

COVID-19 Market Update: 25 March 2020

Australian Unity Pro-D Funds

What does COVID-19 mean for markets right now?

Without wanting to minimise the human and health impacts of COVID-19, it has caused significant falls across risky assets such as shares, listed property and even corporate fixed interest. In very simplistic terms, prices on these assets broadly reflect two main elements – cashflows such as dividends/bond coupons that will be paid, and an appropriate multiple of this cashflow to take into account risk and the earnings rates achievable on other assets. COVID-19 will impact significantly on both elements. Company earnings and dividends will reduce for many organisations as economic activity inevitably reduces. And markets have placed a much higher risk premium on any earnings/cashflow uncertainty. These factors combined have seen global share markets including the Australian index fall by around 1/3 from their February 2020 highs.

How does the Pro-D Investment Philosophy assist my business and clients in these volatile times?

There are two key elements to this answer.

Firstly, is the relationship between client and planner, that is, your risk profiling work and discussions with clients to ensure that they hold an appropriate investment mix for their needs/wants/risk tolerance. To date we've seen few client redemptions, indicating that planners have done a great job of understanding and engaging with clients.

The second element is the Funds' discipline of focusing on appropriate medium-to-long term valuation measures to estimate likely future returns, which then drive the actual exposures. While there is great uncertainty over near-term impacts on economic activity/corporate profitability and so on, we consider it likely that activity will recover (and new industries/companies emerge in the new world), and profits will improve in future – and so the Funds are keen to remain fully invested to achieve long term gains for investors.

Which investments or industries are most vulnerable right now?

Most growth investments have been sold-down indiscriminately to date. Share markets around the world are typically down between 30-40 percent around much of the world since late-February 2020 peaks. Industries/sectors to fall more steeply so far include energy (which has been particularly impacted by the breakdown in negotiations between Saudi Arabia and Russia on oil output quotas), and interest-rate-sensitive and credit-quality-sensitive stocks such as financials/REITs. These sectors may all remain particularly volatile going forward. In defensive assets, high yield credit spreads have widened further than investment grade spreads, leading to reduced prices for these bonds.

How are the Portfolios currently positioned?

At present the Funds are positioned near their neutral overall risk allocation. Markets were generally fairly valued or somewhat cheap prior to the COVID-19 sell-off, and the steep sell-off in listed shares and REITs brought those exposures a little underweight. In the past week, as market trading activity shows a degree of buying interest, we have added a little to share/REIT allocations, bringing portfolio weightings back to neutral.

To date the portfolios' exposure to unlisted property funds and direct property have provided in-built protection when compared to the significant falls on the ASX. Our defensive asset holdings across fixed income and cash alternatives have also performed solidly to this point. Also, the funds' large-cap Australian share exposures via Platypus and Nikko have cushioned returns a little. The Funds' international equities have an element of currency unhedged exposure – with the Australian dollar falling sharply in the past month, this feature has protected returns a little.

Are you looking to make any major changes to the Portfolio?

The Funds are likely to make modest changes as a result of our ongoing review of investment markets, likely returns and risks embedded in company/market valuations.

Firstly, as growth assets have reduced in value during the last month, likely long-term returns are expected to be higher than a month ago. As a result, we wish to implement an overweight exposure to growth assets (this exposure is limited by the Funds' overall asset allocation splits) and will grow our Australian and global share allocations. We will trim direct/unlisted property (which has not significantly re-priced to date), to build these allocations.

Secondly, the sharp fall in the Australian dollar seems overdone, and we will increase currency hedging to benefit.

Further information

If you have any questions, please contact one of our Business Development Managers below. Alternatively, you can speak with our Adviser Services team on 1800 649 033 or email investments@australianunity.com.au.

James Torrens | NSW/ACT/QLD/SA | 0422 424 614 | JTorrens@australianunity.com.au

Aaron Hallifax | VIC/TAS/WA | 0431 615 809 | AHallifax@australianunity.com.au

Important information

Units in the AUFM Managed Fund No.1 ARSN 160 420 986 (Pro-D High Growth Fund), Managed Fund No.2 ARSN 160 421 063 (Pro-D Balanced Fund) and Managed Fund No.3 ARSN 160 421 161 (Pro-D Growth Fund) are issued by Australian Unity Funds Management Limited ABN 60 071 497 115, AFS Licence No. 234454. The information in this document is general information only and is not based on the objectives, financial situation or needs of any particular investor. In deciding whether to acquire, hold or dispose of the product, investors should obtain the current Product Disclosure Statement (PDS) and consider whether the product is appropriate for them. A copy of the PDS is available at australianunity.com.au/wealth or by calling our Adviser Services team on 1800 649 033. Investment decisions should not be made upon the basis of its past performance or distribution rate or any rating by a rating agency, since each of these can vary. In addition, ratings need to be understood in the context of the full report issued by the rating agency itself. The information provided in the document is current as at the time of publication.