Themes and Trends – June 2020

The following comments are based on our discussions with investors and investment managers over the last quarter. We have referred to investors in the comments below but, in most instances, investors will be working closely with their consultants and you can infer that a reference to one is a reference to the other also.

Mid-way through June the daily new Covid cases seemed to be almost flatlining in Australia and in many countries around the world the worst numbers seemed to be behind us. The global trend continued to be upwards, as different countries and regions were at different stages in the progress of the disease. However, the situation in Australia (primarily Victoria) has deteriorated markedly since late June/early July. Although new imported cases of Covid are now few and far between (international border closures have been effective), locally acquired cases are numerous and rising. One would assume we are getting better at testing and tracing and, therefore, treating and quarantining; presumably, the spread of the disease would be much greater if not.

While many countries appear to have been able to contain the numbers of infected since their initial peaks, Australia is not unique in experiencing a second wave following a meaningful period of suppression. Clearly, nobody can be complacent in dealing with this pandemic. In the absence of a vaccine, investors are doing what they can to adjust portfolios for the potentially drawn out social and economic impacts of this virus.

Themes and Trends we have identified since our previous quarterly update are as follows:

- In light of the worsening Covid situation, the Government made the decision to extend the early release super scheme from 24 September to 31 December. Treasury's original estimate that $27billion would be withdrawn from superannuation funds has been surpassed in recent days and the figure has now been revised to $42billion. While APRA fund level data shows that 151 of 176 funds that had submitted data have made early release payments, these redemptions have been heavily skewed towards the largest funds; the 10 largest funds have made 2.5 million payments worth a total of $9.4billion. Unsurprisingly, funds with members from retail, hospitality, tourism and other industries hardest hit by Covid have been significantly impacted.

  Despite the early release scheme, members switching to cash on general market weakness and funding calls as currency hedging contracts rolled over, there have been no indications that funds generally struggled to meet redemption requests in a timely fashion i.e. within the 5 day 'guidance period' set by APRA.

  However, the focus on meeting the volume and scale of redemption requests (as well as the other issues mentioned above) has meant that some funds have had to place consideration of new investment ideas on hold for a time;

- Previously we mentioned that funds (primarily industry funds) with substantial private asset holdings were being criticised from several directions (Government, media and some 'for profit' peers). Criticism focused on the size of holdings, illiquidity and whether valuations had been sufficiently written down as to reflect current market conditions (particularly in respect of assets significantly impacted by the Covid crisis e.g. retail and office property, convention centres and airports).

  Given the liquidity issues raised above and the asset allocation impacts on portfolios of redemptions and equity market falls, commentators anticipated at least some funds would be looking to exit private asset positions and potentially at fire-sale prices.

Our feedback is that this has not turned out to be the case; on balance it appears most funds are in relatively good shape and more funds are continuing their private asset programs and some are looking at new opportunities (primarily domestic where presumably the due diligence is easier in the circumstances).

It seems, to date, Covid has actually shown how resilient and prepared investors were to handle a crisis of considerable magnitude;

- However, while it is reassuring that the funds have managed themselves well in the period to date – and, begrudgingly, this seems to be increasingly recognised – the discussions tend to focus more on the funds themselves than the members they actually exist for. The fact that the funds (industry funds in particular) have delivered for their members over the long term tends to get rather overlooked in discussions of whether early release payments will be met within 5 days, whether funds will remain viable or should merge, whether funds should diversify their member base so that the funds are less impacted by a crisis that targets specific areas of economic activity. All this is important but rather less so than whether the members themselves will have sufficient savings for a comfortable retirement (notwithstanding the other pillars of the retirement system);

- Where investors are looking to make changes to portfolios, some are constrained in terms of the work they can do on potential new managers. With overseas travel off the agenda for the immediate future, and offshore managers unable to make the trip to Australia and/or New Zealand, investors who need to complete on-site due diligence or who require a manager to present to a Board are currently unable to progress new opportunities and therefore must rely on either incumbent managers or new managers they can access in the region. This makes for a somewhat challenging environment for managers in the process of establishing themselves in this region. Domestic consultants may be similarly constrained from finalising new ratings on managers and presumably must monitor currently rated managers virtually;

- Several investors have pointed out that now is the time Governments should be talking, planning and working closely with the superannuation funds. Although it is difficult to see blue sky at present, there is going to need to be substantial investment in the rebuilding and reinventing of Australia and the Australian economy. With Governments reluctant to add to the current record levels of debt, it makes sense that they should sit down with funds representing $3trillion and work creatively and constructively at solutions that will not only help resuscitate the Australian economy but that can be structured in such a way as to match the long term objectives of the superannuation system. Presently the political stoush seems to be drowning out rational discussion but hopefully this can be quietly shelved as the crisis continues and we can gradually progress to a more sensible discussion; and

- Many of the issues discussed above are giving investors pause for thought about how best to position portfolios in case of future crises and whether they should hold a greater proportion of liquid assets and cash on a permanent basis. There has been discussion for some time about increasing flexibility of the superannuation system; allowing, for instance, members to withdraw funds to be used for deposits on first home purchases. Having now had to deal with the reality of the early release scheme, investors may be increasingly trepidatious regarding the likelihood of Governments intervening again in the future.