

EXECUTIVE SUMMARY

- Following extreme volatility in H1, the ASX200 index consolidated through the September quarter
- Long term performance is driven by long term trends. Technology, Healthcare, Renewable energy, Electric Vehicles continue to gain traction
- Growth has long outperformed Value. This may reverse during an Expansion phase
- Leading Indicators are pointing to a global expansion, a positive for earnings growth and equities
- Valuations around 20X forward earnings are fair, given current interest rates and inflation
- Regardless of the US election outcome, further stimulus is expected in the US & elsewhere in 2021
- Investment strategy remains balanced between Growth (Tech, Healthcare), Defensive (Cons Staples, Logistics, Gold) & Cyclical (Banks, Resources, Travel, Gaming)

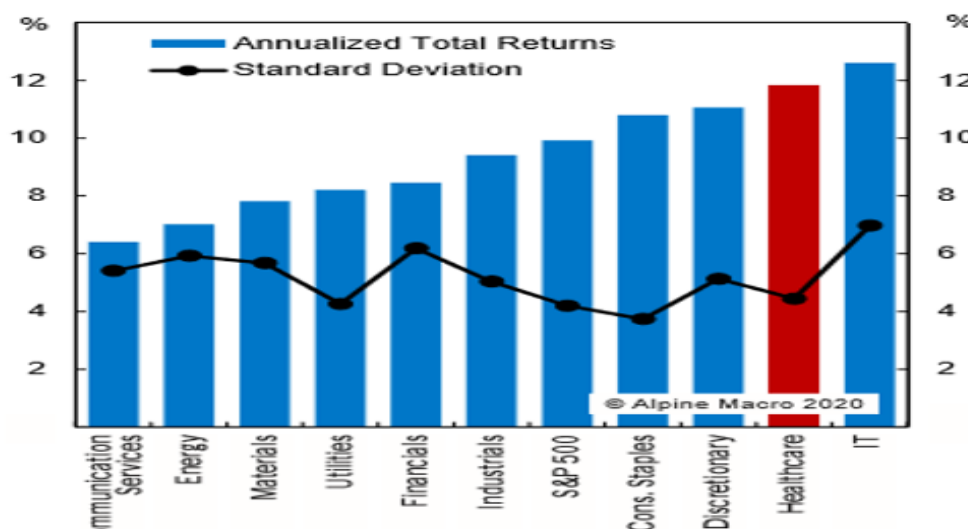
In contrast to the first two quarters, the third quarter finally provided investors a period of relatively stable trading conditions. The ASX200 delivered a total return of -1%. As a portend to some of the longer term trends discussed below, the best performing sector was Information Technology up 10.8%, and Energy the worst, down 13.9%. Financials and Utilities were down 7% and 8.4% respectively, and Materials and Healthcare were both marginally higher. Our defensive portfolio stance has resulted in most portfolios at least performing in line with benchmarks over the quarter and significantly ahead over the last 12 months.

Long Term Trends Drive Long Term Investment Performance

Over the last three decades, long term outperformance has been the domain of Technology, Healthcare and Consumer sectors. More cyclical sectors such as Energy, Materials and Financials have underperformed.

Since the 1980's, Microsoft has been a global top ten stock (by market capitalization). Strong management have enabled the company to continually re-invest itself, to make it relevant to prevailing trends. Since 1989, the stock has delivered an annual total return of 23.5%. Finding the next Microsoft is our challenge!

Annual returns by sectors over the past 30 years



Calculations are based on monthly returns from 1990 to present

Source: Alpine Macro

Disruption has often been a key feature of mega trends. Today the transition away from fossil fuels to a low carbon energy mix will result in large scale change across the landscape. Some sectors and businesses will flourish, others will die. The rate of change could be faster than many expect. The UK has seen power produced from coal decline from over 30% in 2014 to less than 5% today. BP, in its recently released annual outlook, suggested that the peak in oil production may prove to be 2019, courtesy of Covid-19.

The percentage of global power produced from renewables has doubled since 2012, exceeding 10% in 2019. In Europe, renewables now account for more than 20%. Battery technology is evolving, with EV battery pack prices declining 87% since 2010 (Liebriech Associates). EV's are anticipated to be price competitive with ICE (internal combustion engines) vehicles before 2025, on an unsubsidized basis.

Investment implications associated with this are significant. Our suggested approach is via exchange traded funds such as the Global Clean Energy (ICLN) and the Global Lithium and Battery (LIT) ETF's. These offer a diversified exposure to leading stocks across the thematic. From a commodity perspective, we have a preference for copper, nickel, lithium and rare earths.

Growth v Cyclical: The Great Debate

Since the GFC in 2008/09, one of the most striking features has been overwhelming outperformance of Growth stocks relative to Value. Some of the factors behind this trend have included:

- Increasing dominance of Technology & Healthcare over Industrials & Manufacturing
- Transition to a more capital light Digital economy
- Declining interest rates & inflation leading to higher equity valuations
- Extended economic cycles, but low growth

Exhibit 32: Growth has outperformed since the GFC
Relative price performance in local currency

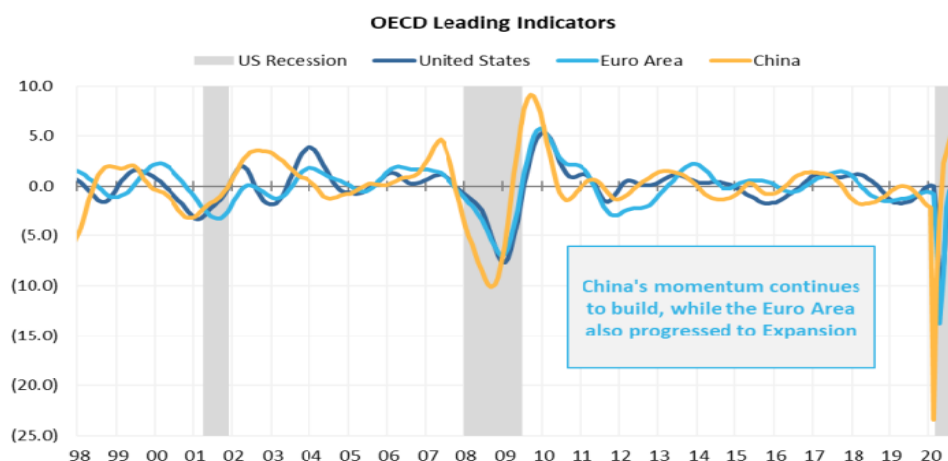


Source: Datastream, Goldman Sachs Global Investment Research

Following the economic meltdown experienced in 2020 and now a recovery, is there a case for increasing exposure to Cyclical? The Peak view is yes, but selectively. Our approach has been to hold quality growth stocks that have cyclical exposure. Stocks like James Hardie (US housing), Aristocrat (casinos), REA (property transactions), Seek (job ads) are examples. Similarly, resource majors such as BHP, RIO (and Fortescue) have cyclical exposure to China's recovery and commodity prices. We have also added to stocks negatively impacted by Covid-19 such as Sydney Airport and Flight Centre.

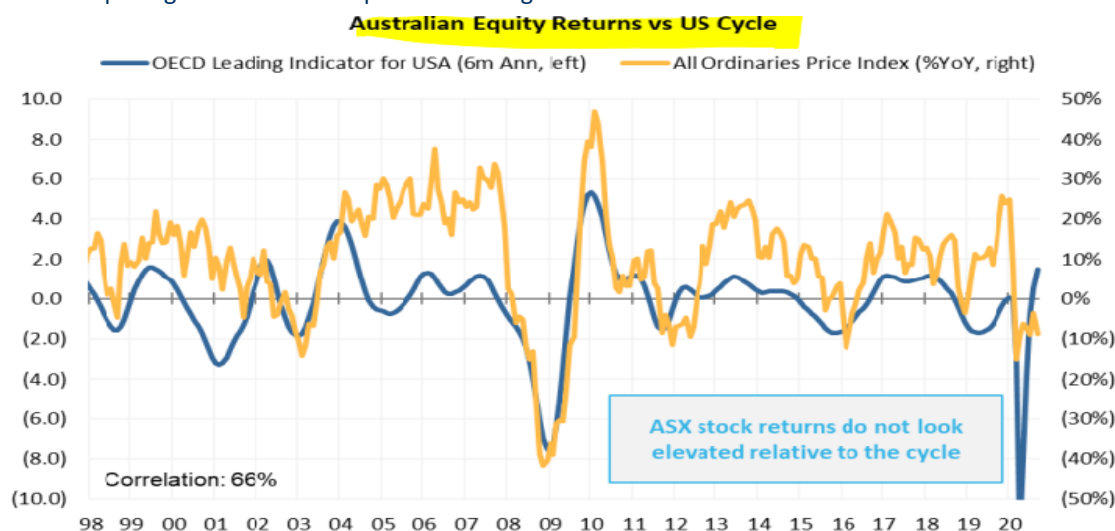
Leading Indicators Support the Case for Expansion

Recent evidence is supporting the case for a "V-shaped" recovery from the economic and equity market lows experienced during the first half of 2020. The following chart of the OECD Leading Indicator series offers a very constructive view that supports the case for expansion in the US, China and Eurozone.



Source: FactSet, Macquarie Research, October 2020

Macquarie Research recently highlighted the relationship between the OECD Leading Indicators for the US is closely correlated with equity returns of the Australian All Ordinaries index. With policy settings in Australia accommodative (especially post last week's Budget) and expansion in Australia's major trading partner-China-it would be surprising if this relationship didn't hold again.



Source: FactSet, Macquarie Research, October 2020

Prospects Favourable For 2021

While the US Presidential election will capture the headlines and, despite the hype and controversy surrounding the campaign, we are not convinced the actual result will have any major impact on financial markets. Both parties appear committed to “doing whatever it takes” to support the recovery that is underway both in America and elsewhere. While Covid-19 continues to provide a headwind, it is clear that it is being managed much more effectively. Death rates have fallen and prospects for a vaccine continue to rise. In Australia, the budget announced last week, is very stimulatory across virtually all sectors.

In 2021, we anticipate earnings growth will show reasonable recovery. Central Bank activity will continue to keep interest rates relatively low, at least until some of the excess capacity in labour markets is absorbed. Stronger earnings will improve equity valuations, and later, work to offset the potential impact of higher rates. As the chart from CSLA highlights, valuations are not wildly out of kilter, given where interest rates are currently, though longer term risks are to the downside.

In the short term, ahead of the US election, we remain defensively positioned across longer term growth, defensive and cyclical stocks and sectors. To summarise main exposures:

- Growth-Healthcare, Technology, Internet, e-Commerce
- Defensives-Consumer Staples, Infrastructure, Logistics, Gold
- Cyclical-Resources, Banks, Travel, Diversified Financials, Building Materials, Gaming

We hope you and your family are healthy and safe during these uncertain and unprecedented times. As always we are very happy to meet with you and discuss your portfolio to ensure that your returns meet your lifestyle needs at your personal level of risk.

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