



Clime Capital Limited

14 July 2020

Company Announcements
Australian Securities Exchange

Net Tangible Asset Backing

Please find attached Net Tangible Assets report of Clime Capital Limited (ASX: CAM) as at the close of business on 30 June 2020.

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NTA Report - June 2020

NTA before tax	Total Portfolio Including Cash	Rolling 12 Month Dividend	Historical 12 Month Dividend Yield
\$0.80	\$118.6m	4.85cps	6.1%

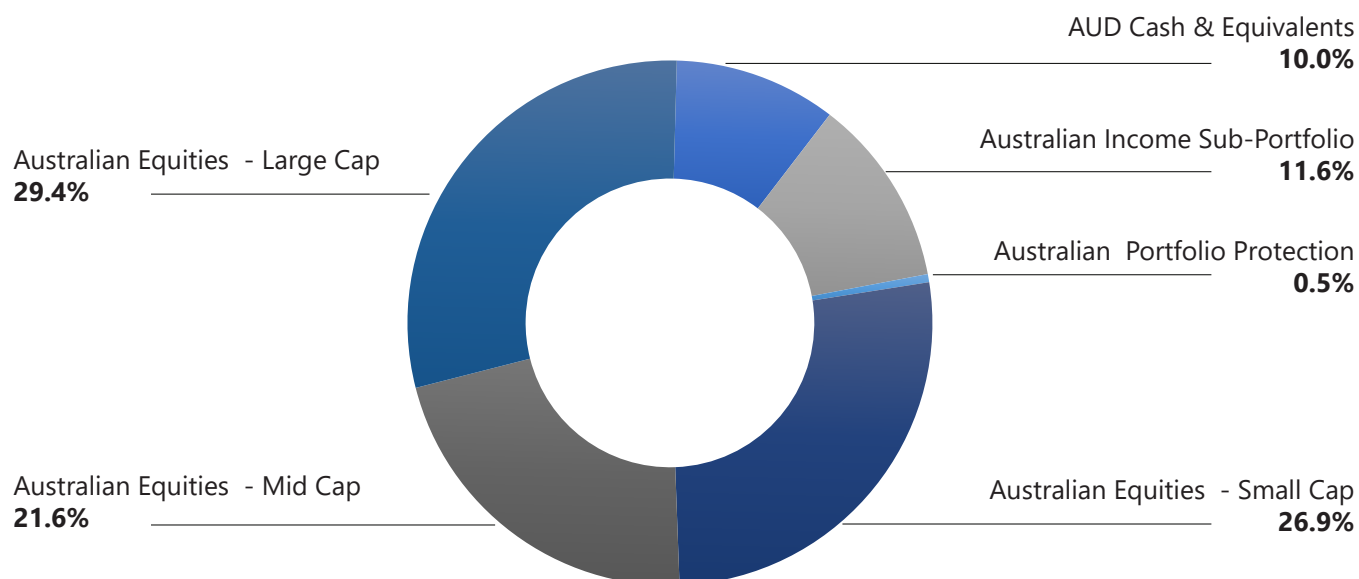
Net Tangible Assets (NTA)

	June ¹	May ¹	April ²
NTA before tax	\$0.80	\$0.79	\$0.72
NTA after tax	\$0.82	\$0.81	\$0.76
CAM Share Price	\$0.79	\$0.77	\$0.76
Historical 12 Month Yield Excl. Franking	6.1%	6.6%	6.6%
Historical 12 Month Yield Incl. Franking	8.8%	9.4%	9.5%

¹ On 19 June 2020, the Board declared a fully franked dividend of 1.05 cents per share in respect of the Company's ordinary shares for the period 1 April to 30 June 2020, payable on 30 July 2020. NTA before and after tax disclosed above for June 2020 and May 2020 are before the effect of this dividend payment.

² On 20 February 2020, the Board declared a fully franked dividend of 1.30 cents per share in respect of the Company's ordinary shares for the period 1 January to 31 March 2020, paid on 24 April 2020. NTA before and after tax disclosed above for April 2020 is after the effect of this dividend payment.

Gross Asset Allocation



Company Overview (\$m) (Cum Dividend)

Assets	\$M
Australian Equities	\$92.4
Australian Income Sub-Portfolio	\$13.7
Australian Portfolio Protection	\$0.7
AUD Cash & Equivalents	\$11.8
Total Portfolio including cash	\$118.6
Notes Payable	(\$27.7)
Net Tangible Assets Before Tax	\$90.9

Top 5 Holdings

Company	ASX Code	% of Assets
BHP Group	BHP	5.8%
Macquarie Telecom	MAQ	4.0%
Mach7 Technologies	M7T	3.9%
Westpac	WBC	3.6%
Bravura Solutions	BVS	3.5%



Portfolio Commentary

The ASX surged back from the depths of its March lows during the June quarter, though this only ultimately reduced the severity of the market drawdown for FY2020. The S&P/ASX200 delivered a return of -7.7% for the 12 months to 30 June 2020, with the Energy (-29%), Financials (-21%) and Real Estate (-19%) sectors the worst performing. The Healthcare (+27%) and Technology (+20%) sectors were the best performers over the last year, supported by low bond yields and the increasing scarcity of genuine growth.

Before detailing contributors, detractors and stock specific theses, we remind investors that Clime remains focused on investing in quality companies using strong valuation discipline. Portfolio holdings are each characterised by niche leadership, strong balance sheets and significant growth prospects. In our experience, these types of businesses are resilient in the face of economic stress and tend to power out of downturns.

Key contributors and detractors to the portfolio return for the June quarter were:

•**Australian Equity Large Cap Sub-Portfolio:** Key contributors BHP Group (BHP), Macquarie Group (MQG), Fortescue Metals Group (FMG), Sonic Healthcare (SHL), Goodman Group (GMG) and Commonwealth Bank CBA, no material detractors.

•**Australian Equity Mid Cap Sub-Portfolio:** Key contributors Appen (APX), Bravura Solutions (BVS), Breville Group (BRG) and REA Group (REA), no material detractors.

•**Australian Equity Small Cap Sub-Portfolio:** Key contributors Macquarie Telecom (MAQ), Mach7 Technologies (M7T), City Chic Collective (CCX), Integral Diagnostics (IDX), RPM Global (RUL) and Omni Bridgeway (OBL), detractor Navigator Global Investments (NGI).

As highlighted above, most portfolio holdings contributed positively to aggregate performance for the June quarter. We update investors on each of these key contributors below.

BHP Group (BHP)

Key positive contributors to portfolio performance in the June quarter within the large caps segment of the investment universe included BHP, which returned 23.6%. BHP has benefited in particular from the strength in the iron ore price, which gained 20.8% over the quarter. This has been driven by both limited supply out of Brazil and continued strength in demand from China, as the country has turned to infrastructure related stimulus spending through the Covid-19 pandemic. China dominates global seaborne demand for iron ore, so this demand strength has outweighed softness in steel demand from the rest of the world.

BHP is a diversified miner, with iron ore accounting for 40% of revenues in the 2019 financial year, copper accounting for 25%, coal 21% and petroleum 14%. These commodities all fell sharply in price as the pandemic accelerated through February and March, while both copper and petroleum recovered strongly in the June quarter. Over this three month period, copper gained 21.6% and the petroleum price increased by 60.8%, outweighing continued softness in coal prices and the 12.5% appreciation of the Australian dollar relative to the US dollar over the quarter.

Although the BHP share price has moved materially higher since the March lows, Clime remains attracted to the high quality asset base, strong balance sheet and fully franked dividend yield. As at the last half year result, BHP's net debt position was only 40% of the EBITDA the company is forecast to have generated last financial year and the company is currently yielding 4.8% fully franked.

Macquarie Group (MQG)

MQG returned 40.4% over the quarter, reflecting a sharp recovery from the bearish lows of March when pandemic related concerns dominated market considerations. Macquarie is the global leader in infrastructure investment management and its asset management operations accounted for 40% of group earnings last financial year. This segment has continued to perform well, garnering strong, positive inflows. Further, ultra-low

interest rates are supportive for valuations of long term infrastructure assets and the dislocation of the pandemic offers opportunities to acquire assets from potentially distressed sellers.

It was pleasing to see the senior management team electing to take bonus payments in the form of stock through this period. This is a strong indication that management backs themselves and has confidence in the future direction of the company. While the market facing parts of the business, being the investment banking type activities, are less predictable, overall Macquarie is a very profitable business. Over the past three years, Macquarie has generated an average return on equity of 14.7%. This compares to a range across the big four banks of only 10.6% for ANZ to 13.7% for Commonwealth Bank.

Fortescue Metals Group (FMG)

Much like BHP, FMG has benefited from the continued strength in the iron ore price, which gained 20.8% over the quarter. The key difference being that Fortescue is focused on iron ore mining, whereas BHP has more diversified commodities exposures. This supported the relatively stronger performance of Fortescue's stock over the quarter, gaining 38.5% compared to 23.6% for BHP, and indeed over the past twelve months, where Fortescue has returned 64.6%.

Fortescue has clearly been one of the most impressive business stories on the ASX. The group is now shipping iron ore at an annualised rate of 170 to 175 million tonnes and achieving world class mining costs of US\$13 per tonne. Given the combination of such an efficient cost base and the strength in the iron ore price, Fortescue was able to deliver an EBITDA margin last half of 53%.

Since the 2012 financial year, the company has been able to reduce its gearing from 62% down to only 5% as at the last result and with no debt maturities this calendar year or next. This has enabled a materially increasing stream of dividend payments. The company is forecast to pay a fully franked yield for the 2020 financial year of 10.5% at the current share price, although this is expected to moderate to 6.3% in the 2021 financial year given a forecast normalisation of the iron ore price.

Sonic Healthcare (SHL)

Sonic Healthcare returned 25.1% in the June quarter, as medical systems in the majority of the company's geographies began to return to more normal levels of activity with the falling incidence of new Covid-19 cases. While the company is integrally involved in Covid-19 related testing, this was more than offset by the absence of normal testing activity.

SHL operates pathology laboratories in eight countries around the world, concentrated in Australia, the United States and Germany and delivering services to approximately 120 million patients each year. The company has one of the most consistent records of dividend payment on the ASX, having not cut its dividend once in the past 26 years.

On the 24th of June, Sonic provided a trading update, informing the market on the performance of the business since the last update on 20 March. At the time of the March update, pandemic related lockdowns had precipitated significant falls in revenue across Sonic's global operations, causing management to withdraw the previously provided earnings guidance for the 2019 financial year.

Positively, management responded swiftly by materially cutting costs to mitigate the fall in revenue. Revenues began to stabilise in late April and by June the majority of Sonic's divisions had returned to pre-Covid levels of revenue. While some geographies, including the US (23% of FY2019 revenue), continue to operate at a lower level, the combination of reduced costs and recovering revenues have meant that the group's trading performance in May was stronger than forecast.

While some costs may return in the current financial year, this result augurs well for forward earnings. Indeed, following this trading update, consensus earnings per share estimates were upgraded by 14% and the company is expected to deliver a result in line with 2019 despite the impact of the pandemic.



Goodman Group (GMG)

Goodman Group returned 24.0%, assisted by the fall in bond yields through the calendar year to date, which has benefited the more interest rate sensitive sectors of the market including property. Australian Government 10 year bond yields started this year at 1.37% and finished the June quarter at 0.87% after hitting an all-time low of 0.56% in March.

From an operational perspective, the company provided a positive trading update in May, reaffirming both earnings and distribution guidance for the 2020 financial year, despite the impact of the pandemic. Across the group's global portfolio, GMG has continued to experience robust demand in the areas of online, logistics, food and consumer goods. The Group has seen increased demand for both temporary and permanent space, particularly from ecommerce operators. This has supported very high group occupancy, at 97.5% at the time of the May update. The company has seen relatively limited disruption to or closure of warehouse facilities over recent months.

REA Group (REA)

REA returned 40.1% over the June quarter as a relaxation of lockdowns has enabled the resumption of more normal residential property activity towards the end of the quarter. Clime remains attracted to the very strong market position of REA in the Australian context in particular, and the continued opportunity to capture more of the value of the services which the company provides through higher prices over time. This long term opportunity takes much greater weight in Clime's approach to investment management as compared to the short term weakness in the residential property market and disruption related to the pandemic.

During the quarter, the company provided financial results up to 31 March 2020. Revenue growth was muted, at 1%, given conditions in the residential property market. Pleasingly however, the company was able to respond to the challenging environment and reduce costs by 9%, resulting in an 8% increase in EBITDA relative to the same period last year. At the same time, conditions were clearly more difficult through most of the June quarter, with a more material decline in listing volumes. The group again responded with further cost cuts, while the short term results through the height of the pandemic will have been negatively impacted.

Appen (APX)

Appen returned 72.3% during the quarter, being one of the few businesses to not only maintain earnings through the pandemic but to continue on a strong growth path. The company provided earnings guidance at their result in February for EBITDA to grow by 25 to 30% this calendar year. At the AGM in late May, the company affirmed this guidance, noting negligible impacts from the pandemic. Additionally, this guidance is based on an AUD/USD exchange rate of \$0.70, which compares to the average rate through the calendar year to date of \$0.67, providing upside risk relative to guidance.

The outperformance of online businesses has been a key thematic through the pandemic and Appen has benefited as a leading online based business servicing online based business customers. The company supports artificial intelligence focused software by providing training data for algorithms.

Appen's customers are the very large tech companies like Alphabet and Facebook. Appen employs crowds of thousands of people to annotate data to improve algorithms for these customers. Importantly, the vast majority of the work that Appen does is related to product upkeep rather than product development, so this is work that their customers need to have done just to maintain the quality of their products. Additionally, in regard to product development, competition is a very important motivator for Appen's customers, meaning that they are unlikely to significantly slow development of new products and risk giving up a potential first mover advantage to their competitors.

Breville Group (BRG)

Breville returned 34.8% through the June quarter, its strong operational performance continuing through the pandemic given an increased focus by consumers on household items. The much greater time spent at home through lockdowns around the world has translated to increased spending on household kitchen appliances, benefiting earnings for Breville.

Through the most disruptive period of the pandemic to the end of April (to date), Breville has continued to trade very strongly. Group revenue growth in the month of April was 20.9% compared to the same month last year, including the effect of currency movements.

Clime has been impressed by the thoughtful approach of the company's leadership in managing Breville through the present environment. On the cost side, the company has reduced its cost base by 25% below the gross profit line to preserve profitability. At the same time, normal product development activity is going ahead as usual, so that medium and long term profitability is not sacrificed. Management intends to keep costs down through the 2021 financial year. This will best prepare the company for whatever demand environment transpires over this time.

During the quarter, Breville raised \$104 million at \$17.00 per share via an institutional placement and share purchase plan, which Clime took part in and increased shares on issue by a modest 4.8%. This raising was to ensure more than adequate liquidity to continue to source long lead-time products through the uncertain trading period ahead. The company has previously undertaken small, bolt-on type acquisitions and has confirmed continued demand for these deals, while this was not specifically called out as a purpose of the raising.

Mach7 Technologies (M7T)

In June US-based medical imaging software company, Mach7 Technologies (M7T) announced a \$40.8 million acquisition of Canadian peer Client Outlook. We took part in the associated capital raise at \$0.68 per share.

We view the acquisition as a transformational merger of best of breed solutions to form the strongest end-to-end healthcare imaging system on the market.

The medical imaging market is ripe for structural change. For healthcare systems globally, effective patient data management has the potential to significantly improve system efficiency and patient outcomes. In the US, the Electronic Medical Record (EMR) was mandated in 2009, requiring hospital systems to invest in patient data management software.

Within the imaging space, Picture Archiving and Communication Systems (PACS) need to be modernised to enable imaging data to be consolidated and included in the EMR, and to be shared across healthcare enterprises which, in the US, range from single entities to hundreds of hospitals.

Well over half the PACS space is dominated by equipment vendors, including GE Healthcare, Lexmark, Agfa, Fuji, and Philips, which traditionally packaged software as add-ons with their equipment. The problem is, the vendor-specific software systems don't talk to each other, resulting in data silos within departments (eg radiology, cardiology) and individual hospitals.

Both M7T (formed in 2007) and Client Outlook (2002) were founded as 'software pureplay' businesses to address the need for vendor neutrality and provide 'data liquidity' across the healthcare enterprise. M7T specialises in Vendor Neutral Archive (VNA) and data routing (the back end), while Client Outlook focuses on viewing technology (the front end) for both Enterprise Imaging as well as departmental (radiology, cardiology etc) PACS.

Both are leaders in their respective domains, with industry research house IDC rating M7T as the best-in-class VNA (2016) and KLAS rating Client Outlook's eUnity product as the best-in-class viewer for enterprise (2019).

This merger is particularly good because, from a technology standpoint, the two are already tightly integrated. M7T and Client Outlook are



resellers of each other's products and have partnered for several years. Their products work together seamlessly.

The merger should also enhance contract win-rates and improve pricing power. Based on our discussions with management, although M7T and Client Outlook previously bid for deals under a single contract arrangement, buyers had a clear preference for single vendors (all else being equal) to reduce supply-chain risk. This is supported by industry research by Reaction Data (2018), which found 67% of buyers preferred a single vendor over a best-of-breed modular approach. M7T is now a single vendor of an end-to-end system combining best of breed components.

In terms of the total addressable market (TAM), M7T can now compete for departmental PACS business, which increases its TAM from US\$750m to US\$2.75bn.

Live tenders have also increased from ~\$30m to \$40m over the next 6 to 12 months and the pipeline of opportunity has increased from \$100m to \$150m. Notably, two contracts each valued at over \$13m are to be decided in the near term. For context, M7T's largest deal yet was its 5-year \$15m Enterprise Imaging contract with Hospital Authority of Hong Kong (HAHK), covering 43 hospitals. Beyond cross-sell opportunities across M7T's and Client Outlook's customer bases, winning large US tenders in the near term should enhance M7T's standing as a vendor of choice among leading hospital networks in its home market.

Financially, M7T comes out of the merger with Contracted Annualised Recurring Revenue (CARR) of \$14.75m, up from \$9.2m, and net cash of \$15m. CY21 revenues are forecast to be \$27m and EBITDA \$5m-\$7m.

This compares to a market cap (at the time of writing) of \$183m or an enterprise value of \$168m. Although the valuation multiple (EV/EBITDA) appears high at 24 times, we highlight that M7T and Client Outlook are only now transitioning to profitability and the combined entity is set to benefit from structural tailwinds for many years to come.

Jumbo Interactive (JIN)

Digital lotteries retailer and software provider Jumbo Interactive (JIN) kept shareholders in suspense during the final week of the financial year with regards to its ticket reseller agreements with Australia's two official lottery operators, Tabcorp (TAH) and WA Lotteries. On 29 June JIN announced an updated reseller agreement with TAH. Negotiations are still in progress with WA Lotteries at the time of writing.

The new TAH agreement was mixed, but in the context of JIN's depressed share price, it was good news. JIN will remain a licensed reseller through to 2030, providing long-term certainty, but will pay Tabcorp annual service fees starting from FY21. The service fee, calculated as a percentage of the underlying ticket value, reduces JIN's revenue margin on its Total Transaction Volume (TTV). In effect, JIN's TTV margin falls from 20% to approximately 16% when the service fee is fully implemented from 2024.

This is good news because JIN should still deliver revenue growth driven by increasing digital share of ticket sales from approximately 30% now. Digital sales have increased more than 6-fold over the last decade, and likely will continue this trajectory.

On this basis JIN should deliver solid double-digit earnings growth even after accounting for the service fee. This is interesting because JIN trades at a healthy free cash flow yield of 7% and has a balance sheet with net cash of \$60m.

In the near term, JIN will redeploy Australian reseller cash flows to ramp up international growth of its new lotteries management Software-as-a-Service (SaaS) business, Powered by Jumbo. This is a multi-billion dollar opportunity across the UK, Canadian and US markets. We expect the SaaS strategy to accelerate in FY21, when early reference sites (Australian charity lotteries) demonstrate improved performance.

Macquarie Telecom (MAQ)

Cloud and telco services provider Macquarie Telecom (MAQ) is a beneficiary of surging data consumption, which is driving demand for its hybrid-cloud, cyber-security and data centre offering. MAQ has an industry leading Net Promoter Score of +71.

In June MAQ announced increased capacity to its data centre portfolio via a new 4MW facility in Canberra to expand its government business. It is also bringing forward capacity at the Macquarie Park campus to service accelerating demand.

As per recent announcements, improving cyber-security is a top priority for the Federal Government. With 43% of government agencies as customers, and with the Canberra facility expansion underway, MAQ is well positioned to capture future demand in this area.

In total, MAQ plans to increase capacity from 13MW to 50MW across the Sydney and Canberra portfolio, representing growth of more than 300%. The capacity expansion will be reflected in a similar revenue growth over the coming years, and even higher earnings growth due to operating leverage.

Although shares doubled over the June quarter, MAQ remains Clime's preferred data centre exposure, and still trades at a discount to larger listed peers despite offering a superior growth profile.

In what we believe will be the exception rather than the norm heading into reporting season, MAQ reiterated pre-COVID guidance of \$63-\$66 million EBITDA (\$55-\$58 million pre-application of AASB16), representing approximately 10% growth. Future earnings growth will accelerate as new capacity comes online.

City Chic Collective (CCX)

A theme across the board during the crisis so far has been the rapid shift to the online retail channel from bricks and mortar. Ladies' fashion retailer City Chic Collective (CCX) is a key beneficiary with a leading brand and 65% of pre-COVID sales already online.

In May CCX provided a positive trading update, with Australia and New Zealand online sales growth up 57% versus the same time last year, which helped offset the impact of store closures in its home markets.

Importantly the international growth strategy appears to be well on track. The US ecommerce business Avenue, which was acquired last year, is 'exceeding expectations' according to management. Successful offshore execution could yield a strong payoff from current prices.

In the update, management said the business had traded profitably during the period. The balance sheet remains well-resourced with minimal debt and significant headroom within its \$40m facility. The team has done an excellent job in the circumstances.

Despite retail being under significant pressure, City Chic is doing well and remains on track to deliver on its global ambitions.

Omni Bridgeway (OBL)

Litigation funder Omni Bridgeway (OBL) is a niche leader in its field and a source of uncorrelated returns in the current environment.

The June quarter saw increasing debate around regulation of Australia's litigation funding industry, which is in relative infancy.

On 5 March the government launched a parliamentary inquiry into litigation funding and its impact on outcomes for plaintiffs. A report is due on 9 November 2020, which will provide the basis for new legislation.

There are many aspects to the inquiry, however, the central issues are the amount of class actions as well as claimants' (i.e. 'ordinary Australians') share of case recoveries (judgements and settlements).



We believe increasing regulation will be manifestly to OBL's advantage, although there are some risks. Given its low exposure to Australian Class Actions (15% of its case book) and global strategy, OBL is well positioned to re-enter the Australian Class Actions market, should regulations increase barriers to entry. It also has limited downside in the event of unfavourable legislation.

The business is in the final stages of a 5-year strategy commenced in 2015 to reduce idiosyncratic case risk and improve earnings quality by moving investments from the balance sheet to fund vehicles with much larger capacity. OBL typically invests 20% of the capital in these funds and acts as manager. Effectively, the funds provide OBL with 5 times the capacity it previously had from investing via its balance sheet while adding additional management fee income. Already strong unit economics should therefore improve, and we'll also see a smoother income profile in the future.

As it stands, OBL is the second largest litigation funder globally, behind UK-based Burford (LSE: BUR), and one of the few litigation funders with local offices in every jurisdiction in which it operates.

Financially, OBL is in a strong position to invest in the global opportunity with total cash and receivables of \$254m and a further \$277m expected from settlements and potential completions.

Closing Commentary

While FY2020 delivered its own set of challenges, as is always the case with business and markets, a range of opportunities also presented themselves. Bushfires and the global Covid-19 pandemic tested both economies and markets in what has been an extraordinary period.

Looking ahead, we maintain that Covid-19 will continue to shape the investment landscape for some time to come. The long shadow cast by the pandemic has indeed been met with an unprecedented global policy response. With health, geopolitical and economic uncertainties still abundant, we seek to balance growth exposure in an era of ultra-low interest rates with the sensible assessment and pricing of risk. As such, the portfolio retains significant cash reserves that can be sensibly deployed as and when high quality opportunities become apparent, at prices representing genuine value.

We now welcome in a new financial year, one that will undoubtedly bring with it further challenges. But we are well prepared; with the portfolio well positioned. Thanks to our investors for your continued support, and best wishes to all in FY2021.



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Market Commentary

While we remain in the midst of a pandemic-induced global recession, we bear in mind that in due course, this too will end. History is clear – all recessions end, and economic downturns are followed by economic recovery. This recession will be no different even though its genesis is unique, and has been a truly shocking experience for markets and the populace alike.

The severity of the global recession and the significance of policy responses have been extraordinary. But we must guard against confusing short term market price movements with the long term prospects of an investment. The daily movement in the prices of most liquid assets generally reflect the speed and flow of “random information” and elevated levels of “noise”, whereas quality assets that benefit from long term economic growth eventually increase in “value” to reflect rising cash flows generated from that growth.

Over time, sometimes quite a long time, the price of the asset will converge with its value. Rational investors patiently seek to generate their returns over long periods. They also diversify their investments across various asset classes and utilise compounding as much as possible.

The onset of this recession has been sharp, and deep. While the policy responses likewise have been rapid and broad, and will dampen the severity of the downturn; they should also continue to aid and hasten the recovery. An unknown factor remains the trajectory of COVID-19 and the burgeoning risk of a second wave. While the timing of any medical solution is still undetermined, history suggests that eventually, human ingenuity will probably discover effective anti-viral drugs and vaccines.

Global central banks have acted in unison to lower the cost of capital and to ensure financial shocks and disruptions are quickly dealt with. In some respects, they appear to be behaving with desperation as they are charged with the funding of government liabilities that have been amassed with unprecedented mountains of debt.

The numbers are huge. To date, the US Federal Reserve balance sheet has expanded to 39% of US GDP – while this is dwarfed (in proportionate terms) in other jurisdictions, as in the European Central Bank (50% of GDP) and the Bank of Japan (117% of GDP). In Australia, the RBA balance sheet has expanded to 14% of GDP after outlaying \$50 billion on asset purchases designed to drive down the bond yield curve (with a specific target of 0.25% for 3 year bonds). In years ahead, these debts will need to be reduced and repaid. In the interim, increased leverage in the global financial system introduces increased risk and lowers resilience.

The path to full recovery for Australia’s economy is unlikely to occur until some point in 2022 at the earliest. It may be that FY23 is the year that Australia’s economic activity and output matches that of FY19. The closure of our borders to international travellers has affected both our tourism and education sectors. Tourism is our fourth largest export earner; in 2019 there were 9.3 million international tourists to Australia who spent a total of \$44 billion. Tourism accounts for 8% of our workforce.

Education is also a large export and generated \$38 billion in 2019. In 2020, this revenue stream will be decimated and any recovery in the first half of 2021 will require a significant commitment to an arrival isolation program. Another headwind is the slowing of population growth. It is likely that FY21 will see Australia’s lowest population growth rate since World War 2.

These observations suggest a significant weakening through 2020 of Australia’s production and income. When the economy recoups its 2019 level in a few years’ time, it will occur with a moderate increase in both our population and work force. Thus, the per capita income of Australia in FY23 will be lower than in FY19. It is also likely that our unemployment rate in FY23 will be higher than in FY19.

Our view is that after a period of sharp retracement in asset prices, there will likely be a long period of subdued investment returns. The best indicator of this is both the low actual and negative real yields of long term government bonds, which suggest that investment returns across the range of asset classes will be lower for a sustained period.

Whilst the short term is always hard to predict, the longer term is more certain. Because this recession is both sharp and deep, the initial recovery off this lower base will probably be stronger than usual. This gives the appearance of a decoupling of market prices from the short term economic pain that is widely felt and seen. It also leads to seemingly logical speculation that market prices are recovering too quickly, will falter and that a correction is imminent.

Thus, we are concerned that many of today’s market prices for liquid assets are already reflecting the expectation of full economic recovery. This implies that in some instances, stock and other asset prices may be excessively optimistic, or indeed over-valued.

We cannot know with any degree of certainty if this will be the case or not. But we do believe that liquid asset prices will be volatile throughout the journey back to recovery. Price volatility is the natural result of zero interest costs and rampant currency printing which creates the fuel for excessive speculation.

Our view is that investors with medium to long term time horizons should stay exposed to growth assets if they are to achieve the returns they require to meet their longer term pension liabilities. The exposure to growth assets (mainly equities and property) can be supplemented and balanced by a measured exposure to corporate debt securities.

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