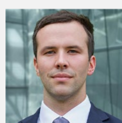
view from the OUTER

EVANS & PARTNERS

30 March 2020

Tim Rocks
Chief Investment Officer
Timothy Rocks



Max Casey
Portfolio Strategist
Max Casey

Peter Dragicevich
Macro Strategist

Thinking ahead

There have been some interesting developments over the past week on some of the issues that we have been watching, particularly infection rates in Italy and the policy response.

- The first is that there is some evidence that the Italian lockdown is working and pointing to a **peak in infection rates**. Since full lockdown started on 9th March, the daily growth in new infections has fallen from 24% to 8%.
- Policy announcements keep coming with the notable ones this week being the second fiscal package in Australia and the very substantial fiscal and monetary packages in the US. The packages have been well constructed to address the major issues of stemming permanent job losses and business closures and addressing issues that could cause systemic problems.
- Based on coal usage, China is recovering rapidly as it eases restrictions. Wuhan has partly eased travel bans and schools are about to reopen.

While the extent of the economic damage and the timing of the recovery is still highly uncertain, the aggressive policy response suggests that the bounce could be strong when it does occur. We are increasingly considering which stocks will benefit. One major theme will be **policy response beneficiaries**. There are two main types of beneficiaries:

- **Consumer goods**. These will benefit from direct government handouts to consumers particularly those on low incomes. These stocks have fallen substantially over fears about shop closures and the impact on short term sales.
- **Housing stocks**. The clear message is that rates will be near zero for a long time.

Recommendation

Intense uncertainty and volatility are likely to linger for some time. Our recommendation continues to be that investors take advantage of weak markets to buy quality stocks at good prices and set portfolios up to make strong returns over the next 3-5 years. We think global consumer and housing stocks are a key part of this given the major fall in prices and the potential for them to benefit from an eventual recovery.

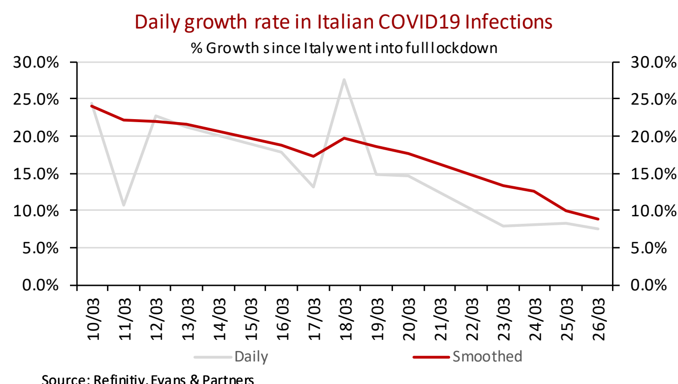
Thinking ahead

The most notable change in the past week has been the the more positive tone to stock markets (although it has been combined with extreme volatility). This has reflected markets shifting focus away from the dire headlines to considering potential peaks in infection rates and the massive policy response now in train. We suspect that this will not be sustained for long, and below we assess recent developments and attempt to put them in context.

We also give our evolving thoughts about investment themes that might play out over a longer time period (say 2 year time frame). As we have made clear for some weeks our investment approach at the moment is to identify quality stocks to buy at good prices. Identifying durable investment themes is part of this approach and it is increasingly clear to us that the size and nature of the policy response will be an important consideration for portfolio construction in the recovery phase.

Peak virus might be coming

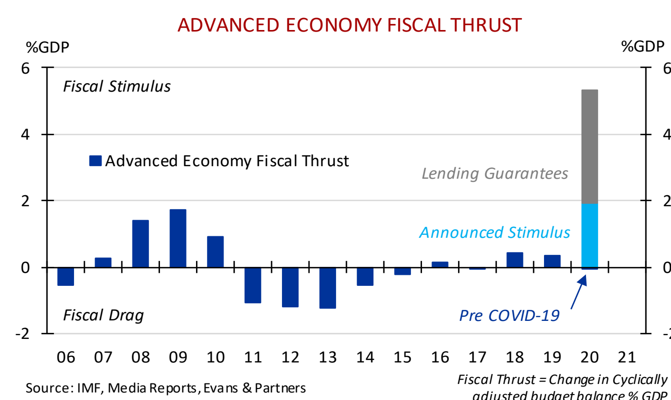
Looking first at developments in infection rates, the interesting recent change is evidence that the Italian lockdown is working and pointing to a **peak in infection rates**. Since full lockdown started on 9th March, the daily growth in new infections has fallen from 24% to 8%. In other words, Italy has proved that 3 or 4 weeks of full lockdown can bring it under control in a western country. The US is maybe 4-6 weeks behind this. If this continues it will allow a better assessment of the length of the health and economic crisis. What is still unknown, however, is how quickly lockdowns can be eased and whether these can be done in such a way that the growth rate in infections does not reaccelerate.



Policy Bazooka

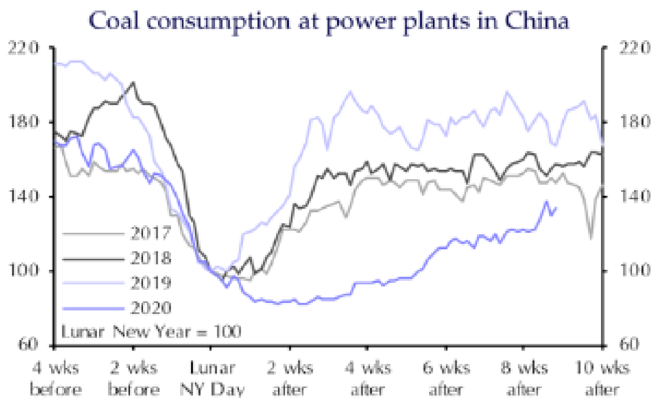
The other major developments were on the policy side. Policy announcements keep coming with the notable ones this week being the second fiscal package in Australia and the very substantial fiscal and monetary packages in the US. The policy response now well exceeds that provided during the GFC period. More importantly the packages have been well constructed to address the major issues of stemming, as much as is possible, permanent job losses and business closures. Monetary measures, and particularly the announcement by the Fed that it would buy corporate credit including ETFs, are directed at putting out bush fires that could cause systemic problems.

The aggregate size of monetary announcements also now well exceeds those from the GFC period. Investors took comfort from this over the past week – but it wouldn't be a surprise if sentiment retraced as information on the short term economic damage continues. Investors are likely to oscillate between optimism on policy and despair on economic damage for some time.



China reopening

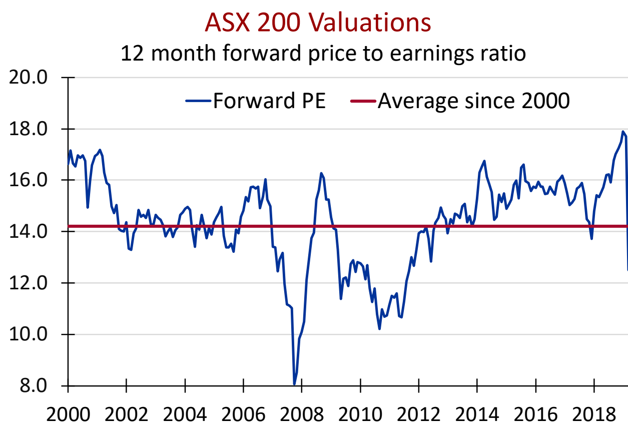
The other important economic news over the past few weeks has been the steadily improvement in Chinese data as the economy reopens. Based on coal usage, China is quickly returning to work. Travel restrictions are been eased in Wuhan and schools are about to reopen. This chart points to electricity production only being down around 10% yr on yr vs 25% a couple of weeks ago.



Source: Capital Economics

Thinking ahead

Our approach has been to add selectively to quality stocks. Many stocks are in the zone where investors who purchase today will make strong returns over the next 3 to 5 years even if there is the risk of continued volatility in the short term. We estimate that the Australian market is currently around 10% below fair value.



Source: Refinitiv, Evans & Partners

Apart from tilting to quality, the other issue that we are increasingly considering is which stocks will do well in the recovery. Obviously those stocks that have suffered the most in transport, banking and tourism have the potential to bounce hard as conditions normalise, provided they remain in business. Our focus is not on these. Instead we wanted to think about the macro themes that might dominate in the first year or two after the crisis is finished.

Policy beneficiaries

One major theme will be **policy response beneficiaries**. Announced stimulus is already enormous and more will follow. It is close to certain that at least part of the stimulus will hit in the recovery phase and result in a bumper year or two from 2021.

There are two main types of beneficiaries:

- **Consumer goods**. These will benefit from direct government handouts to consumers particularly those on low incomes. Most of the beneficiaries will be global companies listed in the US and Europe including clothing, leisure and luxury brand names.
- **Housing stocks**. The clear message is that rates will be near zero for a long time.

Two other issues will add to the "v" in consumer goods:

- Within consumer I think the story is very much about **clothes and gadgets**. It may take some time for people to want to travel again so consumers might spend a greater proportion of their income on stuff rather than experiences.
- These stocks have fallen substantially over fears about shop closures and the impact on short term sales. Many luxury brands are down 30-40%.

Housing stocks have also been hurt based on macro and disruption concerns but confidence could quickly return on the other side.

Policy beneficiaries was also the story in 2010 after the GFC but this time the stimulus will be consumer led not infrastructure led. China has not replicated the massive infrastructure program of 2008, instead its measures have been more targeted. This means that instead of resources being the play it will be consumer stocks. Note that this is also not as beneficial for Australia or the $A as the 2010 recovery.

EVANS & PARTNERS

DISCLAIMER, WARNING AND DISCLOSURES

This document is provided by Evans and Partners Pty Limited (ABN 85 125 338 785), holder of AFSL 318075 (Evans and Partners).

Please refer to the document entitled 'Research Conflicts of Interest Disclosure' available for download from the Important Disclosures section of our website (eandp.com.au) and Evans and Partners' Financial Services Guide (FSG) which is also available on our website.

The information is general advice only and does not take into consideration an investor's objectives, financial situation or needs. Before acting on the advice, investors should consider the appropriateness of the advice, having regard to the investor's objectives, financial situation and needs. If the advice relates to a financial product that is the subject of a Product Disclosure Statement (e.g. unlisted managed funds) or offer document investors should obtain the relevant offer document and consider it before making any decision about whether to acquire the product.

The material contained in this document is for information purposes only and does not constitute an offer, solicitation or recommendation with respect to the purchase or sale of securities. It should not be regarded by recipients as a substitute for the exercise of their own judgment. Investors should be aware that past performance is not an infallible indicator of future performance and future returns are not guaranteed. Any forward-looking statements are based on current expectations at the time of writing. No assurance can be given that such expectations will prove to be correct.

Any opinions and/or recommendations expressed in this material are subject to change without notice and Evans and Partners is not under any obligation to update or keep current the information contained herein. References made to third parties are based on information believed to be reliable but are not guaranteed as being accurate.

This document is provided to the recipient only and is not to be distributed to third parties without the prior consent of Evans and Partners.

EVANS AND PARTNERS DISCLOSURE OF INTERESTS

Evans and Partners and its respective officers and associates may have an interest in the securities or derivatives of any entities referred to in this material. Evans and Partners does, and seeks to do, business with companies that are the subject of its research reports.

AUTHOR CERTIFICATION

We, Tim Rocks, Max Casey and Peter Dragicevich, hereby certify that: all views expressed in this publication reflect our personal views about the subject theme and/or relevant company securities, and no attempt has been made by any other person to influence the views or themes contained within; and we are not in receipt of inside information and this publication does not contain any inside information. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

AUTHOR DISCLOSURE OF INTEREST

I, Tim Rocks, and/or entities in which I have a pecuniary interest, have an exposure to the following securities and/or managed products: Aberdeen Emerging Opportunities Fund, AMP Cap Core Property Fund, AMP Capital Corporate Bond Fund, BlackRock Multi Opportunity Absolute Return, Fidelity Australian Equities Fund, Grant Samuel Epoch Global Equity Share Yield Fund, IFP Global Franchise Fund, Macquarie High Conviction Fund, Plato Australian Shares Income Fund, RARE Infrastructure Value Fund, Schroder Fixed Income Fund WS Class, T. Rowe Price Global Equity Fund, Winton Global Alpha

Fund, Betashares Commodity ETF and Westpac BlueChip 20 (a Separately Managed Account applying a model portfolio which seeks to match the return of the S&P ASX 20 Accumulation Index).

I, Max Casey, and/or entities in which I have a pecuniary interest, have an exposure to the following securities and/or managed products: AGH, APT, CD3, CVCG, EOS, FLC, LSF, TGH, VG1, VG8, VGE.

I, Peter Dragicevich, and/or entities in which I have a pecuniary interest, have an exposure to the following securities and/or managed products: CBA, SUN.

DISCLAIMER

Except for any liability which cannot be excluded, Evans and Partners, its directors, employees and agents accept no liability or responsibility whatsoever for any loss or damage of any kind, direct or indirect, arising out of the use of all or any part of this material. All information is correct at the time of publication; additional information may be available upon request.