

Divergences

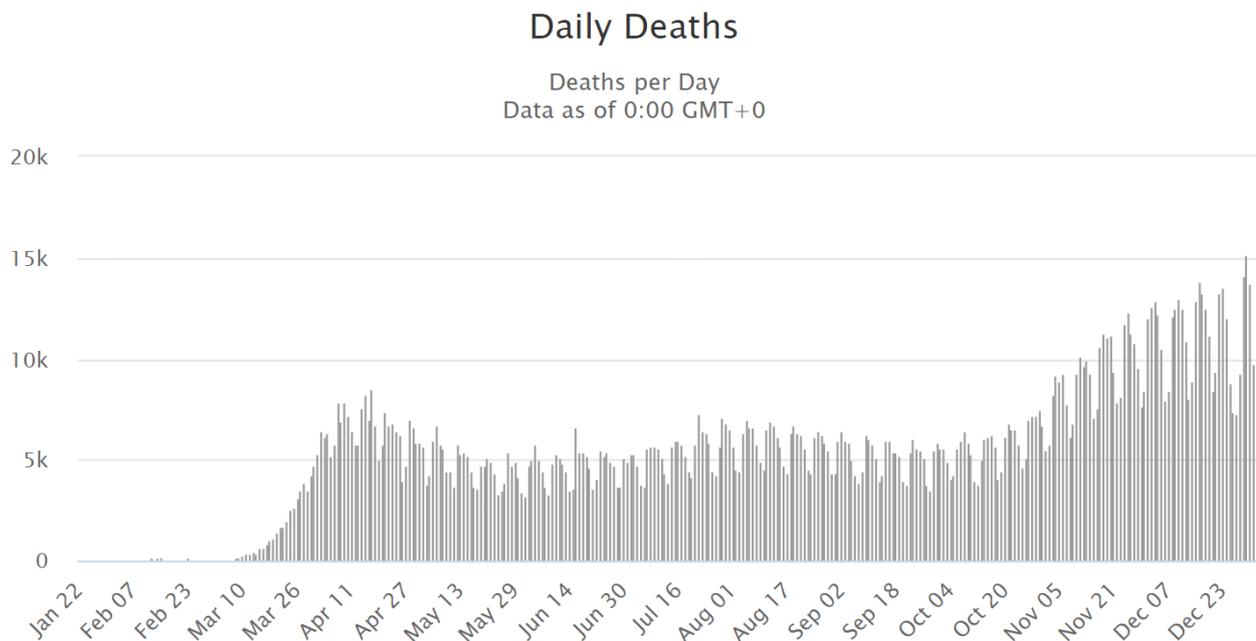
When different indicators are saying dramatically different things, one of them usually has to be wrong.

When the world moved into lockdowns in March, imagine the following scenario:

- ▶▶ Exponential growth of COVID-19 cases is halted, but there is nothing like eradication
- ▶▶ Instead, a level near the March peak persists all through the northern summer
- ▶▶ Colder weather sees new cases rise to around 7x the March level
- ▶▶ Better detection and treatment mean this will not translate 1:1 to death toll but deaths are still around double the March peak and still rising by year-end.

This would sound like the downside case, or at best minimal success – defined as *preventing the over-run of hospitals and the complete collapse of the medical systems.*

Well, that is where we are now:



Anyone who thought the world would not contain COVID-19 is, to date, correct. But much harder to guess would have been the next charts -

Iron ore:



US stocks:



Copper:



Market indicators suggest an economic boom, with economically sensitive commodities setting multi-year highs – even as Europe and (probably) USA face another negative quarter due to second COVID-19 lockdowns.

Can central banks resolve the divergence? Most are guiding extremely stimulatory policy to continue for at least another 3 years (already a year into the crisis). The RBA do not sound as optimistic as their forecasts suggest.

Leading Markets

The US S&P500, Dow Jones and NASDAQ gained +3.8%, +3.4% and +5.7% respectively, all setting records.

MSCI World ex-AUS gained +3.6% in local terms. Emerging Markets rose +7.4% in \$US and Frontier Markets +5.7%.

Some of Europe (notably UK) had double-digit losses in 2020. The year's best market was post-default Lebanon.

US 10-year bonds sold off, almost touching 1% before closing 0.93% (+9bp). High yield broke through +400bp to close at 386 spread (-47bp).

Other Highlights

COVID-19 vaccines received emergency authorisation and commenced rollout. Deaths average 11,000/day to total 1.8m. Markets ignored everything except the successes of vaccine trials; neither record deaths and new lockdowns, nor likely double dip recessions halted gains.

GDPNow expected another double-digit annualised GDP rebound for USA in Q4 although Q1 will be problematic.

The US Congress agreed a small compromise stimulus, while fighting over a greater allocation.

A new Congress takes effect, awaiting Georgia senators. January 6th should see the last round of election challenges.

US unemployment fell to 6.7% (-0.2%) after a modest +245k jobs in November. CPI was steady at +1.2% YoY. Retail sales fell -1.1%.

Eurozone unemployment eased to 8.4% (-0.1%). YoY inflation remained negative (-0.3%) after another negative month.

UK left the EU at year end, completing its transition with issues still unresolved.

China's yuan closed at 6.5 per \$US, the strongest since mid-2018. Prices fell -0.6% in November, taking the year into deflation as pork prices fell.

A crackdown on Alibaba and Tencent echoes Russia's problems with oligarchs seen as threats to the ruling class.

Japan also reported deflation, with core and headline CPI reaching -0.9%.

Domestic

The RBA made no policy changes at December's meeting, continuing to be surprised to the upside by data. Cash rate guidance is explicitly "*more than 3 years.*" The key policy variable is the size of bond purchases in quantitative easing.

The ASX200 returned +1.2%, achieving a slightly cash-plus year. Smallcaps added +2.8% for a solid +9.2% in 2020. The 10-year bond weakened to 0.97% (+7bp), having traded over 1% in the month.

Houses and units appreciated in every capital in December. Melbourne houses and Brisbane units had a negative year.

Australia saw the return of COVID-19, localised lockdown and hard state borders.

China blocked key Australian exports but began the year on hopes of reconciliation.

The trade surplus on goods fell to under \$2bn for the first time since 2018 as exports to China plunged. Q3's current account was +\$10bn (-\$6.3bn).

Retail sales soared +7% in November to be +13% YoY. Household wealth reached a record \$11.35tr.

Unemployment fell to 6.8% (-0.2%) on +90k jobs in Oct despite participation rising to 66.1% (+0.3%). Hours worked rose +2.5. Underemployment fell -1pt to 9.4%. Union membership reached a record low 14.3% of employees.

The population grew +1.3% to 25.7m, but births were down -3% in the latest year reported (2019) with a record low total fertility rate of 1.66 per woman.

New home loan commitments reached a record \$22.7bn in Oct (+0.7%), due to a 30% YoY increase for owner-occupiers.

Commodities and Currency

WTI oil jumped to \$US48.52/bbl (+8.0%), expecting growth in transport. Gold recovered to \$1898/oz (+6.4%). Iron ore closed +22.3% at a 9-year high \$158.

Base metals were mixed: Nickel (+1.21%), Tin (+8.22%), Copper (+0.87%) rose while Zinc (-3.06%) and Aluminium (-1.81%) fell.

The \$A closed at US77c (+4.2%), a multi-year high.

KEY FINANCIAL MARKET DATA – AS AT 31ST DECEMBER 2020 (UNLESS SPECIFIED)**Interest Rate Markets**

Index Performance	1 month	3 months	6 months	1 year	2 year	3 year	5 year
					p.a.	p.a.	p.a.
AustBond Bank Bill Index	0.00%	0.02%	0.05%	0.37%	0.93%	1.26%	1.52%

Key Rates	Dec-20	Nov-20	Oct-20
Australian Cash Rate	0.10%	0.10%	0.25%
90 day BBSW	0.01%	0.02%	0.06%
3 Yr Commonwealth Bonds	0.10%	0.11%	0.13%
10 Yr Commonwealth Bonds	0.98%	0.90%	0.83%
CDX North American 5 Yr CDS	50bp	50bp	66bp
iTraxx Europe 5 Yr CDS	48bp	49bp	65bp
iTraxx Australia 5 Yr CDS	57bp	59bp	71bp
US Fed Funds Rate	0-0.25%	0-0.25%	0-0.25%
US 10 Yr Bond Rate	0.93%	0.84%	0.88%

Equity Markets

Domestic	1 month	3 months	6 months	1 year	2 year	3 year	5 year
					p.a.	p.a.	p.a.
S&P/ASX 200 Acc. Index	1.21%	13.70%	13.20%	1.40%	11.86%	6.73%	8.73%
S&P/ASX Small Ord Acc. Index	2.76%	13.83%	20.28%	9.21%	15.12%	6.57%	10.46%
S&P/ASX 200 A-REIT Acc. Index	0.42%	13.30%	21.19%	-4.61%	6.70%	5.42%	6.99%

International	1 month	3 months	6 months	1 year	2 year	3 year	5 year
					p.a.	p.a.	p.a.
US: S&P 500 (\$US)	3.84%	12.15%	22.16%	18.40%	24.77%	14.18%	15.22%
US: NASDAQ (\$US)	5.71%	15.63%	28.62%	44.92%	40.75%	24.39%	22.12%
MSCI World Acc. (Local Currency)	3.51%	12.36%	19.89%	13.48%	20.21%	10.20%	11.57%
MSCI World Acc. (AUD)	-0.46%	5.85%	9.74%	5.58%	16.19%	11.04%	10.88%
FTSE 100 (£)	3.28%	10.86%	6.40%	-11.55%	1.87%	-1.80%	4.77%
MSCI Emerging Markets (\$US)	7.35%	19.70%	31.14%	18.31%	18.36%	6.17%	12.81%

Fixed Interest Markets

Bonds	1 month	3 months	6 months	1 year	2 year	3 year	5 year
					p.a.	p.a.	p.a.
BarCap Global Agg Acc. (Hgd AUD)	0.26%	0.79%	1.47%	5.09%	6.14%	4.62%	4.55%
AusBond Composite Bond Acc.	-0.27%	-0.10%	0.92%	4.48%	5.86%	5.42%	4.56%
ICE BoAML High Yield TR (\$US)	1.91%	6.48%	11.49%	6.17%	10.21%	5.89%	8.43%

Data*	Current Period		Previous Period	
<i>Employment Data</i>				
Employment Growth	November	90,000	October	178,800
Unemployment Rate	November	6.80%	October	7.00%
Participation Rate	November	66.10%	October	65.80%
<i>Lending Finance</i>				
Housing Finance	October	0.70%	September	5.90%
Personal Finance	October	4.30%	September	8.50%
Business Finance	October	-2.10%	September	57.20%
<i>Other</i>				
Balance on goods and services	October	7,456m	September	5,815m
Retail Sales	October	1.40%	September	-1.10%
Building Approvals	October	3.80%	September	15.40%

*All data is seasonally-adjusted.

Median Fund Manager Returns (Morningstar)	1 month	3 month	6 month	1 year	2 year p.a.	3 year p.a.	5 year p.a.
Australian Equity Large Cap	1.24%	14.30%	15.24%	1.30%	11.32%	4.94%	7.38%
Australian Equity Small Cap	2.78%	13.21%	24.33%	10.68%	16.52%	7.96%	9.99%
Global Equity Large Cap	0.44%	7.83%	11.27%	4.76%	14.66%	9.94%	9.77%
Global Equity Small Cap	2.32%	12.98%	18.86%	7.92%	15.12%	6.33%	8.54%
Australian Fixed Income	-0.19%	0.18%	1.49%	4.58%	5.78%	5.22%	4.37%
Global Fixed Income	0.33%	1.30%	2.74%	5.28%	6.19%	4.51%	4.34%
Australian Listed Property	0.55%	13.02%	21.14%	-4.42%	6.62%	5.08%	6.75%
Australian Cash	0.00%	0.02%	0.07%	0.36%	0.93%	1.22%	1.49%
Conservative ¹	0.30%	2.10%	2.96%	2.16%	4.31%	3.34%	3.36%
Moderate ²	0.47%	3.51%	4.61%	2.72%	5.66%	3.55%	3.93%
Balanced ³	0.78%	6.04%	7.54%	3.08%	7.73%	4.42%	5.40%
Growth ⁴	0.95%	7.97%	9.78%	3.00%	9.45%	5.07%	6.45%
Aggressive ⁵	1.24%	10.13%	12.29%	2.90%	11.37%	5.98%	7.59%

¹ Growth Assets 0-20%

² Growth Assets 21-40%

³ Growth Assets 41-60%

⁴ Growth Assets 61-80%

⁵ Growth Assets 80%+

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