Australian Equity Monthly
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Australian market commentary

The S&P/ASX 200 Accumulation Index returned 10.2% during the month. Australian equities enjoyed a strong month (in fact, the best monthly return since 1992) on positive COVID-19 vaccine news, additional quantitative easing measures locally and increased certainty regarding the US presidential election result. There was a sharp rotation into value stocks and those deemed “COVID-19 losers” also saw strong support. Australian equities kept pace with developed markets during the month. In major global developed markets, the DJ Euro Stoxx 50 was up 19.3%. Japan’s Nikkei 225 was up 15.1%, the UK’s FTSE 100 was up 12.7% and the US S&P 500 was up 10.9%.

The Reserve Bank of Australia (RBA) delivered a rate cut and additional quantitative easing to support the recovery at its 3 November meeting. The cash rate was cut from 0.25% to 0.10%, as was the 3-year yield target. The RBA also announced that it would purchase AUD100 billion of government bonds (largely around the 5- to 10-year maturities) over the next six months.

Domestic economic data releases in November were mostly upbeat. Employment rose by 178,800 positions in October, significantly exceeding market expectations for a fall in employment. The unemployment rate ticked up to 7.0%, which was also better than expectations. The NAB Survey of Business Conditions showed improvement, rising to 1 in October (from 0 the previous month), with business confidence also turning positive, rising to 5 (from -4). Retail sales were down 1.1% in September. National CoreLogic dwelling prices saw a second consecutive monthly rise in November, ending the month up 0.8%.

Capital raisings continued in November. Insurance Australia Group raised AUD 750 million in capital to strengthen the balance sheet in response to losing their business interruption insurance test case in NSW. GUD Holdings also raised capital totalling AUD 70 million in order to fund its acquisition of AMA Group’s Automotive Components and Accessories division.

Sector returns were largely positive in November. The best performing sectors were energy (28.5%), financials (16.1%) and communication services (13.6%). Real estate (13.6%) and industrials (12.3%) also outperformed the broader market. Consumer discretionary (8.5%), materials (7.3%), information technology (4.6%), healthcare (2.7%) and utilities (1.5%) lagged the market. Consumer staples (-0.7%) was the worst performing sector and the only one to post negative returns.

Energy was the best performing sector on the back of stronger oil prices as the prospect of successful COVID-19 vaccines saw improved future demand prospects for oil. Woodside Petroleum (27.7%), Santos (30.2%), Origin Energy (29.5%) and Oil Search (41.6%) were the key drivers of sector performance.

The financials sector continued its outperformance from the month prior, driven by strong performance from the big four banks: National Australia Bank (24.7%), ANZ (22.2%), Commonwealth Bank (14.6%) and Westpac (14.1%). Banks benefitted from the value rotation together with reduced tail risks around the credit cycle following a fall in deferred mortgages and SME loans.

Communication services also outperformed. Key drivers of outperformance included Telstra (14.5%), REA Group (22.8%) and Seek (21.1%).

The Healthcare sector underperformed as defensives lagged the market. Underperformance was led by Sonic Healthcare (-5.4%), Ansell (-6.9%) and Pro Medicus (-8.8%). Sector heavyweight CSL (3.4%) also lagged the market. The utilities sector underperformed with APA Group (-1.3%) and AusNet Services (-4.9%) posting negative returns. AGL Energy (8.2%) and Spark Infrastructure (3.2%) also lagged the broader market.

The consumer staples sector was the worst performing sector. Key detractors included Woolworths (-3.1%), Treasury Wine Estate (-6.3%) and Elders (-5.4%). Treasury Wine Estate fell as Chinese tariffs on certain categories of wine were announced on 27 November. The company admitted demand from China would be extremely limited if the tariffs remain in place.

Australian market outlook

The ongoing global COVID-19 situation remains fluid with countries such as the US experiencing record high COVID-19 fatalities, while many European countries are back in lockdown due to second and third waves. Meanwhile Australia and other countries are emerging from lockdowns. The hopes of a vaccine solution by late 2020 or early 2021 to help allow a pathway back to normality became clearer in November. We now have three vaccine candidates from Pfizer, Moderna and AstraZeneca that look promising together with Chinese and Russian vaccines that are also touted as being successful.

The prolonged period of elevated risks appears to be reducing as uncertainties around COVID-19, the global trade war and US election —to name a few—are clearing up. We always believed that two conditions precedent were required for the value rotation to take hold: clearing the US election and positive news on either a vaccine or therapeutic protocols. Both occurred in the same week in early November, spurring a market rally and sharp rotation into value.

The global business cycle continues to surprise on the upside with strong Purchasing Manager's Index (PMI) and Institute of Supply Management (ISM) data helped by the unprecedented and quick government interventions. With vaccines on the horizon, economies are likely to start the long road of recovery out of the pandemic-induced economic shock.

Interest rates have essentially been anchored by central bank intervention globally while inflation expectations are showing a recovery from low levels. This setup has historically been positive for value as bond yields trickle up, resulting in a steepening of the yield curve.

M&A is likely to be part of the recovery process given the low interest rate environment, and cash position of private equity and corporates. The earnings yield to debt yield gap remains wide and thus corporates can buy earnings growth very cheaply with debt.

The banks appear to be well provisioned and we expect increased profits and dividends going forward over the next few years.

Despite the recent rotation and thus sharp rally in value, it has still materially underperformed growth over the past 12 months and has a long way to reverse this underperformance. We have seen in the past that value typically outperforms for at least 12 months after a major trough in earnings.

The tough decade for value investors has created attractive investment opportunities that a well-disciplined value investor can harness. Our process is well positioned to take advantage of the opportunity set that requires a long-term investment horizon that looks through the current uncertainty, and a detailed bottom-up focus that identifies attractively priced companies that we believe are positioned to be rewarded in the economic recovery.

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