Tactical Thoughts – November 2020

The 2020 US election is finally over and a new President has been declared. Joe Biden was announced as the President-elect of the United States, along with Kamala Harris as his Vice President-elect. This is a historic moment for the US with the Democratic Party candidate, Joe Biden winning the most votes ever after a very close election which the sitting Republican President, Donald Trump, is yet to concede. Biden is set to be inaugurated on Wednesday January 20, 2021.

While legal challenges and recounts leave some uncertainty, it looks likely that the Senate will remain Republican, thus the prospect of a so-called 'Blue (Democratic) Wave' has dissipated. This may make it challenging for Biden to accomplish large scale stimulus once he is in the White House. Nevertheless, expectations are as much as a US$1 trillion stimulus package, which could potentially be enacted even before January's inauguration. This is materially less than what might have been seen under a Democratic sweep, but it should be sufficient to boost US economic growth in the coming quarters even with the rapidly growing numbers of Covid-19 infections. Wealthier Americans also face the prospect of higher taxes, but we think steading the ship will be Biden's first priority and changes in tax policy are likely to be announced later.

We expect limited impact in the short term internationally from a Biden win apart for possible US dollar weakness. Many commentators are saying he will re-join the World Health Organisation (WHO) and re-engage on the Trans-Pacific Partnership (TPP), but the new President is likely to focus most of his efforts in his initial months on domestic issues. Looking further out, a Biden victory is a great signal to markets that climate change is of key importance, and we expect investments and regulation to move to favour renewable energy sources and better protection of the environment.

New Zealand equities posted another month of gains in October and now are up +5.2% for the year to date. Key drivers last month included strong performance from the retirement sector, logistics companies and retail property as domestic confidence and activity continued to improve. The first three weeks of the month saw the market post strong gains of +6.2%, but this unwound in the final week due to an off-shore sell-off sparked by a looming US election and virus case numbers putting the UK, Germany and France back into lockdown.

The Labour Party achieved a major victory in the general election enabling them to form the first majority Government since MMP was introduced in 1993. We see little change to the current trajectory, with fiscal and monetary policy likely to continue to underpin New Zealand's economic recovery. Domestic economic data continues to improve as we seem to have moved past the worst of the Covid-19 pandemic. The ANZ Business Confidence Index improved its deep deficit by almost half from -28.5 to -15.7 for September, while the BusinessNZ Manufacturing PMI followed suit to a reading of 54.7, now 4.7 points above the neutral 50-point line.

Australian stocks rose +1.9% in October, but were flat in NZ$ terms. The rise was driven by banks and the tech sector and a couple of high-profile takeover announcements also boosted sentiment. We believe the RBA cutting the cash rate to a record low of 0.10% on November 3 is a positive for Australian equities. Consumer and business confidence is rising which is manifesting itself in improved earnings and dividend expectations. We expect these trends to continue over the coming months as state (and international) borders reopen, stimulus measures kick in and monetary policy remains accommodating.

Strong gains for the S&P 500 early in October were subsequently given up as renewed concerns around increasing infections took hold. Daily coronavirus cases in the US increased throughout the month to over 80,000 per day and have continued to escalate into November.

Europe equities sold off in October after a second wave of the Covid pandemic hit the economic block with all major economies reporting record spikes in infections. Governments across the continent and the UK had imposed local restrictions to avoid national lockdowns but sadly following the summer this approach appears to have had limited success. Many governments have now implemented harder measures which has caused high-frequency data of European activity to move lower. Survey data also highlights a recovering manufacturing sector, but a slowing service sector, which is once again subject to restrictions. As a consequence, European equities delivered negative returns over the month with Germany, the noteworthy laggard.

Brexit has not gone away either and no deal was struck at the European Council meeting in mid-October. This meeting had previously been seen as a key deadline and after a brief pause, talks have resumed with both sides seeking to agree a trade deal before year end. UK equities felt the brunt of the indecision and combined with a new strict lockdown being announced, weak investor sentiment pushed the benchmark FTSE 100 index down -4.9% in £ terms. With two sizeable headwinds against it, we remain cautious on both UK equities and Sterling.

China finally relaxed some of their harsh internal controls restricting travel between provinces that had been in place since the outbreak. This so far has pleasingly not led to a resurgence in cases. China's success in controlling the virus has allowed its economy to recover strongly, achieving +4.9% year on year for third-quarter GDP which many countries across the world would be envious of at this time. Joe Biden as the next US president will likely mean more predictability and openness regarding foreign policy towards China and renewed engagement in Sino-US relations, both of which are positive catalysts.

Now that the US election is over, investor focus is likely to shift back towards delivery of a safe and effective vaccine. The news on November 10, that Pfizer has developed a vaccine with 90% efficacy, is a very positive development and we have seen equities meaningfully rally as a result. Covid-19 has fast-forwarded many investment trends but the longer-term outlook for equities is strong. A surge in new cases and/or the implementation of new lockdowns highlight that risks are always present. **Either way pandemic dynamics continue to act as a major driver of asset price returns**.

Recommended Tactical Asset Allocation

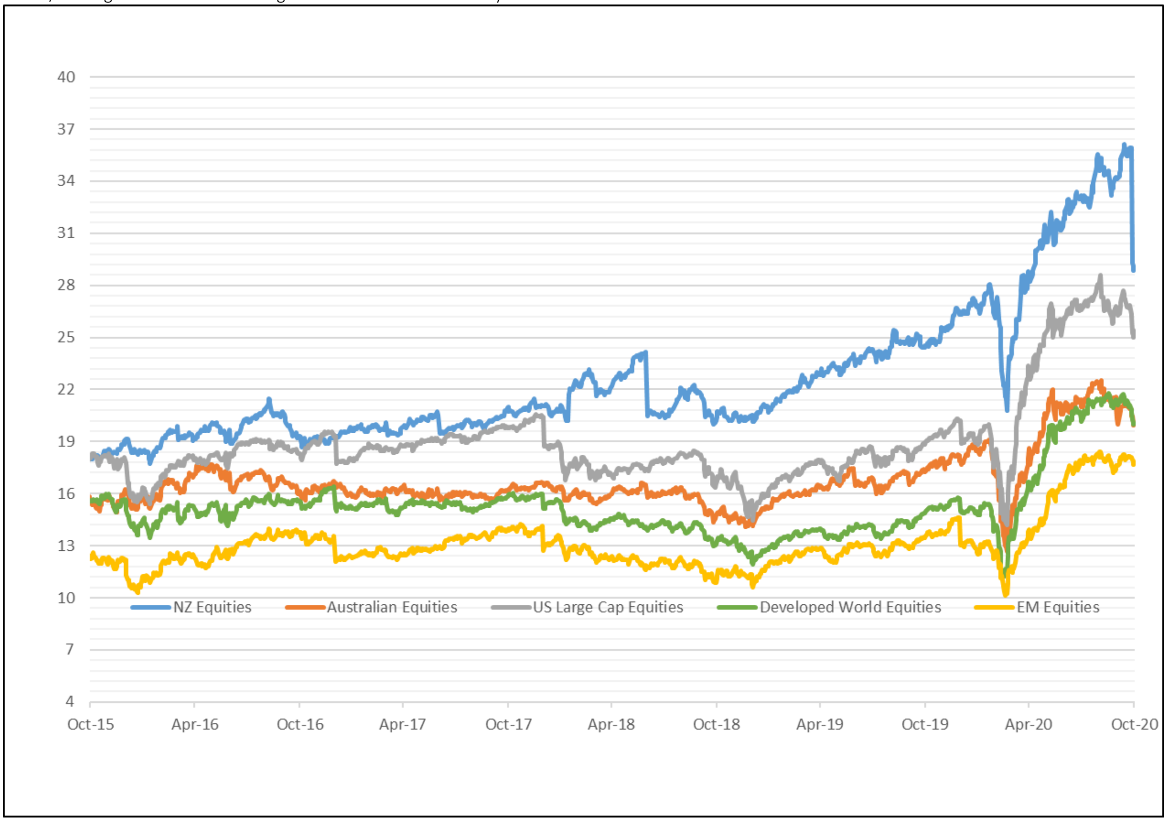
Underweight □□■□□ **Overweight**

Asset Class	Tactical	Rationale
NZ Equities	□□□■□	Labour’s decisive victory means political stability and little change to the status quo. Given the country’s success with Covid, we stay Moderately Overweight.
Australian Equities	□□■□□	With Victoria now out of lockdown, the RBA lowering interest rates and the likelihood of a domestic lead recovery, we are Neutral on the outlook.
US Large Cap Equities	□□■■□	With Biden elected President, markets can move forward. Volatility and sector rotation risk remain but overall we remain constructive.
US Small Cap Equities	■□□□□	Small caps continue to lag and clients should have the bulk of their US exposure in large caps.
Developed World Equities	□■□□□	Europe and the UK battle second waves of Covid-19 and with the overhang of Brexit continuing we prefer staying Moderately Underweight.
EM Equities	□□■□□	We remain selective with a preference for economies who can minimise the health and economic impacts of Covid-19. Chinese equities stand out in this regard.
NZ Listed Property	□□□■□	With low interest rates and a reasonably defensive yield we stay constructive on Listed Property.
Fixed Interest	□□■□□	The new issue market has re-opened and the retail bond pipeline looks healthy. We favour allocating to the primary market on an issue by issue basis.
Cash	□■□□□	While we have reduced cash in recent weeks, we see some trimming in client portfolios and cash building up in some cases. Expectations for an effective vaccine is impetus to begin to re-deploy.

Market Price Earnings ratios

Price Earnings ratios 2015 – 2020*

*Price/Earnings Ratios are Bloomberg Best estimates for forecast year one.



Price Earnings ratios versus average*

Price Earnings*	NZ Equities	Australian Equities	US Large Cap Equities	US Small Cap Equities	Developed World	EM Equities
As at 31 October	28.8	19.9	25.0	32.4	20.0	17.6
10-year average	19.5	15.5	17.1	28.8	14.3	12.2
5-year average	22.6	16.7	19.0	33.8	15.2	13.1

*Price Earnings ratios are Bloomberg Best estimates for forecast year one.

FX Returns to 31 October 2020

NZ$ FX performance percentage returns to 31 October 2020

Currency Pair	1m	3m	6m	12m
NZ$/ US$	0.0%	-0.2%	8.0%	3.1%
NZ$/ AU$	1.8%	1.4%	0.0%	1.1%

Source: Eikon, Bloomberg, November 2020.

Index Returns to 31 October 2020

Index percentage returns in their currency

Asset Class	Index		1m	3m	6m	12m
NZ Equities	S&P/NZX 50 Gross	NZ$	2.9	3.0	14.7	12.0
Australian Equities	S&P/ASX Accumulation 200	AU$	1.9	1.0	8.7	-8.1
US Large Cap Equities	Russell 1000 Total Return	US$	-2.4	0.9	15.0	10.9
US Small Cap Equities	Russell 2000 Total Return	US$	2.1	4.2	18.1	-0.1
Developed World Equities	MSCI EAFE*	US$	-4.1	-2.2	7.4	-9.0
EM Equities	MSCI EM*	US$	2.0	2.3	19.3	5.9
NZ Listed Property	S&P/NZX Property Gross	NZ$	5.9	12.0	23.5	4.2
Fixed Interest	S&P/NZX Corporate A	NZ$	0.2	1.4	2.9	5.8
Cash	ANZ New Zealand Call Rate	NZ$	0.0	0.1	0.1	0.5

Source: Eikon, Bloomberg, November 2020 (*not total return index).

Index percentage returns translated into NZ$

Asset Class	Index	1m	3m	6m	12m
NZ Equities	S&P/NZX 50 Gross	2.9	3.0	14.7	12.0
Australian Equities	S&P/ASX Accumulation 200	0.0	-0.4	8.8	-9.2
US Large Cap Equities	Russell 1000 Total Return	-2.2	1.4	6.9	7.5
US Small Cap Equities	Russell 2000 Total Return	2.4	4.7	9.9	-3.1
Developed World Equities	MSCI EAFE*	-3.8	-1.8	-0.1	-11.7
EM Equities	MSCI EM*	2.2	2.7	11.0	2.7
NZ Listed Property	S&P/NZX All Real Estate	5.9	12.0	23.5	4.2
Fixed Interest	S&P/NZX Corporate A	0.2	1.4	2.9	5.8
Cash	ANZ New Zealand Call Rate	0.0	0.1	0.1	0.5

Source: Eikon, Bloomberg, November 2020 (*not total return index).

Macquarie Interest Rate and FX Forecasts

Rate	3Q2020A	4Q2020E	1Q2021E	2Q2021E	3Q2021E
Australia Cash Rate	0.2500	0.2500	0.2500	0.2500	0.2500
Australia 10yr govt	0.7873	0.9000	0.9000	0.9500	1.0000
US Fed Funds Rate	0.0000	0.0000	0.0000	0.0000	0.0000
US 10yr Treasury	0.6840	0.8000	0.9000	1.2500	1.4500
NZD OCR	0.2500	0.2500	-0.2500	-0.5000	-0.5000
NZ 10yr govt	0.5020	0.6000	0.6000	0.6500	0.6500
NZ$/ US$	0.6617	0.6700	0.6600	0.6600	0.6700
AU$/ US$	0.7162	0.7400	0.7400	0.7500	0.7600
NZ$/ AU$	0.9240	0.9054	0.8919	0.8800	0.8616
EUR/ US$	1.1721	1.2200	1.2100	1.2000	1.1900
US$/ JPY	105.48	103.00	104.00	105.00	105.00
GBP/ US$	1.2920	1.3400	1.3600	1.3700	1.3900

Source: Macquarie Securities, November 2020.

Stock in Focus – Laybuy Holdings (LBY ASX)

Our stock in focus this month is Laybuy Holdings (LBY), a leading provider of Buy-Now-Pay-Later (BNPL) services in New Zealand, with a growing presence in the UK which is set to become its largest market. The company listed on the ASX in September, and we were fortunate to have the Founder and CEO, Gary Rohloff, discuss the exciting opportunities that lie ahead.

Laybuy's technology allows customers to pay for retail purchases in interest free instalments over six weeks for both online and in-store purchases through participating retailers. The company now has over 6,100 merchants and 542,000 active customers, and has seen significant growth arising from the Covid-19 pandemic and the shift to online sales.

In February, Laybuy partnered with MasterCard to issue digital cards through its mobile based app and pay for transactions anywhere that MasterCard is accepted. Laybuy differentiates itself from other providers by its six weekly instalments, never charging interest, and not being available in grocery or liquor stores. The company also offers a compelling addition, Laybuy Boost, which allows customers to increase the value of their purchase but with no additional credit risk to Laybuy.

The UK market is in its infancy in terms of BNPL and Laybuy has several strategic retail partnerships in place, including with Premier League teams, JD Sports and WH Smith. Fraud has been a larger than expected risk in the UK as the company expands but partnerships with first-class credit check and anti-fraud providers has significantly reduced these risks of late.

Coming into Christmas, we are a little cautious on the company given the UK implemented a strict lockdown in the days following Gary's presentation. That being said, this Christmas will be vital for retailers to generate sales after an extremely challenging year and Laybuy's customer funnel is well placed to drive Gross Merchandise Value and Net Transaction Margin which are two key operating metrics. Laybuy is currently not profitable but it is still in land grab mode particularly in the UK where they compete head-to-head with the two other major BNPL providers.

Macquarie or Hobson Wealth do not provide equity research on the company at this time. Given its risk / return profile, we do expect Laybuy shares to appeal to a wide number of Hobson Wealth clients, but if you would like to learn more please reach out to your adviser.

Bond and Currency Markets not the signal they once were?

Mark Fowler – Head of Investments

In the past, there was a near universal consensus that bond and currency markets are much better at reading the macro-economic picture impacting financial markets, and thus can be a useful guide for equity investors when assessing risks and the direction of share markets.

Currently, if we were to look at equity markets you wouldn't guess that many industries will be either permanently impaired or face prolonged recoveries or that political and social risks are rapidly rising. High yielding debt instruments (riskier bonds) are now back to some of their lowest levels in yield and currency markets have been stable with little in the way of price volatility.

Does it mean therefore that there are no risks on the horizon, and neither COVID nor the US elections, China nor Brexit are likely to disturb markets? The answer I would have thought has to be no. Risks are ever present but divergences between markets and reality are common, and in fact, markets have known to be wrong from time to time! However, today, this must be adjusted for by the role that governments now play in modern asset-based economies. In the past, divergences were due to market psychology and incomplete information; but now there are other factors.

First, we are now highly indebted, with global debt exceeding ~3 times and financial assets ~5 times GDP. This implies that capital markets are now the dog and real economies are merely the tail, and what happens in that 'cloud of finance' determines the reality. It is government intervention on steroids.

Secondly, Bond and Currency markets are no longer 'signals', but interpreters of government responses, and their current signalling is that neither defaults, price discovery nor volatility can be permitted while an inflationary surge is unlikely.

Global Debt (US$ trillion, % GDP)

	Households	Non-Financial Corporates	Financial Corporates	Government	Total
US$ trillion					
1990	10	10	7	10	37
2000	17	24	24	21	86
2007	35	43	54	35	167
1Q2020	48	76	64	70	258
% of GDP					
1990	41%	41%	29%	41%	151%
2000	44%	72%	59%	55%	230%
2007	58%	76%	87%	58%	279%
1Q2020	62%	95%	84%	91%	331%

Source: IIF

In the initial aftermath of Covid, many market commentators were predicting residential house prices in New Zealand to be down somewhere in the region of ~10-15%. The market then witnessed the large-scale government response and now we are hearing reports that this same market could move higher in 2021 by as much as ~10%.

It is now governments and central banks that stands between the chaos of falling asset prices, job losses and consumption. Bond and Currency markets are no longer the signals they once were. In an environment of non-existing signals, sticking with portfolios makes sense.

*This article was published in the NZ Herald on November 2, 2020.

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