2021: THE OUTLOOK FOR AUSTRALIAN EQUITIES

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It was a year like no other. Extreme volatility and uncertainty gave way to bear and bull markets, but perhaps more importantly, it presented opportunities to invest in the market.

The Lucky Country

In Australia once again we are the Lucky Country. But I believe you make your own luck. And the reality is, Australia has done a great job managing the health issues around COVID. The government has stepped up in a timely manner to provide fiscal stimulus to support the economy. And that really leaves us in good stead. And it's no accident that we're in the position that we are today relative to other countries around the world. So, it is important to have the vaccine rolled out, but I think Australia is somewhat different to the rest of the world. We are in a very good relative position on that front. So that's why we're so confident that the Australian economy will react better as we come out of this downturn.

A year like no other

Reflecting on 2020; it was an extremely volatile year in markets but also a very challenging year. It was all about COVID and initially the market was reacting to economies being closed globally, even our own, and you saw that with the very sharp sell-off in March in particular. And we've seen the flip side more recently, a very strong rally in markets and a rebound on the back of an effective vaccine, easing monetary policy, and also a lot of fiscal policies, spending policies that have been announced by governments. So, from the March lows, the Australian stock market is up more than 40% which is quite an extraordinary performance. So, we've seen a bear market and a bull market all in one year. That type of volatility is extreme, and you wouldn't have blamed anyone for going to cash in March given the uncertainty in the headlines that we were reading in the paper. but, having said that and from our point of view, we saw a lot of buying opportunities. So, we topped up on some of our stocks that we already held in our portfolio, but it also gave us the opportunity to top up on some other companies that we thought were great buying opportunities. Companies like Qantas (ASX: QAN), Aristocrat (ASX:ALL) and Ramsay Health Care (ASX:RHC).

Record month and signs of a rotation to value

November was a very strong month for the Australian Stock Market and markets globally. We saw a strong rotation into value stocks and we're a value manager, so we saw the benefit of that in all our strategies. All our strategies outperformed. And the reason for that is the market is anticipating an economic recovery and that's where value does really, really well. So, if you look at some of our stock portfolio holdings, Oil Search (ASX:OSH) was up 40% in the month, Fletcher Building (ASX:FBU) up 39%, Event Hospitality (ASX:EVT) up 30%. These are companies that are very sensitive to better economic growth, and we're starting to see that manifest in share prices and earnings in time.

2021 Outlook

The Aussie economy is robust at the moment, and we believe that will continue. Consumer confidence is high, house prices are holding in, and that holds us in good stead as value investors. So, we think that the outlook is quite healthy.

A resurgence in mergers and acquisitions

One of the other things that I think will be interesting in 2021is that we've started to see the first signs of M&A in the market. And we think that's a continuing theme, especially for 2021. And most of the companies that we're seeing that are being taken over, or where there is corporate interest, are all these reasonably priced companies that the market doesn't think are too exciting, but actually are reasonable businesses. And that's really in our wheelhouse. We think that there will be an M&A cycle and we will see that in 2021. And we're starting to see that already across our portfolio.

It won't be a year without risks

What are the risks for 21? The risks are interest rates, I think there's a big complacency around the level of interest rates and people expecting them not to go up at all. Now that's a big X-factor for the markets but also the valuation of the market is quite high. When you look at industrials excluding financials for the ASX 200, it's at all-time highs, and obviously anticipating what we believe will be a recovery and a recovery in earnings also. The market is anticipating a recovery and so the risk is that the recovery doesn't take hold as we expect, and it doesn't manifest in earnings and then we get a sell off because valuations are high. Now, obviously it's a relative game and we are invested in companies that we believe are representing relative value, but we are also dependent and expecting an earnings recovery. And if that doesn't manifest there is risk to the market and to the market levels.

Value poised to benefit from an economic recovery

From our point of view as value investors, it's set up quite nicely and we think that being exposed as we are to domestic cyclical companies, and underweight US dollar owners, we think that it holds us in good stead for the year ahead. And value always outperforms out of any downturn. We saw that during the GFC, and we believe that we are starting to see that rotation now. So, again our focus doesn't change, we're looking for high quality companies with good management teams, conservative balance sheets that are reasonably priced.

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