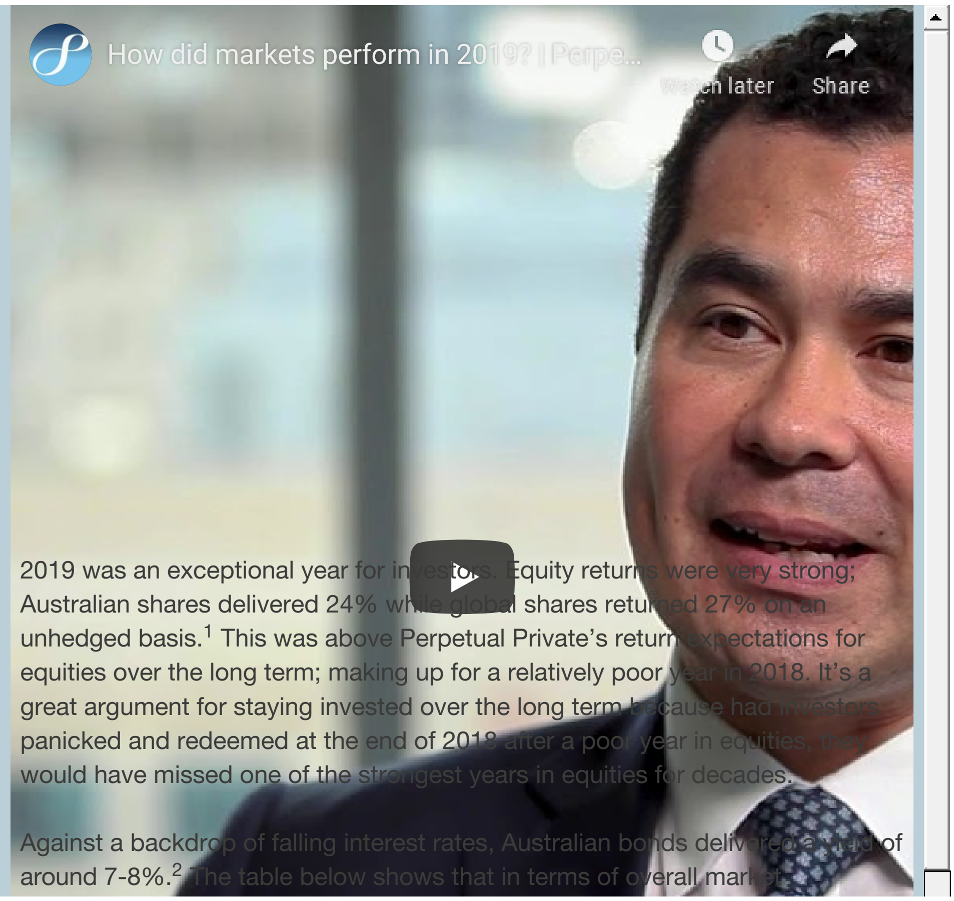
WHAT TO EXPECT IN 2020: INVESTMENT TRENDS TO WATCH

PERPETUAL PRIVATE INSIGHTS
05/03/2020

It was a shaky start to 2020. We've seen early in the year with the Corona virus that market events can come out of left-field; contributing to an uncertain and volatile investment environment. In this article, Kyle Lidbury, Head of Investment Research at Perpetual Private discusses some of the known investment themes and provides an outlook for markets in 2020 which may include some 'unknowns'.

HOW DID MARKETS PERFORM IN 2019?



2019 was an exceptional year for investors. Equity returns were very strong; Australian shares delivered 24% while global shares returned 27% on an unhedged basis.[1] This was above Perpetual Private's return expectations for equities over the long term; making up for a relatively poor year in 2018. It's a great argument for staying invested over the long term because had investors panicked and redeemed at the end of 2018 after a poor year in equities, they would have missed one of the strongest years in equities for decades.

Against a backdrop of falling interest rates, Australian bonds delivered a yield of around 7-8%.[2] The table below shows that in terms of overall market performance. 2019 was a good year all around for investors, with the exception of cash, delivering a negative real return (i.e. after inflation) with cash rates at historic lows.

Financial market returns, as at 31 December 2019

Asset class	Index	12-month (%)
Australian shares	S&P/ASX 300 – TR	23.8
Global shares	MSCI ACWI - NR (unhedged)	26.8
Global property trusts	FTSE EPRA/NAREIT Developed (Unhedged)	22.1
Australian bonds	Bloomberg Ausbond Composite	7.3
Cash	Bloomberg Ausbond Bank Bills	1.5

Source: FactSet, Perpetual Private

WHAT IS THE OUTLOOK FOR MARKETS IN 2020?

Reflecting on 2019, we saw a considerable decline in economic activity within China due to the China-U.S. trade war, which also had knock-on effects to other export-oriented economies such as Germany. However, even just some small resolutions on the trade front was enough to restore confidence in markets, contributing to a strong equity market rally during the fourth quarter of 2019.

As we come into the start of 2020, the outlook for markets remains positive with economic indicators pointing towards continued strength and tailwinds for corporates. However, there's always the potential for unknown 'unknowns' and this year, the outbreak of the corona virus (or COVID-19) in China has caused markets to experience heightened volatility, with a significant sell-off during the last week of February 2020. We expect that this situation will continue to unfold as the health crisis plays out, with the full effect on markets yet to be seen. Despite this uncertainty, we continue to encourage clients to remain exposed to risky assets and have confidence to stay invested. Focusing on long term goals and staying the course is usually the best approach during uncertain times.

WHAT ARE THE TOP PERFORMING SECTORS?

For the past five years, unhedged global equities have outperformed Australian equities on average. However, investors should note that currency has contributed around 4% p.a to this outperformance, as the Australian dollar has depreciated relative to overseas currencies over that period of time.[3]

Outside of the currency effect, two sectors that have seen significant outperformance are:

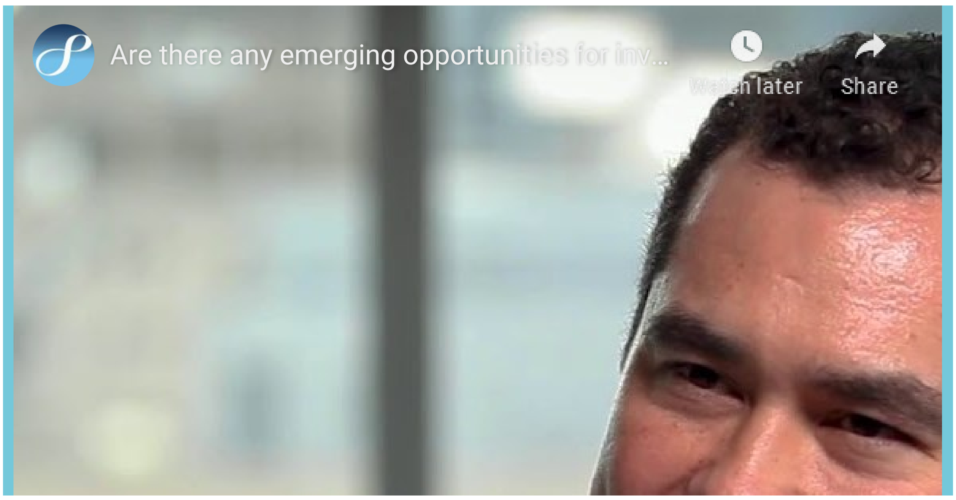
- **Health care**. An ageing population combined with the increased prospect of spending in this space has seen this sector perform exceptionally well. In Australia, stocks like CSL and ResMed have been big drivers of return.
- **Technology**. We've seen an enormous surge in growth of the value of technology stocks as investors speculate about the significant uplift in revenues that these stocks have the potential to generate over the short to medium term.

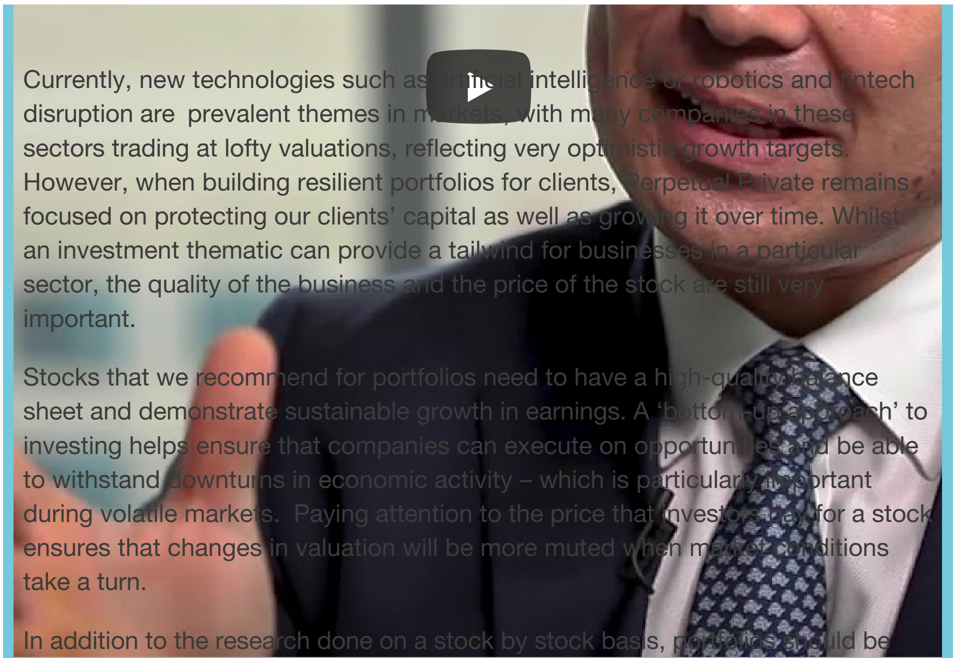
Note: While these sectors have driven a lot of the performance in equities, historical performance is not a reliable indicator of future performance.

The Australian sharemarket provides limited exposure to these sectors. While there are a handful of names in healthcare and technology, more than half of the Australian sharemarket is comprised of financial and resources stocks, when measured by market-cap weighting.

It's important for investors to be aware that not considering global equities as part of a balanced portfolio means potentially missing out on opportunities to participate in a broader range of stock returns from these high-growth sectors.

WHAT ARE THE EMERGING OPPORTUNITIES?





Currently, new technologies such as artificial intelligence or robotics and fintech disruption are prevalent themes in markets, with many companies in these sectors trading at lofty valuations, reflecting very optimistic growth targets. However, when building resilient portfolios for clients, Perpetual Private remains focused on protecting our clients' capital as well as growing it over time. Whilst an investment thematic can provide a tailwind for businesses in a particular sector, the quality of the business and the price of the stock are still very important.

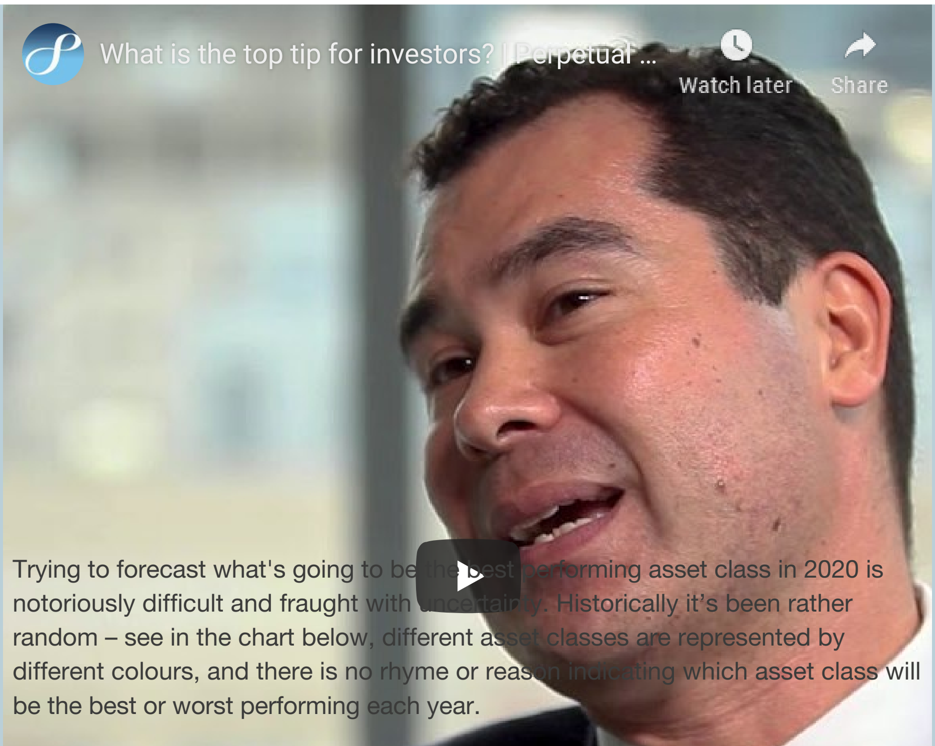
Stocks that we recommend for portfolios need to have a high-quality balance sheet and demonstrate sustainable growth in earnings. A 'bottom-up approach' to investing helps ensure that companies can execute on opportunities and be able to withstand downturns in economic activity – which is particularly important during volatile markets. Paying attention to the price that investors pay for a stock ensures that changes in valuation will be more muted when market conditions take a turn.

In addition to the research done on a stock by stock basis, portfolios should be diversified across a broad range of asset classes and opportunities, ensuring that clients are not overly reliant on a single stock or asset class performing in order to achieve their objectives.

Private or illiquid markets – only just now growing in prevalence in the Australian funds management landscape – are an area where Perpetual Private has been investing on behalf of clients for over 10 years. Our proprietary alternative asset programs; the Growth Opportunities Fund and Income Opportunities Fund, provide clients access to a range of opportunities in private credit, private equity and other alternative unlisted strategies.

Despite how strongly markets have performed over the last decade, there are still pockets of opportunity where investment opportunities persist, particularly in illiquid or inefficient markets, where demand for capital outstrips supply. By providing access to a program that invests in these skill-based opportunities, Perpetual Private clients have been able to take advantage of differentiated return drivers; providing diversification to traditional equity market returns.

TOP TIP FOR INVESTORS IN 2020



Trying to forecast what's going to be the best performing asset class in 2020 is notoriously difficult and fraught with uncertainty. Historically it's been rather random – see in the chart below, different asset classes are represented by different colours, and there is no rhyme or reason indicating which asset class will be the best or worst performing each year.

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	13Y CAGR

EM Eq. 25.2%	Aus. FI 14.9%	EM Eq. 38.4%	Global FI 9.3%	Aus. FI 11.4%	A-REITs 32.8%	DM Eq. 47.0%	A-REITs 26.8%	A-REITs 14.4%	A-REITs 13.2%	EM Eq. 27.1%	G-REITs 4.8%	DM Eq. 27.9%	DM Eq. 6.7%
Aust. Eq. 16.2%	Global FI 9.2%	Aust. Eq. 37.6%	Aus. FI 6.0%	Global FI 10.5%	G-REITs 26.1%	Int. Eq. 42.5%	G-REITs 25.7%	G-REITs 11.6%	Aust. Eq. 11.8%	Int. Eq. 14.8%	Aus. FI 4.5%	Int. Eq. 26.8%	Global FI 6.7%
Cash 6.7%	Cash 7.6%	Port 12.3%	G-REITs 5.0%	Cash 5.0%	Aust. Eq. 19.7%	G-REITs 20.3%	DM Eq. 14.7%	DM Eq. 11.5%	EM Eq. 11.7%	DM Eq. 13.3%	A-REITs 3.3%	Aust. Eq. 23.8%	Int. Eq. 6.5%
Global FI 6.6%	Port -20.5%	A-REITs 9.6%	Cash 4.7%	Port -1.5%	EM Eq. 16.7%	Aust. Eq. 19.7%	Int. Eq. 13.9%	Int. Eq. 9.8%	Int. Eq. 8.4%	Aust. Eq. 11.9%	Cash 1.9%	G-REITs 22.1%	Aus. FI 5.9%
Port 5.2%	DM Eq. -25.3%	Global FI 8.0%	EM Eq. 4.3%	A-REITs -1.6%	Int. Eq. 14.7%	Port 16.7%	Global FI 10.4%	Port 5.3%	DM Eq. 8.0%	Port 8.8%	Global FI 1.6%	A-REITs 19.6%	Aust. Eq. 5.7%
Aus. FI 3.5%	Int. Eq. -27.2%	G-REITs 6.3%	Port 3.9%	DM Eq. -5.6%	Port 14.5%	EM Eq. 13.0%	Aus. FI 9.8%	Global FI 3.3%	Port 7.6%	A-REITs 6.4%	DM Eq. 1.4%	EM Eq. 18.6%	Port 5.6%
Int. Eq. 0.2%	G-REITs -34.7%	Int. Eq. 4.4%	Aust. Eq. 1.9%	G-REITs -6.5%	DM Eq. 14.4%	A-REITs 7.3%	Port 9.6%	Aust. Eq. 2.8%	Global FI 5.2%	Global FI 3.7%	Int. Eq. 0.6%	Port 17.2%	EM Eq. 4.9%
DM Eq. -2.1%	Aust. Eq. -38.9%	Cash 3.5%	A-REITs -0.7%	Int. Eq. -7.4%	Global FI 9.7%	Cash 2.9%	EM Eq. 6.9%	Aus. FI 2.6%	G-REITs 4.6%	Aus. FI 3.7%	Port 0.6%	Aus. FI 7.3%	G-REITs 3.9%
A-REITs -8.4%	EM Eq. -41.2%	Aus. FI 1.7%	Int. Eq. -1.1%	Aust. Eq. -11.0%	Aus. FI 7.7%	Global FI 2.3%	Aust. Eq. 5.3%	Cash 2.3%	Aus. FI 2.9%	G-REITs 2.2%	Aust. Eq. -3.1%	Global FI 7.2%	Cash 3.6%
G-REITs -16.9%	A-REITs -55.3%	DM Eq. 0.8%	DM Eq. -1.9%	EM Eq. -18.4%	Cash 4.0%	Aus. FI 2.0%	Cash 2.7%	EM Eq. -4.3%	Cash 2.1%	Cash 1.7%	EM Eq. -5.1%	Cash 1.5%	A-REITs 2.3%

Source: Factset, Perpetual Private

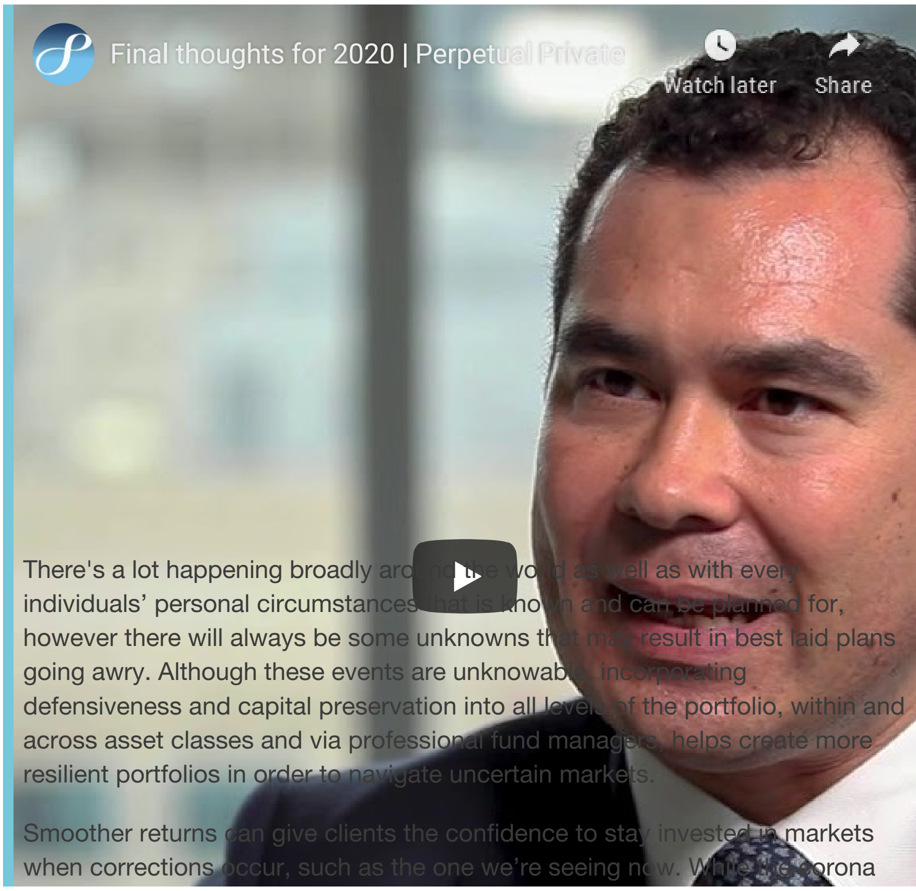
What's not as random is the diversified portfolio, investing across many asset classes, represented by the dark blue box in the chart above.

While a diversified portfolio may not be the best performer (relative to certain asset classes) in any one year, neither is it the worst performer. Typically, the portfolio travels through the middle of outcomes, navigating the extreme changes in market sentiment that can affect the performance of individual asset classes.

Trying to forecast the best performing asset class is subject to a myriad of possibilities and circumstances. At the start of 2020, it was generally viewed that the economy was going to be supportive for growth and equities would continue to perform well this year. Yet, just two months into the new year, the advent and spreading of corona virus would suggest that the case for equities to deliver strong returns is, at the very least, more uncertain.

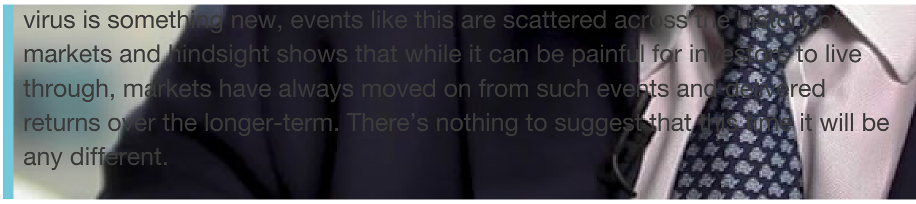
Having diversity across multiple asset classes helps account for non-forecastable events, which can contribute to a smoother return profile over time. It also allows Perpetual Private advisers to more effectively plan for client needs and objectives, as a smoother return profile lowers volatility and increases certainty of portfolio outcomes.

FINAL THOUGHTS



There's a lot happening broadly around the world as well as with every individuals' personal circumstances that is known and can be planned for, however there will always be some unknowns that may result in best laid plans going awry. Although these events are unknowable, incorporating defensiveness and capital preservation into all levels of the portfolio, within and across asset classes and via professional fund managers, helps create more resilient portfolios in order to navigate uncertain markets.

Smoother returns can give clients the confidence to stay invested in markets when corrections occur, such as the one we're seeing now. While the corona



virus is something new, events like this are scattered across the history of markets and hindsight shows that while it can be painful for investors to live through, markets have always moved on from such events and delivered returns over the longer-term. There's nothing to suggest that this time it will be any different.

1. Australian shares: S&P / ASX 300 Index, Global shares: MSCI Index (unhedged), as 31 December 2019
2. Australian bonds: Australian 10-year bond yield, as 31 December 2019
3. Comparison is based on S&P / ASX 300 Index to MSCI Index (unhedged), rolling over five years, as 31 December 2019