ECONOMIC AND MARKET COMMENTARY
DECEMBER QUARTER 2020

Australia:

Key points:

- **The Australian economy continued to recover in the December quarter following the easing of social distancing measures amidst falling COVID-19 case numbers and positive announcements in relation to vaccines.**
- **The Reserve Bank of Australia (RBA) announced a package of measures including reducing interest rates to 0.10% at its November meeting.**

The economic outlook continued to improve over the December quarter despite lockdowns in November for South Australia and in December for New South Wales' Northern Beaches. A number of state border restrictions were implemented to limit travel from various coronavirus hotspots including New South Wales following the Northern Beaches outbreak. Australian equities surged over the quarter (13.8%) off the back of Victoria reopening and higher resource prices. Energy, Financials (ex-Property Trusts) and Information Technology were the highest performing sectors for the quarter, posting returns of 26.1%, 22.8% and 22.8% respectively. Health Care (-1.0%) and Utilities (-5.4%) were the weakest performing sectors.

Economic data released over the quarter showed signs of recovery as the Australian economy grew by 3.3% in Q3, marking the strongest quarterly growth in GDP since 1976. The strong rebound in economic activity was led by the relaxing of COVID-19 restrictions in October in Victoria and increased trading activity between states. Household spending rose by 7.9% over the quarter, reflecting increased consumption of goods and services. Annual GDP growth to September 2020 remained negative at -3.8% but was an increase from the June 2020 reading of -6.4%. Inflation was 1.6% over the September quarter, driven largely by prices of childcare, fuel and financial services. Overall, year-on-year inflation was positive at 0.7%, rebounding from the 0.3% decline in the June quarter with the re-opening of the economy.

The federal government introduced the Economic Recovery Plan in October proposing the JobMaker Plan, personal income tax relief and further infrastructure investments. The JobMaker Plan includes $1 billion towards training places for job seekers and incentives for employers to hire young job seekers by subsidising wage costs by up to $200 a week. In November, the Reserve Bank of Australia (RBA) announced additional stimulus measures to support economic recovery and employment, including reducing interest rates from 0.25% to 0.10% and engaging in a $100 billion quantitative easing program.

The RBA stated that it would not consider increasing the cash rate until inflation was ‘sustainably within the target range of 2-3%’. The unemployment rate fell to 6.8% in November 2020, from a peak of 7.5% in July, but still well above its pre-pandemic level.

Other economic conditions also improved over the December quarter. The manufacturing index (measured by the Australian Industry Group Australian Performance of Manufacturing Index) increased to 52.1 in November, reflecting higher manufacturing activity compared to the September quarter (a reading of 50 indicates an expansion in activity). Victoria recorded its first month of expansion in manufacturing activity since March 2020, whilst South Australia had the largest fall amongst states due to lost production from the three-day shutdown. The services index (measured by the Australian Industry Group Australian Performance of Services Index) increased to 52.9, up from 36.2 in September. Business sentiment (measured by the NAB Business Confidence survey) improved for the fourth consecutive month to 12 in November from -4 in September, indicating increasing optimism with the reopening of businesses in Victoria and substantial progress in the development of vaccines. Consumer confidence (measured by the Westpac Bank Consumer Sentiment Index) continued to rise, finishing the year at 112 in December, the highest reading since October 2010.

Returns for period ending 31 December 2020	Quarter	1 Year
Australian Equities[1]	13.8%	1.7%
Consumer Discretionary	11.1%	12.1%
Consumer Staples	6.2%	5.1%
Energy	26.1%	-27.4%
Financials, ex Property Trusts	22.8%	-5.9%
Health Care	-1.0%	4.3%
Industrials	5.7%	-12.2%
Information Technology	22.8%	52.4%
Materials	15.9%	18.9%
Telecommunications Services	12.7%	3.6%
Utilities	-5.4%	-15.7%

[1]S&P/ASX 300. Below are sub-sectors.

Overall, the Australian Dollar (AUD) appreciated against major currencies over the quarter with the Trade-Weighted Index measuring 63.4 at the end of December, up from 60.7 at the end of September. The AUD appreciated against the USD to its highest level since April 2018, from 71.08 US cents at the beginning of the quarter to finish the year at 77.02 US cents. The AUD also appreciated against nine of the G10 members in 2020 (the exception was the Swedish krona), driven by rising prices in industrial metals (particularly iron and copper) underpinned by the economic recovery in China.

The Australian Government 10-year bond yield increased by 13bps to 0.98% over Q3. Australia’s 10-year government bond yield continued to trade above the US 10-year bond yield (0.91%) for another quarter. This resulted in the Bloomberg AusBond Composite Index posting a negative overall return of -0.1% for the December quarter.

International:

Key points:

- **Reported global COVID-19 cases exceeded 83 million and the death toll surpassed 1.8 million by the end of the 4th quarter.**
- **Fiscal and monetary policy remained accommodative over the quarter as governments and central banks continued to combat the economic effects of COVID-19.**
- **Economic data released during the quarter broadly showcased a recovery in economic activity as well as in investor sentiment from vaccine breakthroughs and rollouts.**

Global equities rallied on the back of COVID-19 vaccine breakthroughs and rollouts while investors overlooked increasing European and US COVID-19 infection rates, which exceeded previous highs and resulted in harsher lockdowns in a number of places. Investor sentiment also picked up following vaccine announcements and the US election outcome. Tension between China and the United States continued, with President Trump issuing an executive order banning American investors from transacting securities of certain Chinese companies. Trade relations deteriorated further between China and Australia, with restrictions imposed on Australian wine, lobsters, coal, and timber. The MSCI World Index ex Australia (hedged to AUD) posted a 11.7% return over the quarter, taking its one-year performance to 10.6%.

US equities gained 12.1% over the quarter, as measured by the S&P 500 Composite Index in local currency terms, with the strong performance attributable to the US election result and optimism around the rollout of vaccines. The incoming Biden administration campaigned for an infrastructure spending program and providing support for US growth and employment, which was viewed favourably by investors, while the expectation (at the time) of a divided Congress was expected to prevent drastic changes to taxation and regulation. The Federal Reserve reinforced its stance on supporting current levels of quantitative easing, with economically sensitive sectors being the biggest beneficiaries. In the last days of the year, the US Congress approved a long-awaited pandemic relief plan for companies and households, which will extend many of the current support measures.

Economic data released in Q4 for the US continued to reflect improvements in most areas, with the economy expanding by an annualised 33.4% in the third quarter of the year, the biggest quarterly expansion ever and a substantial rebound from the steep contraction in Q2. The US Congress approved a new $892 billion aid package in December, providing $600 payments for most Americans. The Markit US Manufacturing PMI improved to 57.1 in December, marking its 8th consecutive monthly increase (any number above 50 signals an expansion in manufacturing activity). The National Association of Home Builders/Wells Fargo Housing Market Index (HMI) ended its recent trend of increases, falling to 86 in December from its record high of 90 in November (although remaining well above 50, which indicates more builders view sales conditions positively). Unemployment in the US fell to 6.7% by quarter end (down from 7.8% last quarter). However, consumer sentiment remains low at 76.9 for November (down from 80.4 at the end of last quarter), as measured by the University of Michigan Consumer Sentiment Index. US annual core inflation was reported at 1.6% in December, down from 1.7% in September.

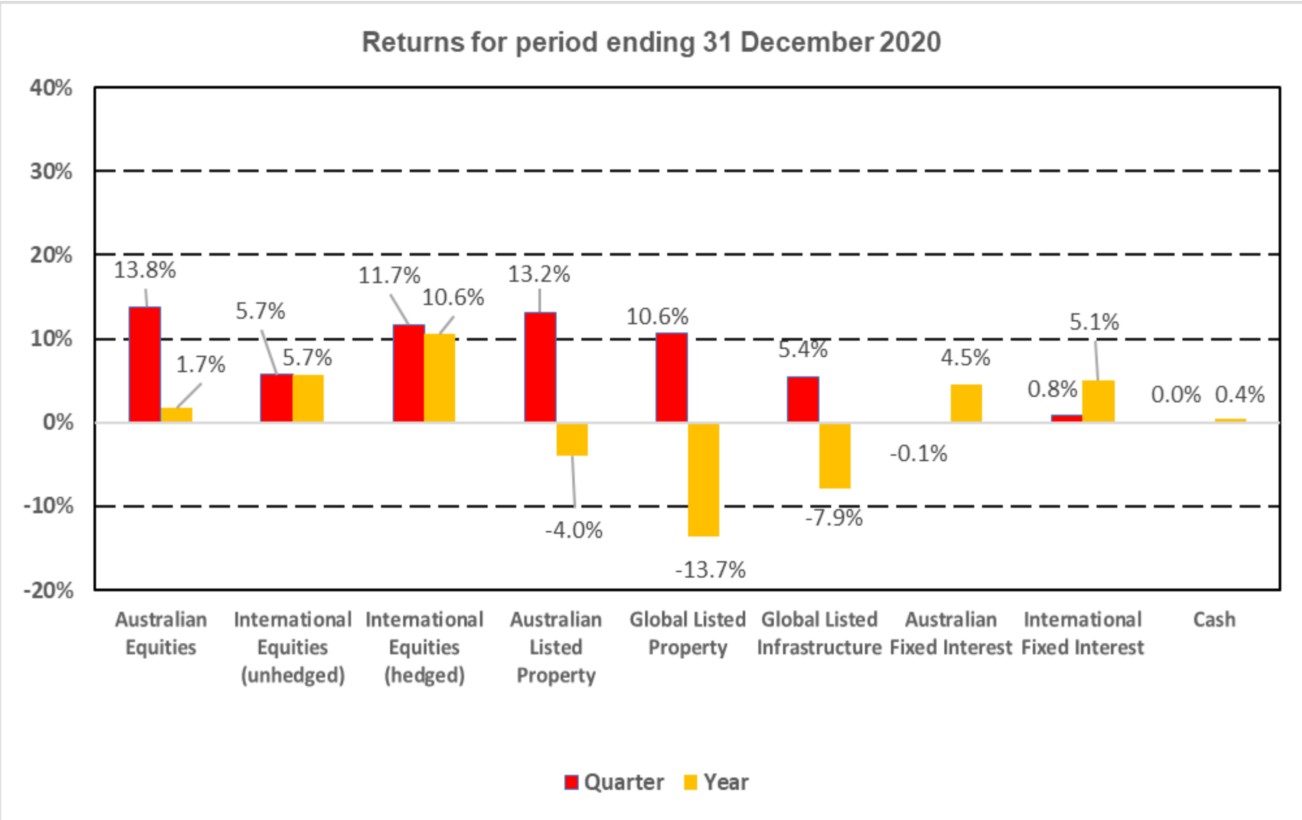
European equities rose by 11.4%, as measured by the Euro Stoxx 50 Index in local currency terms. As well as the positive vaccine news, returns were also impacted by a landmark €1.85 trillion budget package as well as an agreed Brexit trade deal between the EU and the UK. The European Central Bank left interest rates unchanged at -0.5% in December but extended and expanded several COVID-19 programmes until 2022. Manufacturing activity lifted over the quarter, with the Markit Eurozone Manufacturing PMI reaching 55.2 in December, up from 53.7 in September. Eurozone headline inflation came in at -0.3% in December 2020, whilst annual Eurozone core inflation (which excludes prices of volatile items such as food and energy) came in at 0.2%.

China and Hong Kong equities generated strong returns despite dampened investor sentiment from uncertainty in geopolitical risks, the US executive orders and anti-trust developments within China, with the Shanghai Composite Index returning 7.9% (in local currency terms).The Caixin Manufacturing PMI recorded 53 in December (a reading above 50 indicates an expansion of the manufacturing sector compared to the previous month), retreating from a decade-high of 54.9 in November, but nonetheless reflecting more confident expectations by Chinese firms. China's GDP increased in the September quarter, growing by 2.7% after its 11.7% expansion in the previous quarter.

Japanese equities rallied alongside other markets, returning 12.8%, as measured by the MSCI Japan Index (in local currency terms). The Markit/Nikkei Final Japan Manufacturing PMI rose slightly over the quarter, ending at 50.0, bringing an end to 23 months of consecutive sub-50 readings. Prime Minister Yoshihide Suga declared a state of emergency in the Tokyo metropolitan area to fight the increased number of coronavirus infections. In line with forecasts, Bank of Japan kept the short-term policy rate unchanged at -0.10% and voted to extend its corporate finance support program for a further six months until the end of September 2021, making additional purchases of commercial paper and corporate bonds. Year-on-year inflation fell further below pre-pandemic levels to -0.9% in November, as consumption remains low due to the pandemic.

Global bond yields diverged over the December quarter. The US 10-year government bond yield rose by 25bps to 0.91%, whilst the UK 10-year yield remained fell slightly to 0.20%. The German 10-year yield decreased by 5bps to -0.58%, and the Italian 10-year yield fell more significantly, by 32bps, amid increased quantitative easing by the European Central Bank.

Global listed infrastructure and global listed property continued to recover ground, posting strong returns of 5.4% and 10.6% respectively over the December quarter, as measured by the FTSE Developed Core Infrastructure 50/50 Index (AUD hedged) and the FTSE EPRA/NAREIT Developed Rental Net TRI Index (AUD hedged) respectively. Despite their recovery in Q4, their one-year returns remain negative at -7.9% and -13.7% respectively.



Returns for period ending 31 December 2020	Quarter	1 Year
International Equities (unhedged) [1]	**5.7%**	**5.7%**
North America	5.0%	9.3%
UK	8.8%	-18.3%
Europe (ex UK)	7.3%	1.2%
Japan	7.1%	4.3%
Asia Pacific (ex-Japan)	10.4%	14.1%
Emerging Markets	11.2%	7.8%
China A Shares	9.4%	27.8%
International Equities (hedged) [3]	**11.7%**	**10.6%**
Australian Listed Property [4]	**13.2%**	**-4.0%**
Global Listed Property [5]	**10.6%**	**-13.7%**
Global Listed Infrastructure[6]	**5.4%**	**-7.9%**
Australian Fixed Interest[7]	**-0.1%**	**4.5%**
International Fixed Interest[8]	**0.8%**	**5.1%**
Cash[9]	**0.0%**	**0.4%**

1. S&P/ASX 300 Accumulation Index
2. MSCI World ex-Australia Index (with net dividends reinvested in A$)
3. MSCI World ex-Australia Index (with net dividends reinvested hedged in A$)
4. S&P/ASX 300 A REIT Accumulation Index
5. FTSE EPRA/NAREIT Developed Net TRI Index (Net Total Return hedged in A$)
6. FTSE Developed Core Infrastructure 50/50 Index (Net Total Return hedged in A$)
7. Bloomberg AusBond Composite Index
8. Barclays Global Aggregate Hedged in AUD Index
9. Bloomberg AusBond Bank Bill Index

All returns are based on accumulation indices. Data sourced from eVestment Alliance, Datastream and Thomson Reuters.