OUTLOOK FOR FINANCIAL MARKETS as at 1/12/20

Economic Outlook

Positives
- Record low interest rates.
- Low inflation.
- Central Banks mandating exceptionally low interest rates (*as mentioned above*) and conducting "Quantitative Easing" (*money printing of a sort*) in order to keep long term interest rates low.
- Massive Government Fiscal support from all countries.
- Vaccines and other treatments for COVID closer to reality.

Negatives:
- Higher unemployment and underemployment.
- Lower economic output than pre COVID.
- Reduced global trade / increased protectionism – might improve with Biden replacing Trump
- Specific to Australia is China Vs Australia.
- Global pandemic.

Financial Market Outlook

Cash (*Australian*)

Interest rates for on call accounts are virtually zero and on Term Deposits are 0.6% per annum or less in most cases.

Fixed Interest

Fixed interest options are vast and varied, Fixed Rates or Variable, short or long term. Globally the fixed interest markets are much larger than share markets and options come in all shapes and sizes – Government Bonds, Semi Government Bonds, Corporate Debt / Credit, Mortgage or Asset Backed Securities, Structured Loans (*such as CLO's & CDO's*), High Yield and Emerging Market Debt. And then there is Private Debt i.e. direct loans than aren't listed on a trading platform such as the ASX. Further risks or opportunities to add value exist with global fixed interest due to currency fluctuations vs the $Australian. Basic interest rates are mostly historically low (*especially Government Bonds*) but in a relative sense there are still same higher rates (*without taking on too much risk*) for those prepared to cast a wide net. Fixed Interest returns come from 4 main sources:

1. The interest paid.
2. Gain or losses in the traded price of various fixed interest securities – mostly increases in interest rates determined by the market is a result of falling prices and vice versa.
3. For global fixed interest exposure there maybe gains or losses due to currency fluctuations.
4. Various trading strategies using futures, options and short selling.

I think it is still possible to eke out an OK return from fixed interest investments without taking on too much risk, provided the investments are carefully selected and actively managed. I think it should be possible to generate returns of 3% to 5% per annum.

Shares (*both Australian and Global*)

My view on the *outlook for shares is fairly simple. From my observations some shares are very expensive (and should be avoided*), some are around fair value, and some are cheap to varying degrees. I think it is possible to generate good returns from investing in shares, provided the portfolio is actively managed by skilful experts and does not follow or is not influenced by various share indices – because a share index represents a cross section of all shares in a particular category (*such as the largest 200 companies*) which by default means it includes all the really expensive shares and also those companies that will perform really poorly moving forward. We live in a time of great change there will be many opportunities for businesses to do very well while at the same time some businesses, if they aren't agile enough will stagnate or drift into a steady decline or in few cases just simply not survive.

Property (*both Australian and Global*)

Similar to my outlook for shares, in the current environment, I think there will be property investments that do poorly, some that do ok and some that do quite well. The key is to be selective in which properties you invest in and by extension which property funds you choose to manage your property exposure. In some senses it is fairly simple – you should look for properties with the following characteristics:

- Quality property in a good location for the type of property it is. Preferably buildings that are not too old.
- Financially strong tenants who will have no problems paying the rent. E.g. Government departments, Large Corporations (*e.g. BHP, Westpac, Woolworths etc.)*
- Low or zero vacancies.
- Long term leases, with automatic annual rental increases and tenant to cover all the outgoings.
- Low gearing. i.e. borrowings to purchase the property being less than say 40% of the property's valuation.
- Good starting yield (*income return to investors*) of around 6% or more.

Property exposure can be achieved by investing in direct property funds (*which may have some withdrawal limits or be for fixed terms*) or can be via property funds that are listed on stock exchanges or managed funds that invest in listed property funds. At the beginning of 2020 I would have said that on average listed property was relatively more expensive than the equivalent direct property but since the COVID induced sell off in February and March (*and subsequent partial recovery*) listed property now seems better value than it was and on a par with unlisted direct property.

With the right exposure to commercial property (*some retail, office, industrial, medical, social infrastructure*) I think it should be possible to earn an income yield of at least 5% per annum (*or more*) and some capital growth over the medium term.

Private Equity (*investing in unlisted businesses*)

I think the outlook for investing in this category is good if you choose the right manager and structure, such as:

- Partners Group Global Value Fund, and
- Ellerston JAADE Australian Private Assets Fund

These type of investment over the medium and long term should be able to earn you at least 8% per annum or more. They should also be less volatile than shares listed on stock exchanges. The quid pro quo is that redemptions take longer – up to 3 months in normal circumstances.