

ECONOMICS & MARKETS

Learning the lessons of an extraordinary year of 2020

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When the COVID-19 pandemic hit Australia in March 2020 it brought immediate and severe financial gloom. Shares plunged 37% and the economy slumped to its first recession in nearly 30 years¹.

But against that backdrop, 2020 turned out far better for diversified investors than was feared early in the pandemic.

The development of vaccines became the good news of the second half of 2020 and offered hope of a return to life as normal. The anticipation of economic recovery, paired with ultra-low interest rates, drove a rebound in many investment markets and we did see a strong growth rebound in the second half.

In 2021, we expect to see solid returns as markets shift from pandemic winners to cyclical investments, but the gains will likely be slower than seen coming out of the March pandemic lows of 2021.

For investors, 2020 was better than feared

The list of negatives brought about by the COVID-19 pandemic cannot be ignored.

Unemployment surged, with severe disruption to industries like airlines, retail and the office sector. Globalisation took a further blow and tensions rose with China. Public debt skyrocketed. But there were a number of key positives.

The massive fiscal support provided by governments shielded businesses from collapse and saved jobs and incomes. Debt forbearance schemes headed off defaults, while plunging interest rates helped borrowers service loans.

Economies began to reopen after social distancing helped contain the virus, with nations like Australia, New Zealand and Asian nations doing better on this front than the US and Europe. The November 2020 election of US President Joe Biden offered the prospect of less global policy uncertainty and reduced international tensions in 2021 and beyond.

Disruption caused by the pandemic massively accelerated a number of broader productivity gains. These include the faster take up of technology like virtual meetings, e-commerce and use of the cloud to cut costs and boost output for business.

As a result, the pandemic has shown it is possible for people to work from home and enjoy a more balanced lifestyle – increasingly in regional areas where property prices are generally more affordable.

The benefits of science – typified by the rapid development of vaccines - has also served as a rebuke to populist politicians and offers hope for better management of issues like climate change in the future.

The lessons of 2020

Timing market moves is hard – getting out at the top of the share market in February 2020 was hard, but getting onboard again for the rally in March last year was even harder.

Don't fight the central banks – while they could not prevent the magnitude of the fall in share markets, their massive money easing was a key driver of the recovery.

Investment valuations need to be assessed relative to interest rates – low rates make shares relatively attractive.

Depressions can be avoided – 2020 showed a large, rapid, well-targeted economic policy response can protect an economy from a significant shock and enable it to rebound quickly.

Turn down the noise – stick to a long-term investment strategy.

Reasons for optimism through the remainder of 2021

Recent bumps in the road of vaccine roll out has not stifled the overall goal of achieving herd immunity in many developed countries by the second half of this year.

Fiscal stimulus and easy monetary policy continue to work through the system, with even more fiscal stimulus being injected into the US economy. Continuing high saving rates indicate significant spending potential as confidence improves.

Low inflation, and hence low interest rates, mean we are still in the “sweet spot” of the investment cycle.

After having run up so hard since early November 2020, shares are still vulnerable to a short-term pull back. But we are likely to see a continuing shift away from investments that benefitted from the pandemic and lockdowns (technology, health care stocks and bonds) to investments that benefit from recovery (resources, industrials, tourism stocks and financials). We expect global shares to return around 8% this year, but we anticipate there may be a rotation away from tech-heavy US shares to more cyclical markets in Europe, Japan and emerging countries.

Australian shares are likely to be relative outperformers returning around 12%.

Australian home prices are likely to rise 10-15%, boosted by record low mortgage rates and government incentives, but the pause in immigration and weak rental markets will likely weigh on inner city areas, and units in Melbourne and Sydney.

Nine things for investors to remember

- Harness the power of compound interest – under the principles of the ‘Rule of 72’, it takes 144 years to double an asset’s value if it returns 0.5% p.a, but only 14 years if the asset returns 5% p.a.
- Don’t get thrown off by the cycle – investors can often abandon a well thought out strategy at the wrong time during falling markets– as some may have done in March last year.
- Invest for the long term - get a plan that suits your wealth, age and risk tolerance. And stick to it.
- Diversify - don’t put all your eggs in one basket.

- Turn down the noise. As discussed earlier.
- Buy low, sell high - the cheaper you buy an asset, the higher its prospective return, and vice versa.
- Beware the crowd at extremes. Don't get sucked into the euphoria or 'doom and gloom' around an asset.
- Focus on investments that you understand – it's probably best to stay away from companies that have complex and hard to understand valuations or business models.
- Accept it's a low nominal return world – historically, when inflation around 1.5%, the average return of 7% for super funds begins to look pretty good.

Important notes

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