SECOND QUARTER 2020 REVIEW & OUTLOOK
EXECUTIVE SUMMARY

09 July 2020

PORTFOLIO THEMES

- We continue to favour larger, high-quality companies, but our assessment of the market's future path will determine if we shift toward smaller cyclical firms.
- Unlike many past cycles where the bull market's leading category underperformed in the subsequent bear, large Technology equities have held up relatively well during the bear market and initial bounce off the market lows. Consequently, we are not yet convinced the recovery will be a conventional new bull led by small value.

MARKET OUTLOOK

- **Equities Appear to be in a New Bull Market:** The rally since late March looks to us to be a new bull market forming as equities look further into the future and anticipate a recovery.
- **Equities are Leading the Economic Recovery:** As a leading indicator, equities have started recovering well before Covid-19 is gone, restrictions are removed, or the economy recovers.
- **Early Bull Markets Begin with Pessimism:** Volatility is to be expected, but with pessimism about a second wave growing and positive data garnering little fanfare, we think more gains are likely.

Global equities followed one of history's worst quarters with one of its best in Q2, soaring 19.2%.[i] Year-to-date, global equities are down -6.3%.[ii] Similarly, emerging market (EM) equities rose 18.1% in Q2, as growing progress—and clarity—on major emerging and developed countries' Covid-19 lockdown relaxations continued.[iii] Though we believe an initial recovery is indeed underway, equities' path from here isn't pre-determined. While we remain vigilant and monitor multiple variables, there is little reason equities shouldn't do well from here.

To quote Q1's Executive Summary, "The coronavirus wasn't even known to researchers until mere months ago—and much about it remains unclear. Beyond this, will government mandated social distancing and Covid-19 containment guidelines expire soon, or will governments around the world extend them again? Will infection rates keep falling in Europe and allow normal life to resume, or will containment efforts there long endure? These questions can't be answered now, but all have resolutions. Yet equities should increase long before those resolutions emerge." At that time, equities were one week past March 23's low. From then through quarter end, they rose 33.0% in a V-shaped rebound, catching most of the world off guard.[iv]

We see this bounce as a new bull market starting, but one that is acting more like the recovery side of a hugely oversized market correction than a conventional early bull market. That said, it is far too early to be certain and we aren't suggesting markets are on a pre-set course. However, a sustained climb with periodic volatility seems much more likely than another steep downturn. As noted in Q1's Review, relatively quick reopenings would likely fast-track a recovery, triggering a correction-like market rebound in speed and lack of leadership rotation. That seemingly is underway.

i. Source: FactSet, as of 30/06/2020. MSCI ACWI Index return with net dividends, 31/03/2020 – 30/06/2020.

ii. Ibid. MSCI ACWI Index return with net dividends, 31/12/2019 – 30/06/2020.

iii. Ibid. MSCI Emerging Markets Index return with net dividends, 31/03/2020 – 30/06/2020.

iv. Ibid. MSCI ACWI Index return with net dividends, 23/03/2020 – 30/06/2020.

Sentiment is classically early bull market. Few investors believe the rally. As Ken highlighted in a recent column, pundits dismiss positives as fleeting or faulty—a mindset he coined "the Pessimism of Disbelief." Most see the abysmal forecasts for Q2 GDP and quarterly earnings and believe equities are disconnected from reality—inflated by government or central bank largesse. They say markets ignore upticks in Covid-19 caseloads. Few fathom the simple fact that equities are leading indicators. Equities typically pre-price conditions 3 – 30 months out. In the all-time record-fast bear market, equities shifted focus to the very near end of that range, pricing the sudden, sharp economic contraction lockdowns wrought. But as that reality became widely known, markets shifted their focus. As is normal after a bear market-sized plunge creates pessimism, equities shifted to the 3 – 30 month range's far edge—a time when Covid-19 is old news, having been vanquished by a vaccine or just gradually diminishing.

Already, easing lockdowns have helped sprout economic green shoots. This should have surprised no one, considering there was nothing fundamentally wrong with the economy before lockdowns halted growth. This improvement is getting plenty of attention, but few expect it to last. As several states and countries pause or even reverse reopening plans, fears of renewed lockdowns remain. While a renewed, widespread lockdown could have a severe effect on equities, this scenario seems unlikely. Crucially, nearly every investor is considering this, so the markets have likely factored in a potential Covid-19 recurrence to a large extent already. To justify bearishness, we think it would take a probable negative that isn't widely discussed—and therefore isn't pre-priced now. We don't see any such thing.

The US election in November also garners many headlines. Polls currently show the Democratic presumptive nominee, former Vice President Joe Biden, far ahead of President Trump. However, in our view, it remains premature to forecast this election. Almost any outcome from a Democratic sweep to a Republican one is possible. We will detail those in the full Review—plus the potential market impacts of the various outcomes, none of which should apply quite yet.

In Europe, the EU's €1.85 trillion budget proposal grabbed headlines. The EU announced its long-term 2021-2027 budget—the key item: a coronavirus relief proposal of €500 billion in grants and €250 billion in loans, financed in part by newly issued common EU debt-a big step toward fiscal transfer union. Though headlines were positive on the development-both for the alleged near-term benefits for Covid-19 relief and the longer-term benefits of greater EU unity-we don't think its passage or failure will materially impact Europe's economic recovery. Additionally, the UK announced its tariff regime-the UK Global Tariff (UKGT)—which details what Brexit on World Trade Organization (WTO) terms would look like. While the regime upholds a few tariffs for industries such as the auto sector and agriculture, the outcome is broadly freer trade with non-EU nations. We also have greater clarity now, for even if a no-deal Brexit occurs, UKGT terms would apply to the EU. Ultimately, this very different from fears of a more-protectionist UK, and the removal of no-deal Brexit uncertainty is a positive, in our view.

In emerging markets, tensions between China and India briefly surged last month after military incidents at a disputed border region, leaving some concerned with further conflict between these nuclear-armed nations. However, both sides seem to be focused on de-escalation. Additionally, in Brazil, calls mounted in May for the impeachment of President Jair Bolsonaro. In addition to criticisms of the government's handling of the coronavirus response, these center around allegations by ex-Justice Minister Sergio Moro that President Bolsonaro fired the head of the federal police in order to install an ally. Presently, the legislature and President Bolsonaro are occupied with Covid-19 matters. While EM equities' rapid June ascent may slow, and further reopening hinges on politicians' unpredictable decisions, we think the rebound is a new bull market beginning—running alongside a similar move in the developed world.

At a sector and style level, things are evolving largely as we expected. As equities fell in Q1, we observed that the market behaved as it typically does in a correction, rather than a long bear market with volatile declines late. It was just much bigger than a correction. Accordingly, we expected the categories that led as the last bull market matured to lead in the recovery—namely, the largest growth-oriented equities in Tech and Tech-like industries. Only if the bear market persisted did we expect a leadership shift toward smaller, more cyclical companies. So far, that has worked well in global markets. While many called for small value equities to lead based on historical data, that hasn't happened with consistency. The categories that led before the decline fell less than broad markets in the decline and have led markets higher in the upturn. Of course, like always, days and multi-week periods have seen countertrends. But overall, large, high-quality companies have outperformed. We expect this to continue, but we are actively monitoring this trend.

Risks exist—as always and bear market recoveries are rarely smooth. Yet as we will show in the full Review, equities retracing the gains and re-testing March's low after this large a recovery would be a historical anomaly. While many remain pessimistic, we believe this is indication of the pessimism that characterises early bull markets. With positive economic data being met with broad skepticism and negativity about a second wave growing, we think more gains are likely.

Should you have any questions about any of the information provided, please contact FIA at: Email: Australia@Fisher-Investments.com.au

Phone:+61 2 8211 0625

Mail: Level 25, Aurora Place, 88 Phillip St, Sydney NSW 2000

For clients in Australia, Fisher Investment's (FI) wholly-owned subsidiary, Fisher Investments Australasia Pty Ltd (FIA), which holds an Australian Financial Services Licence (#433312) with the Australian Securities and Investment Commission (ASIC), serves as the investment manager. In this arrangement, FIA delegates portfolio management to its parent company, FI. FI is an investment adviser registered with the United States Securities and Exchange Commission (US SEC). As of 30 June 2020, FI managed assets valued over $178 billion AUD. FI maintains two principal business units – Fisher Investments Institutional Group (Fisher) and Fisher Investments Private Client Group (FIPCG). FIPCG manages and serves a variety of equity, fixed income, and balanced assets for significantly all of FI's private client accounts. FIIG services significantly all of FI's institutional accounts. FI's Investment Policy Committee (the IPC) has ultimate decision-making authority and accountability for the firm's strategies.

Unless otherwise specified, references to investment professionals, operations personnel, and middle and back office personnel are references to FI employees. "We", "our," "us" and "the firm" generally refer to the combined capabilities of FIA and FI.

The foregoing information constitutes the general views of FI and should not be regarded as personalised investment advice or a reflection of the performance of FI managed strategies. There can be no assurances that they will continue to hold this view; FI may change its views at any time based on new information, analysis, or reconsideration. This analysis is for informational purposes only. It has been formulated with data provided to FI and is assumed to be reliable. FI makes no claim to its accuracy. Investing insecurities involves the risk of loss.

This material is designed for use with wholesale prospects and clients.