0.5% for the year to August (consensus: 0%), snapping a 7-month downturn. Auto sales also climbed 11.8% over the same period. This is encouraging as it suggests the breadth of growth of improving away from investment to consumer spending as well. Industrial output also beat expectations rising 5.6% for the year (consensus: 5.1%), its fastest climb in eight months. For momentum to be sustained we would like to see further recovery in consumer demand as a sign of stronger consumer confidence.

Inflation

The Producer Price Index (PPI) fell -2.1% for the year to September while the Consumer Price Index (CPI) softened to 1.7% growth over the same period. The weakness in producer prices suggests limited inflationary pressures within the Chinese economy and marks an eighth consecutive month of annual declines. At present inflation is well-contained, a far cry from the price shock induced by food prices early this year.

Credit growth

Chinese credit growth maintained a strong level in September with the stock of outstanding credit growing 13.5% over the last year. Key drivers were government bond issuance and higher bank loan volumes. Some of this also reflects growth being brought forward with quotas on property lending expected to constrain credit growth for the rest of the year according to Bloomberg. Financial conditions continue to accommodate the recovery and combined with stronger consumer spending add support to the recovery continuing in the months ahead.

Trade

Chinese exports rose for a fourth-consecutive month and 9.9% for the year to September (consensus: 10%), the strongest result since March 2019. Imports also recovered, rising strongly to 13.2% for the year to September (consensus: +0.4%), the strongest growth since December last year. The import surge was partly driven by food pressures with Chinese food supply impacted by flooding and poor weather. It is also a reflection of purchasing American farm goods to get closer to the import targets detailed in the phase one trade deal agreed at the start of this year. The overall result saw the trade surplus at US$37bn, down from $58.9bn in August. This period of successive trade surpluses may reappear as an issue in the future with China arguably benefitting from the fiscal support of other countries that drove demand for its exports. A lack of similar measures (at scale) within China has seen the country’s trade surplus expand sizeably not only against the US but also against Europe. We already saw what these imbalances can lead to with the trade conflict instigated by President Trump and arguably, the ground is being laid for more of the same.

Geopolitics

Chinese firm ByteDance’s social media app TikTok was a target of a government ban by the US on national security grounds. This was resolved through the sale of a 20% stake of TikTok Global to tech firm Oracle and Walmart ahead of an IPO over the next year. This commitment still appears to be on foot while tensions have otherwise been subdued between China and the US with China unwilling to exacerbate this issue.

Europe

A second wave of coronavirus cases emerged over the quarter and eventually triggered rising hospitalisations and, sadly, deaths. This has seen limited lockdown restrictions reappear with negative economic results likely. Brexit concerns emerged increasingly as the UK and EU are running short on time to finalise a formal trade agreement to avoid a harsher UK exit scenario.

United Kingdom

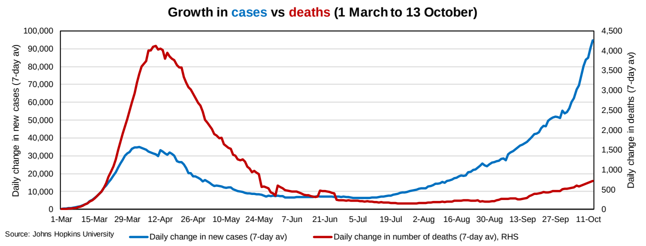
Brexit concerns increased over the quarter as we approach the deadline for a finalised transition from the EU. A formal trade agreement is required by year-end to avoid the “hard”

Brexit scenario where the UK and EU revert to WTO requirements and harsher tariff rates that come along with that process. It remains to be seen how negotiations will move forward given both the UK and EU appear to be at an impasse. While we believe there is scope for compromise (and indeed this would be our base case given an already weakened economic state) we do note the adverse scenario remains possible. This would exacerbate the economic weakness of both the UK and EU but in our view would be a localised downside risk.

The UK economy grew 2.1% in August, well below consensus expectations for 4.6% growth. Much of the increase was driven by accommodation and hospitality sectors following the easing of lockdown restrictions. On that note the impost of new restrictions in response to surging coronavirus infections once again poses a near term threat for the British economy. It has already prompted speculation of further government stimulus being required. The UK is not positioned well to handle a negative Brexit outcome.

Coronavirus pandemic

12. Daily case vs fatality growth in Europe (Mar-20 to Sep-20)



Over the course of the quarter we saw daily case growth escalate across Europe with a daily average well in excess of the prior peak. The daily case growth (7-day average) rose from 7k as at 30 June to 94.6k as at 13 October. This growth has been widespread and comes as Europe enters its colder winter months (there is conflicting reports as to colder temperatures being more hospitable for the virus). Late in the quarter we also saw the level of deaths (the **red** line in Chart 12) begin to arise, albeit well below the levels experienced in April, an acknowledgement that authorities are doing better to protect more vulnerable members of society. Across Europe restrictions have begun to tighten but governments are walking a tightrope to avoid being too restrictive as they arguably were in the first wave of the virus. The focus appears to be on reducing mass public gatherings particularly in poorly ventilated locations with Paris and several French cities seeing curfews implemented. This will be quite punitive for the hospitality sector especially and may prompt further government intervention in the months ahead.

Business Activity and Economic growth

European PMI surveys improved over the quarter. The IHS Markit Eurozone Composite rose to 50.4 in September, up from 48.5 in June, while the Manufacturing PMI saw a steeper increase to 53.7, up from 47.4.

While these readings were above 50 and indicating expansion, the pace of the recovery moderated particularly for the services sector which declined from 48.3 to 48 over the same period. This was largely due to weakness in the services sector where concerns over the rise in coronavirus infections saw business confidence falter and the impost of new restrictions poses another challenge.

Notably there is divergence at a country level with Germany leading in terms of the Composite PMI results, a reflection in part of its greater reliance on the manufacturing sector. It also reflects a stronger fiscal response than we saw in the aftermath of the global financial crisis with retail sales bouncing back strongly as well.

The current results suggest that there is potential for growth to falter in the December quarter with countries such as Spain amongst the worst affected. A lot will hinge on government decisions regarding virus containment and when these can be loosened to spur recovery in the services sector. This has struggled in the face of social distancing requirements.

Policy

The European Recovery Fund was agreed upon in an unprecedented gesture of solidarity. This stood in stark contrast to the divisions that resulted in the European sovereign debt crisis following the global financial crisis in 2011. This will be a mutual obligation across EU members of €750bn which will aid the recovery in the medium-term for European states as this funding is due to be raised from next year.

Company news (Notable strong and weak performers during the 2020 September quarter)

Corporate Travel Management (+83%)

Corporate Travel Management (CTD) performed strongly over the quarter as a result of a better-than-expected full-year result accompanied by the announcement of the takeover of a US competitor. Aggressive cost cutting measures helped limit FY20 net loss to -$8.2m (vs. +$86.2m pcp) and FY20 EBIT of $74.4m was achieved. Although impacted by global travel restrictions, the outlook remained encouraging, with management highlighting pent-up demand for travel services and the company's ability to run a profitable business solely servicing domestic travel markets in key North American, European, and Australian markets while border restrictions remain in place. A $375m capital raising was also announced for the purchase of a US-based rival, Travel and Transport, and to provide additional funds for CTD to pursue its acquisition ambitions.

Netwealth Group Ltd (+69.2%)

Netwealth Group (NWL) continued to benefit from the industry's shift away from institutional wealth platforms and recorded a positive FY20 result. Funds Under Administration (FUA) increased +35.0% yoy to $31.5bn supported by strong net inflows of $9.1bn. Funds Under Management (FUM) performed similarly, increasing +84.4% yoy to $7.3bn. Although acknowledging the uncertainties of COVID-19, NWL expects FY20 results to slightly exceed previous guidance of $120m in revenue and underlying EBITA of $62m.

Mesoblast Ltd (+56.3%)

Mesoblast (MSB) revealed positive results from its clinical trial of Remestemcel-L on COVID-19 patients. Results showed an 83% survival rate of ventilator-dependent COVID-19 patients who were treated with two infusions of MSB's allogenic cell therapy, Remestemcel-L. This compares to a 12% survival rate among ventilator-dependant COVID-19 patients at another hospital over the same time. The treatment involves injecting stem cells to the patient, which are believed to limit the inflammation in the lungs when the immune system responds to COVID-19. A $100m capital raising was announced shortly after to help fast track the development of the drug.

Unibail-Rodamco-Westfield (-40.1%)

Unibail-Rodamco-Westfield (URW) suffered from a combination of pandemic lockdowns, asset price write-downs, and tenants refusing or unable to pay rents. URW pulled FY20 guidance, and estimates suggest net rental income from European and North American operations may plunge by more than a quarter as a result of missed rental payments, potential tenant bankruptcies, and reduced footfall from social distancing. The revival of foot traffic in some regions, such as Germany and Austria, over June-August was not enough to overcome the emergence of a second wave towards the end of the quarter and URWs share price continued to slide.

IOOF Holdings Ltd (-32.0%)

IOOF Holdings' (IFL) finished the quarter lower after announcing a $1.5bn acquisition of MLC and a subsequent $1.0bn capital raise was not well received by the market. FY20 underlying NPAT from continue operations fell -32.3% to $124.0bn with significant COVID-19 induced market movements, legislative changes, and competitive dynamics weighing on the result. The acquisition of MLC will see IFL become the largest retail wealth manager with a combined FUMA of $510bn and is expected to be EPS accretive in FY21.

AMP Ltd (-29.6%)

AMP (AMP) continued its slide after the announcement of an unexpected trading update which guided towards a -50.0% decline in underlying NPAT for 1H21, allegations of sexual harassment from senior management, and the speculation of a potential carve-up of the wealth manager after the shock resignation of the Chairman (David Murray, following public backlash of AMPs handling of the sexual harassment allegations).

Sources: ASX company announcements, Bloomberg, *Australian Financial Review*, *Sydney Morning Herald*

Movers and Shakers for the quarter of September 2020

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month ∆ (%)	Quarter ago close ($)	Quarter ∆ (%)	Year ago, close ($)	Year ∆ (%)
CTD	Corporate Travel Management	17.23	15.53	10.9	9.41	83.0	18.34	-6.1
NWL	Netwealth Group Ltd	15.18	14.00	8.4	8.97	69.2	9.11	66.6
MSB	Mesoblast Ltd	5.08	5.31	-4.3	3.25	56.3	2.14	137.4
ARB	Arb Corp Ltd	27.65	26.32	5.1	17.95	54.0	19.05	45.1
ALQ	ALS Ltd	9.21	8.73	5.5	6.56	40.4	8.02	14.8
APE	Eagers Automotive Ltd	9.15	8.92	2.6	6.75	35.6	14.22	-35.7
WTC	Wisetech Global Ltd	25.79	28.18	-8.5	19.35	33.3	34.73	-25.7
MP1	Megaport Ltd	16.09	17.04	-5.6	12.08	33.2	9.09	77.0
APT	Afterpay Ltd	79.99	91.44	-12.5	60.99	31.2	35.87	123.0
SUL	Super Retail Group Ltd	10.52	10.70	-1.7	8.05	30.7	9.82	7.1

Source: Bloomberg, IOOF

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month ∆ (%)	Quarter ago close ($)	Quarter ∆ (%)	Year ago close ($)	Year ∆ (%)
URW	Unibail-Rodamco-Westfield CDI	2.42	3.31	-26.9	4.04	-40.1	10.65	-77.3
IFL	IOOF Holdings Ltd	3.08	4.26	-27.8	4.53	-32.0	5.89	-47.7
AMP	AMP Ltd	1.31	1.53	-14.7	1.86	-29.6	1.83	-28.5
WHC	Whitehaven Coal Ltd	1.05	0.93	12.4	1.43	-26.9	3.11	-66.4
ORG	Origin Energy Ltd	4.30	5.60	-23.2	5.84	-26.4	7.97	-46.0
A2M	A2 Milk Co Ltd	14.05	17.01	-17.4	18.66	-24.7	12.16	15.5
BVS	Bravura Solutions Ltd	3.40	3.67	-7.4	4.50	-24.4	4.14	-17.9
IAG	Insurance Australia Group	4.38	4.77	-8.2	5.77	-24.1	7.90	-44.6
AVH	Avita Therapeutics Inc - CDI	6.90	7.02	-1.7	9.00	-23.3	11.80	-41.5
CIM	CIMIC Group Ltd	18.55	21.17	-12.4	24.12	-23.1	31.45	-41.0

Source: Bloomberg, IOOF

Long-term asset class performance to September 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)	-3.7%	-0.4%	16.0%	-10.2%	4.8%	7.3%	5.9%	6.9%	6.0%	7.3%
Australian equities - Mid caps	-3.0%	5.2%	37.0%	2.3%	8.1%	12.0%	11.3%	9.3%	6.8%	10.3%
Australian equities - Small caps	-2.8%	5.7%	30.9%	-3.3%	6.5%	10.0%	6.2%	3.5%	3.5%	5.6%
Australian equities - Micro caps	-1.0%	21.3%	75.7%	4.7%	9.4%	11.8%	6.9%	1.7%	3.9%	#N/A
International equities	-0.3%	3.8%	9.9%	4.3%	11.2%	10.1%	12.7%	12.9%	7.1%	3.5%
International equities (Hedged)	-2.9%	6.4%	25.4%	6.4%	7.0%	10.4%	10.1%	11.7%	8.0%	#N/A
International equities - Small caps	0.8%	3.2%	13.9%	-3.3%	5.4%	7.5%	10.4%	12.0%	7.1%	6.4%
Emerging Markets equities	1.5%	5.2%	10.5%	4.0%	5.6%	8.5%	7.8%	5.6%	6.3%	#N/A
Australian REITs	-1.5%	7.0%	28.3%	-16.6%	3.7%	5.6%	8.5%	9.5%	3.3%	6.3%
Global REITs	0.0%	-1.9%	-4.0%	-23.1%	1.6%	1.6%	6.6%	7.9%	4.2%	#N/A
Global REITs (Hedged)	-2.6%	0.6%	9.3%	-21.5%	-2.0%	1.8%	4.3%	6.8%	4.6%	#N/A
Global Infrastructure	2.0%	-2.0%	-3.9%	-13.7%	5.8%	6.4%	10.2%	11.0%	#N/A	#N/A
Global Infrastructure (Hedged)	-0.4%	0.8%	9.0%	-10.2%	2.9%	6.9%	8.1%	10.3%	#N/A	#N/A
Trend following (in US Dollars)	-2.5%	-0.4%	-5.1%	-3.8%	0.9%	-2.3%	2.5%	0.8%	3.2%	5.6%
Australian bonds	1.1%	1.0%	1.6%	3.2%	6.0%	4.5%	5.1%	5.6%	5.8%	6.0%
Australian bonds – government	1.2%	1.0%	1.2%	3.1%	6.2%	4.6%	5.2%	5.6%	5.8%	6.0%
Australian bonds – corporate	0.5%	1.5%	3.1%	3.5%	5.5%	4.7%	5.1%	5.9%	6.0%	6.2%
Australian bonds - floating rate	0.0%	0.5%	1.9%	1.7%	2.4%	2.7%	2.9%	3.7%	4.3%	4.7%
Global bonds (Hedged)	0.4%	0.7%	3.0%	3.5%	4.7%	4.5%	5.2%	5.7%	6.4%	7.0%
Global bonds - government (Hedged)	0.6%	0.5%	1.3%	3.0%	4.8%	4.4%	5.3%	5.7%	6.4%	6.9%
Global bonds - corporate (Hedged)	0.0%	1.7%	9.3%	4.9%	5.2%	5.7%	5.9%	6.6%	6.8%	7.5%
Global bonds - High Yield (Hedged)	-1.5%	3.3%	15.1%	-0.2%	2.1%	6.1%	5.8%	7.8%	8.5%	#N/A
Emerging Market bonds (Hedged)	-2.1%	2.1%	14.8%	-0.3%	2.4%	5.9%	6.0%	6.6%	7.9%	9.9%
Cash (AUD)	0.0%	0.0%	0.1%	0.6%	1.4%	1.6%	1.9%	2.6%	3.6%	4.0%

Sources: Bloomberg, IOOF calculations

* AUD total returns as at Sep-20 assuming reinvestment of dividends except where specified otherwise
** 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 (AUD)
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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