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Editorial

When we are all older and greyer, sitting in our rocking chairs and slippers and contemplating what happened in the last 100 years, we will remember 2020. The pandemic challenged our lives, and now the President of the United States is challenging democracy. With many states undecided, he called for counting to stop, a step no President has previously contemplated on election night. In reality, counting may continue for weeks before we know a final result.

After **Donald Trump** falsely claimed a win at a 2am speech, he continued tweeting long into the night, inciting his followers to doubt the election results when there is no evidence of fraud. Twitter refused to allow many of his tweets.

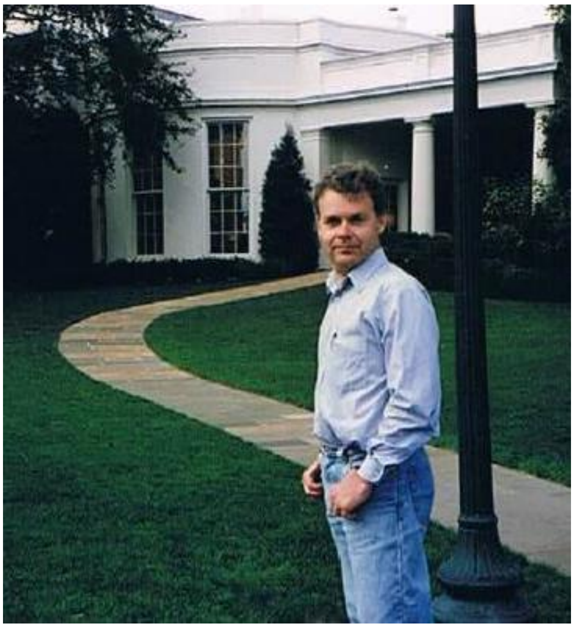
US Election price fluctuations with Sportsbet

Time	Joe Biden	Donald Trump
9:00AM	$1.45	$2.80
1:15PM	$2.00	$1.80
1:30PM	$3.25	$1.36
1:45PM	$3.75	$1.28
2:15PM	$5.00	$1.12
4:15PM	$2.20	$1.67
8:30PM	$1.65	$2.00
1:30 AM (Thurs)	$1.50	$3.20
6:00am (Thurs)	$1.36	$3.75
8:30am (Thurs)	$1.11	$6.50

Overnight counting swung momentum away from the President, and it has been fascinating to watch betting markets ebb and flow. At one stage yesterday, **Joe Biden** paid $5 for a $1 bet after being favourite for weeks before. At the time of writing, he is a firm favourite again.

The US feels so different to the country my family visited on a wonderful holiday in 1998. On a walk in Washington DC, we strolled past The White House and saw a queue near the gates. I asked a policewomen what was happening, and she said The White House was open to the public that day. She invited us four

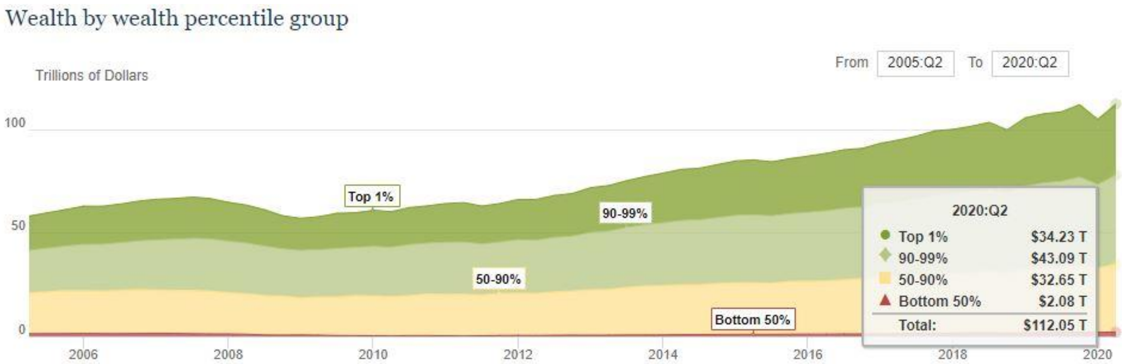
Aussies to go straight in. I don't recall a detailed security check, and in fact, we entered through the kitchens. This photo shows me standing near the window of the Oval Office as a tourist not even carrying a passport.

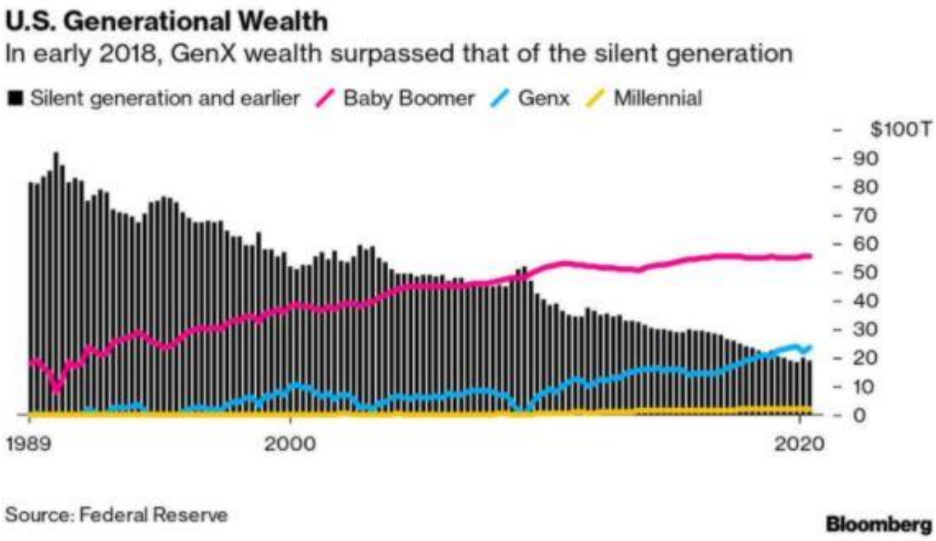


A lot has changed in 22 years. Globally, the threat of terrorism legitimately makes such casual entry into the halls of power impossible. There are no tours of the West Wing. The election shows how deeply divided the nation is, with a red block of Republican support in the middle and blue of the Democrats on the east and west coasts. From Washington to New York to San Francisco, businesses have boarded up their premises this week, fearing rioting by supporters of the losing party.

For all the faults of Australian politics, it's difficult to imagine a Prime Minister whipping up a crowd to challenge a poll result on declaration of a winner. A few days ago, Bloomberg reported that a Federal Court judge rejected Republican attempts to invalidate 127,000 votes in Texas. *"For lack of a nicer way of saying it, I ain't buying it,"* U.S. District Judge **Andrew Hanen** said.

Let's look at two US charts as background to what the country looks like, and one cause of this divide. The **Federal Reserve Board** issues data on wealth by percentile groups, and as shown below, the top 1% own as much wealth as the bottom 90%. And 17 times the wealth of the bottom 50%. That's an incredible wealth disparity, and although Donald Trump's promise to 'drain the swamp' was more words than action, it tapped into this inequality.





Among the generations, the Baby Boomers have the money from decades of prosperity, rising asset values and inheriting the wealth of their parents, who are now dying. Millennials who are already up to 40-years-old will also inherit much of this wealth, but without the right parents, it will be far more difficult to compound asset returns when bond rates are negative in real terms, debt will be passed on by the trillion and stock markets are already expensive.

Compared to US politics, investments markets look sane and rational, even as they rally into a global pandemic of rising numbers and a major threat to economic growth in Europe and the UK in particular.

Back to investing with a wide range of topics this week ...

We start with **UBS Securities** research on why companies with a strong tech focus have performed so well on the stock market, and why it might continue.

The pandemic and decline in travel has reduced demand for oil, and a **Joe Biden** win would boost support for renewables. Market forces will continue the shift the energy mix. **Douglas Huey** asks whether demand and supply for oil means we will never see oil prices as high as in the past.

Then **Simpson Sanaphay** explores four themes that affect investment portfolios during an economic recovery, while **David Gait** warns about investing that focuses on spurious index weight comparisons that encourage unwelcome short termism. Thought provoking insights into where our investing should be heading.

Remember Brexit? With the attention on the US, it's easy to overlook the problems in Europe and especially the UK. In 2016, the Brexit result was as much a surprise as the Trump win. **Michael Collins** examines the latest implications of Britain's EU exit amid a global pandemic. It will be a long, tough winter for **Boris**.

And a couple of videos of my sessions with **Chris Cuffe** and **Noel Whittaker** at the **Morningstar 2020 Individual Investor Conference,** held last week. It drew over 2,000 registrations and anyone who signs up for a free trial with Morningstar can tap into the expertise of other leading names such as **Hamish Douglass, Gemma Dale, Kate Howitt, David Harrison and Anton Tagliaferro.**

Meanwhile, as a sampler, there is free access to Chris talking about investing lessons and particularly how he selects fund managers, and Noel on long-term investing to make retirement simpler and healthier with more financial security. My personal thanks to both for sessions that received a lot of good feedback.

This week's White Paper from **Perpetual Investments** is a hot-off-the-press view from three analysts on the US election results and its impact on markets and economies.

Now, back to counting the legitimate votes, if Donald allows it ...

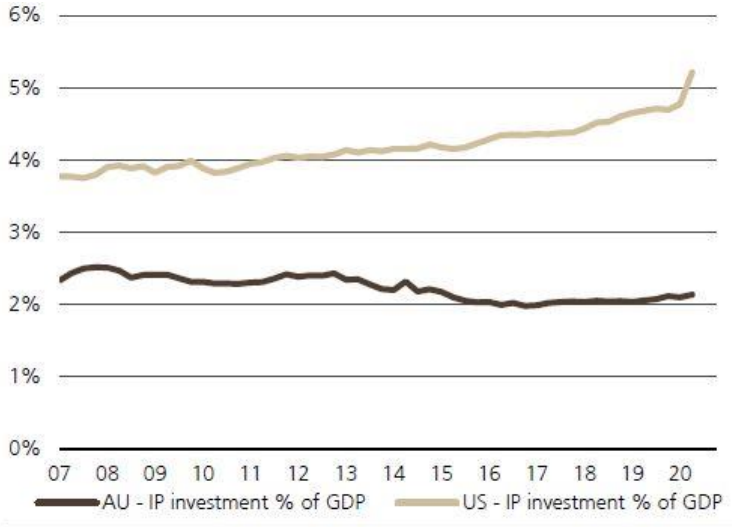
Why the market applies a premium to tech companies

Graham Hand

Compared to the US, where technology stocks are now the largest sector of the S&P500 at 27% of the index, Australia has a small tech component. Despite this, Australian businesses also face significant tech disruption, often by companies not traditionally associated with 'tech', such as Steadfast (ASX:SDF), James Hardie (ASX:JHX), CSL (ASX:CSL), Resmed (ASX:RMD) and REA Group (ASX:REA).

Many companies are using tech to disrupt competitors, and with intellectual property investment only 2% of Australia's GDP compared to 5% in the US, as shown in Figure 1, tech disruption has barely started on a long journey.

Figure 1: IP investment remains much lower in Australia than in the United States



Source: ABS, UBS

An innovative way to measure tech disruption

Equity analysts at UBS Securities in Australia embarked on innovative research to measure tech disruption. They were asked to rate which stocks are most effective in using data and technology relative to peers in their sector. They also checked which stocks use tech phrases in their stock exchange updates, including references to artificial intelligence, machine learning, natural language, deep learning and predictive analysis. UBS reports:

"Appen, Telstra, Insurance Australia Group, PRO Medicus, Seek, ASX, Flight Centre, QBE Insurance and Xero mentioned these phrases at least 100 times over the past five years."

Overall, they found that stocks identified as tech focused had Price/Earnings ratios (P/Es) that were significantly higher than their peers. UBS then back-tested to show that stocks with high tech disruption scores outperformed stocks with low disruption scores by an annualised 14% since the start of 2016.

Table 1 shows the identified companies and their tech disruption and tech mention scores.

Tech stocks which UBS likes include Appen, NextDC, Nanosonics, and REA. Non-tech stocks with a high-tech disruption score or lagging share prices include Aristocrat Leisure, CSL, ResMed, James Hardie, Breville and Steadfast Group. UBS thinks Altium and Magellan are worth watching, all listed above.

Tech disruption explains Growth outperforming Value

UBS also finds that tech disruption is contributing to the ongoing outperformance of Growth over Value stocks, which is a major issue for fund managers who have built their businesses on identifying 'Value' (or companies trading at below their fundamental values). The increase in the valuation gap between high and low PE stocks has, in part, been justified by high PE stocks producing significantly higher earnings growth than their low PE counterparts, as shown in Figure 2. Tech companies are usually Growth stocks.

Since the start of 2007, earnings of growth firms have nearly doubled, while earnings of value stocks have halved. The high growth firms justify higher multiples due to their higher earnings growth. The earnings of tech disrupters have also consistently grown faster than tech laggards since 2016 (Figure 3).

Tech disruptors are Growth stocks and benefit from lower rates

UBS has also written notes on how ultra-low rates are having a major impact on the prices of Australian equities:

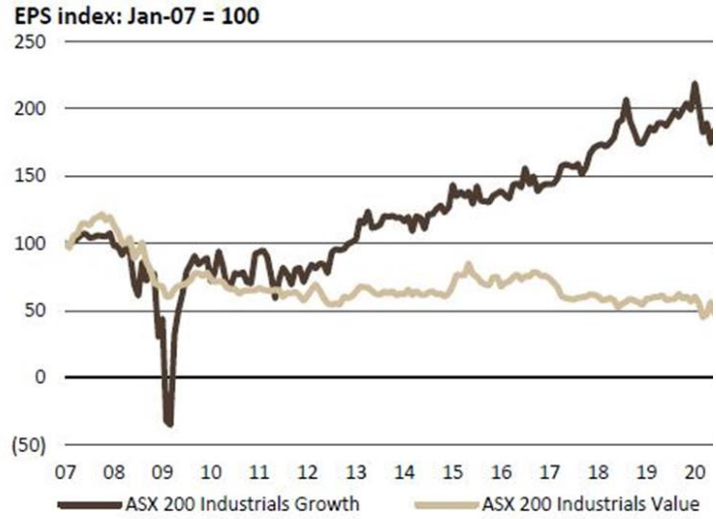
"An additional insight from those notes is that a lower risk-free rate means that long-dated future cash flows matter more than near-term cash flows in a discounted cash-flow framework. Put differently, the terminal value component accounts for a greater proportion of the value of the equity. Growth stocks are

Table 1: Key growth names

	ROE		FY22 PE			Tech Scores^ (quintile	
	FY22	3 yr ave.	Now	20-Feb	R&D/sales	Disruption	Mention
ALU	43.6	38.1	50.8	37.1	12%	5	5
NXT	2.2	2.7	361.8	194.9	na	4	5
APX	17.0	23.3	30.9	26.9	3%-5%	4	5
NAN	19.2	19.6	69.2	56.9	15%	4	1
REA	34.0	30.2	36.5	32.8	<8%	5	4
RMD	21.3	22.3	33.4	33.2	7%	5	4
JHX*	11.2	12.3	22.3	19.5	1%	5	2
SDF	12.1	11.6	18.9	23.5	na	5	2
ALL	20.7	34.1	18.7	19.9	12%	4	3
BRG	21.2	22.6	38.0	29.9	6%	4	3
CSL	26.0	31.1	36.5	35.9	10%	3	4
MFG	51.9	45.2	21.5	24.3	na	3	1

Source: FactSet, UBS * JHX is ROA, ^ 5 = highest quintile, 1 = bottom quintile, Top panel is tech names, bottom panel is other attractive growth names

Figure 2: Earnings of ASX200 growth stocks versus value stocks since 2007



Source: FactSet, UBS

Figure 3: Tech disrupters EPS relative to tech laggards

Source: FactSet, UBS

longer duration assets (more cash flows in the future). Value stocks are shorter duration assets (less cash flows in the future).

Tech disruptors are Growth stocks and therefore benefit from lower rates due to their duration. Lower rates also mean that tech disruptors are able to finance technology at lower cost and take a longer-term view on tech-related projects. Lower overall market EPS growth is also positive for tech disruptors and other Growth stocks due to the scarcity premium that they command."

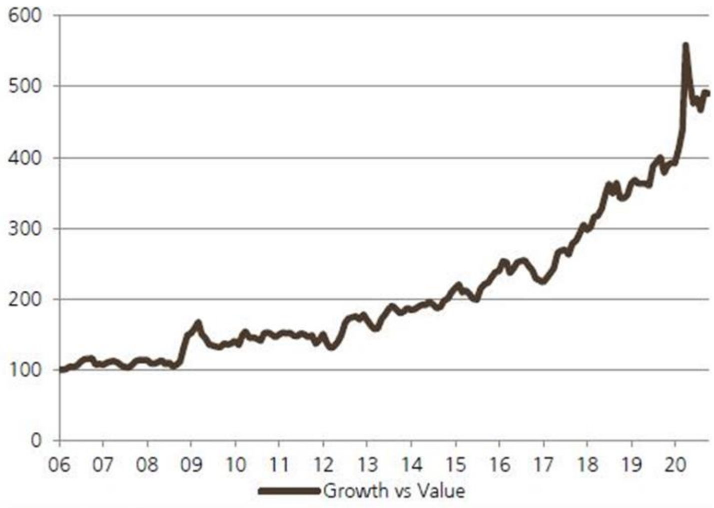
Figure 4 highlights the decade of Growth outperforming Value.

In a note of optimism that investing is not only a tech story, UBS also notes:

"High quality industrials that are able to maintain solid earnings growth in a low interest rate environment are likely to outperform."

The market is also seeing larger stock-specific price reactions to news events, as so much of the price is determined by long-term expectations. Either a threat to or affirmation of this future potential sends investors to buy and sell and the market catches the momentum. The potential for long-term durable competitive advantages is especially valued.

Figure 4: Growth outperforming Value since the GFC



Source: FactSet, UBS

Graham Hand is Managing Editor of Firstlinks. This article draws on the work of Pieter Stoltz, Jim Xu and Paul Winter, Equity Analysts at UBS Securities. This article contains general information only and does not constitute personal financial product advice. It does not consider any investor's objectives, financial situation or needs.

More articles and papers from UBS, a sponsor of Firstlinks, can be [found here](#).

Video: How Chris Cuffe finds fund managers who 'swing the bat'

After 40 years inside the world of managing investments and selecting fund managers, **Chris Cuffe** summarises his experiences into a few quick lessons. His observations are not the traditional cliches about past performance and management styles, but what really works when selecting investments. [Watch now…](#)

The **Morningstar 2020 Individual Investor Conference** was held over 29 and 30 October and drew over 2,000 registrations. It offered investors the opportunity to tap into the expertise and knowledge and Australia's leading investors.

Some of the highlight sessions include:

- Hamish Douglass from Magellan discusses the US election, long-term trends and your portfolio
- Gemma Dale from nabtrade on the rise of the retail investor
- Kate Howitt from Fidelity on how she selects stocks
- David Harrison from Charter Hall Property discusses how it's all about location, location and ... strategy.
- Anton Tagliaferro of IML on finding long-term opportunities in the current market.

Get access to all the recordings and explore all Premium benefits (including the Sharesight portfolio service) with a **[free Morningstar Premium trial](#)**. No credit card required.

Chris Cuffe is Founder and Portfolio Manager of the charitable trust, Third Link Growth Fund and Chairman of [Australian Philanthropic Services](#). He is the Co-Founder of Cuffelinks, the predecessor to Firstlinks, and sits on the boards and investment committees of many companies and family offices. The views expressed are his own.

Video: Noel Whittaker on investing until you're 100

At any point in time, regardless of the existence of a severe event like COVID-19, the outlook is always unclear and range of outcomes uncertain. Rather than speculate about markets, it's better to stay the course with a diversified portfolio based on your attitude to risk. Author and personal finance expert Noel Whittaker talks with Graham Hand. Watch now…

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Noel Whittaker is one of the world's foremost authorities on personal finance and an international bestselling author. His latest book, Retirement Made Simple, is available at www.noelwhittaker.com.au.

Momentum or rupture: has demand for oil already peaked?

Douglas Huey

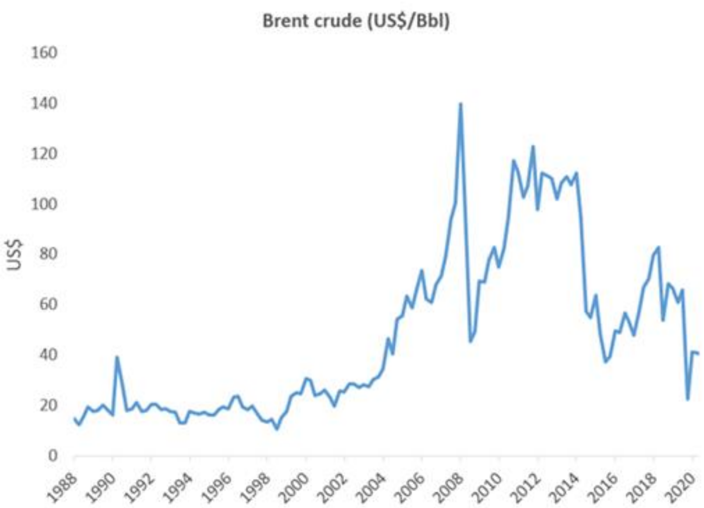
'Peak oil' is a phrase that has been around for some time, but some industry watchers believe that we may have now already reached that milestone.

While the world is currently in the grip of the COVID-19 pandemic and its effects are grabbing the headlines, in a decade's time - from a purely economic perspective - COVID-19 may be seen just as importantly as ringing the bell on oil, which has been the dominant energy source for the past century.

Demand for oil may never reach prior levels

BP PLC, one of the seven global 'supermajor' oil companies, has called the top for oil, saying that demand will never again reach pre-pandemic levels and will be, in its most bullish case, broadly flat for the next two decades. Fossil fuel demand will be challenged by other power types, namely electricity, which will be supplied by a growing grid of cheaper solar and wind sources.

Others believe global oil demand could rise above pre-COVID levels by mid to late 2020s before declining. Oil demand may rise from 91.7 million barrels a day (MMbls/d) this year to slightly above 100MMbls/d by the mid-2020s. In a conservative net zero emissions (EU + China) case, brokers are predicting oil demand will then fall to 75MMbls/d (a decline of ~25% from 2019 levels).



Source: Bloomberg

Where the OECD and China pursue net zero carbon outputs, oil demand could fall to 54MMbls/d (-45%) by 2060. In a net zero (all countries) scenario, demand could fall to as low as 21MMbls/d (~-80% from current levels).

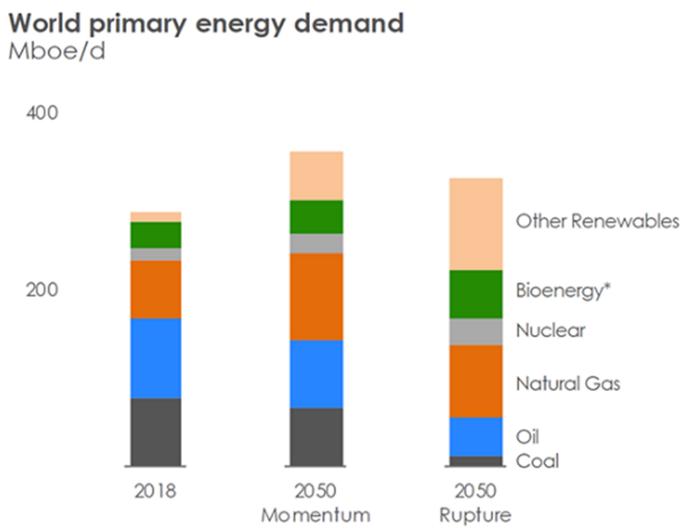
For its part, French oil giant Total SE (another supermajor) has set out two likely future scenarios:

In its **first scenario**, which it has called 'Momentum 2050', there is a green deal in Europe, while outside of Europe actions are based on individual country carbon targets. There is also aggressive deployment of proven technologies such as EVs, solar and wind, and biofuels. Under this scenario, 60% of cars are electric and sustainable aviation fuels make up 15% of total demand by 2050.

In its **second, more extreme scenario**, called 'Rupture 2050', all countries commit towards net zero carbon emissions with strong shifts in public policies as well as technology breakthroughs in new industries like hydrogen, synthetic fuels and carbon capture. Under this scenario, it has 75% of cars as being EVs and 60% of aviation being sustainable by 2050.

For Total, it is not that energy demand will dwindle – all of its scenarios see an increase in demand for energy globally – but that low-carbon power will increase its supply.

Under both scenarios Total is anticipating oil to peak in the coming decade, saying demand growth will end around 2030 and then decline due to the electrification of end uses, transport transformation and the greening of the petrochemical industry.



Source: Total SE

What about the supply side?

As we all know however, the oil price is a function not just of demand but also of supply. Will we see another cycle in the oil price in the next decade as supply falls to match demand, or is the fall in demand sure to make it all downhill from here?

The first point to make is that not everyone agrees that peak oil is here or is imminent. Oil remains the standard from which all other power sources are judged and is seen by many in the industry (and OPEC) as the only commodity that can satisfy the demands of an increasing global population and expanding middle class.

However, even a long-term price of US$40 a barrel does not necessarily mean value destruction for the lowest-cost oil majors in the medium term. Rather, the lack of incentive to invest in new fields could see them run down their reserves and not drill new wells, increasing free cash flow in their fossil fuel operations while they pivot towards delivering power from carbon-free (renewable) sources.

The other alternative could be that the fall in investment because of low oil prices and the subsequent supply shortfall in the medium term triggers another oil price hike in the 2020s, before we see another top out of prices in the 2030s as electricity makes more of an impact, i.e. we will see one last oil price cycle.

Contrarian investment opportunities

For the moment, investors in oil-related equities are relying on price levels remaining at current levels, i.e. that we will not see another cycle of oil prices rising on the back of a supply-side squeeze. This may present an opportunity for the judicious (and somewhat contrarian) investor.

We are understandably cautious about the oil industry but given the cheap valuations in the sector it would be unwise to ignore it. For our part we hold Royal Dutch Shell in the global portfolios. We believe Shell is well placed to perform in the coming years, having adapted its cost structure to operate in the current low-price environment. Shell is capable of paying a 5% dividend yield even if the oil price stays low.

In the past few years, Shell has also transformed its upstream portfolio, having divested its high cost projects and invested in offshore projects which will yield significant returns as oil demand continues to recover from its pandemic lows.

Relative to other oil majors, Shell is better placed as the energy complex transitions away from oil, being the industry leader in gas (LNG) and will benefit as governments worldwide reduce their reliance on energy generation from coal. Furthermore, Shell can leverage its substantial retail network and differentiated trading capability to creatively profit from the shift to renewable and green energy.

Douglas Huey is a Portfolio Manager at [PM Capital](). The content reflects opinions as at the time of writing and may change. PM Capital may now or in the future, deal in any security mentioned. It is not investment advice.

Through the looking-glass: what counts is not tied to an index

David Gait

Disbelief.

"So if I understand correctly, you're saying your business model is based upon buying the rights to products that have been banned in Europe for safety and environmental reasons, and selling those same products into Asian countries which have yet to ban them?"

The CEO nods enthusiastically. "*Exactly!*" He leans forward. "*Environmental arbitrage! So long as they are legal in one or more countries, there is value left in them."*

More disbelief. It's 2020. How is this still happening? This is a company which easily accesses society's savings via the stockmarket. There is plenty of disbelief still to be had elsewhere among listed Asia Pacific companies. The power generation company which attributes its success to "not letting the women in". The mining company whose dam collapsed, killing 19 people and polluting almost 700 kilometres of watercourses.

Too much easy access to capital

All are the easy recipients of society's capital. Why?

In the sequel to Lewis Carroll's 'Alice in Wonderland', Alice climbs 'Through the Looking-Glass' and finds another fantastical world, absent of reason and where everything is reversed. Time moves backwards. Events can be remembered before they happen. The right foot belongs in the left shoe.

This crisis of logic is all too evident when investing in Asia Pacific. As the Red Queen says to Alice, "it takes all the running you can do to keep in the same place." Sustainable investment in Asia Pacific is running hard now, but the goal seems to be getting further away. Rather than losing their licence to operate, such companies are having little difficulty accessing equity markets. Why?

Short-termism has for some time now been the prime suspect. As the investment industry has given way to the speculation industry, there is less emphasis on understanding long-term risks and opportunities and more focus on next quarter's results and a quick trading profit.

Short-termism and 'metric fixation'

But perhaps there is another, more fantastical culprit lurking in Alice's Financeland in the shape of 'metric fixation', or fixation with measurements.

Jerry Muller defines metric fixation as:

'the aspiration to replace judgement based on experience with standardised measurement'.

Metric fixation would be at home in Alice's Looking-Glass world. An 'upsidedownbacktofront' idea that wreaks havoc wherever it goes. Muller notes the damage wrought by metric fixation across all aspects of society from academia to policing to healthcare. So too with Asia Pacific investing.

Metric fixation must itself share some of the blame for short-termism. The obsession with performance-related pay based on short-term measurable outcomes has been a major contributor to shrinking time horizons of both companies and investors.

Metric fixation has also been instrumental in the relentless drive towards passive investment. Currently an estimated US$3.75 trillion of society's savings are allocated passively to listed companies, based not on human judgement but rather on inert quantitative models. Before long, passive investment will be the primary means by which capital is allocated to listed companies in the region.

The journey towards passive capital allocation has been a long and winding one, but its origins lie less in the search for cheaper costs and more in the desire to quantify and model investment risk. Metric fixation. The real risk of losing money from owning shares is complex and requires subjective judgement. But that is hard to model or count.

Instead, the rise of metric fixation has led to the invention of benchmark risk.

Benchmark risk is another wonderful Alice character. It makes no sense. Why would losing 40% of an investment but still outperforming an arbitrary index be a good outcome? The closer a portfolio is to the index and some of its dubious constituents, the less 'risky' it becomes. For as long as the industry continues to define risk in terms of deviation from arbitrary benchmarks, the outcome is an inexorable move towards passive investment.

Why passive investment matters

According to the WHO, tobacco kills more than one million Indians each year, accounting for 10% of all deaths in the country. More than the global deaths from COVID-19 to date. Each year. So why does India's largest tobacco company, with a market share of over 70%, have such easy access to society's savings? With a market capitalisation of over US$30 billion, its largest underlying shareholders are all passive funds.

Why would society choose to allocate so much capital passively to a company that poses such health dangers? Looking-Glass absurdity.

Why isn't the move towards sustainable investment in Asia Pacific counterbalancing this? Here too, metric fixation is causing trouble.

The obsession with quantifying Environmental, Social & Governance (ESG) issues is challenging. Looking-Glass illogic is rife. The worse the company's real sustainability impact, often the greater the likelihood of a high ESG score. India's leading tobacco company has an AA ESG ranking and sits near the top of at least two ESG benchmarks, courtesy of its size and its sizeable ESG reports.

It is not just ESG scoring where metric fixation has warped the outcomes. Sustainable Development Goals (SDGs) mapping makes little sense but is fast becoming the norm. The Asian group hoping to source coal from a new mine next to the fast-bleaching Great Barrier Reef map themselves to the Education, Health and Sustainable Cities SDGs.

Investor engagement impossible to quantify

The requirement to quantify the impact of investor engagement with companies is also nonsensical. Improving access to affordable medicines. Phasing out toxic chemicals. Encouraging greater board diversity. Increasing tax rates. Improving working capital for smallholder suppliers. More governance checks and balances. Engagement success in these areas usually takes years and can rarely, if ever, be attributed to one actor. Even when it can, putting a dollar price on such qualitative aspects of impact is as nonsensical as the Looking-Glass Jabberwocky.

If metric fixation is a problem, what are the solutions?

In the world of sustainable investment very little which counts can be counted or 'metricated', let alone standardised. Rather than produce banks of ESG data, the far greater challenge facing Asia Pacific companies and investors is to be authentic, resonant and imaginative when it comes to sustainability. These three characteristics do not lend themselves to metrication nor incentivisation. They require judgement and much effort to understand.

Is the approach to sustainability authentic and built upon a clear sense of purpose? Or a box-ticking, marketing-driven path towards short-term gain? Does it resonate across all aspects of the business? Or is it a marriage of convenience with little commonality? The coal company with the solar panels. The tobacco company with the award-winning eco-hotel business.

Is there evidence of imagination?

What really counts?

The Asian bank which developed a successful mobile payments system, enabling millions of people in rural areas without access to bank branches to access simple savings products in a country where financial inclusion is still below 50%. The computer power supply company building an electric vehicle power business. Or is management stuck with a fixed mindset, unable to imagine how sustainability can be a driver of returns? The paint company still selling toxic paint where it is still legal to do so. The all-male board unable to imagine how to get from A to B.

Asia Pacific is home to many of the world's greatest development challenges. According to the UN, 25% of the population still live in multidimensional poverty. Over 600 million people still have to resort to open defecation. Inequality. Water scarcity. Climate change. There are still plenty of companies which are part of the problem, exploiting vulnerabilities and cutting corners without consequence.

Fortunately, there are also plenty of wonderful companies in the region, full of purpose and resolve to address Asia's development challenges. The medical diagnostics company providing over 40 million affordable tests a year in a country which spends less than US$75 per person, per year on healthcare. The testing company helping to reduce the use of hazardous substances across supply chains. Prudent 'micro-mortgage' providers helping to solve India's 75 million unit housing shortage challenge. The sustainable plant-based nutrition company. Affordable medicines. The electric vehicle powertrain maker. The electric vehicle testing company. The solar inverter manufacturer.

None of these companies is perfect. Few of them have ESG data departments. Many have not mapped themselves to the SDGs. Most of them do not meet the requirements of the metric fixators. Investing in them creates benchmark risk. They are not the Region's largest companies. They don't automatically suck up large passive allocations of society's capital. What they all have instead is an abundance of authenticity, resonance and imagination.

And in the long-run, authenticity, resonance and imagination are what is needed if we are to outrun metric fixation, passive investment and short-termism and escape Lewis Carroll's fantastical Financeland.

David Gait is a Portfolio Manager at Stewart Investors, part of the First Sentier Investors group. First Sentier Investors is a sponsor of Firstlinks.

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Four themes to set your portfolio for economic recovery

Simson Sanaphay

We are only months into the start of a new economic cycle, and this is a perfect opportunity for investors to get positioned for years of economic growth ahead. The cycle is already off to an unusual start, kicking off with a pandemic and unprecedented government and central bank stimulus.

Not surprisingly, there is good and bad news for investors looking to reposition their portfolio. The good news is that there are clear thematics that long-term investors can take advantage of over the next decade.

The investment themes guiding the next cycle

Some of these thematics have been driven by health risks stemming from COVID-19, including those that resulted from a shift in consumer spending and businesses re-orientating operations.

Niche technology groupings like eCommerce, digital payments and collaboration/productivity tech are expected to benefit from the post-COVID-19 behavioural shift. But let's also not forget the value end of the market that is set to benefit from the growth recovery and especially from a vaccine. We're keeping an open mind for COVID-19 therapies and vaccines that are plausible, plentiful and potent that would see a normalisation of consumer services and underpin cyclical sectors.

The not-so-good news is volatility is not going to vanish in the short term, and there is still a lot of stimulus and accommodative monetary settings required to recover from COVID-19. Policy co-ordination will be paramount to ensure sustainable economic gains do not vanish once temporary programmes and initiatives fade.

The Reserve Bank announcements this week have taken measures even further, including reducing the cash rate to 0.1%, setting the 3-year government bond target to 0.1% and expanding asset purchases (quantitative easing) to $100 billion of Commonwealth and State bonds.

Looking forward, investors can consider the following thematics as crucial to their portfolio construction.

1. Borrowers cash in on debt

Governments will take advantage of a low yield environment to finance long term infrastructure spending, which is expected to be a large driver of growth and a primary tool for reducing elevated unemployment rates due to the pandemic.

Businesses will also be opportunistic to borrow at 'rock bottom' yields to fortify their balance sheets and it is expected that balance sheet management will be a key part of strategy as the economy re-energises, and as we've seen the correlation between balance sheet weakness versus balance sheet strength is a key measure between performance and underperformance.

For investors, fixed income opportunities will arise in both the primary and secondary 'over-the-counter' bond markets as new issuances are created to finance corporate and government objectives.

2. Identifying sectors with long-term growth potential

The vaccine is key to long-term stability as economic recovery kicks in. This means that investors will be more guarded and cautious, particularly until the vaccine becomes a reality.

Given we already have high valuations in some sectors, like tech, we have a mid-2021 ASX200 target of 6200, and it will not just be an upward trajectory. We expect sector rotation from COVID-19 beneficiaries such as the tech sector/health sector to the cyclical sectors that includes resources and industrials especially if there is firmer footing in a broad economic recovery.

But we can also see an expectation that government, central banks and regulators will maintain discipline in nudging the recovery forward.

3. Consider elevated risk the new normal

Volatility is here to stay, and investors should prepare their portfolios accordingly. Risk remains at elevated levels, with some of the key risk-factors including:

- The US presidential election fallout and post-election destabilisation
- Racial inequality unrest
- Global trade restrictions, particularly as a result of any escalation of US-China tensions
- Second waves of COVID-19 across continents or key countries as the northern winter settles in
- Any failure or significant setback of promising vaccines.

Our recommendation through this period of heightened volatility is not to play the short game and avoid trying to time the market.

Investors can consider structured investments, which can be tailored to produce income in flat, falling or rising markets. We anticipate a flat equity market, with crowded investment positions shifting away from out-of-favour sectors, such as industrials, materials and financials, until growth becomes sustainable and delivers heightened production and economic activity and rising yields.

4. Seek balance and remain allocated through the investment cycle

Citi prefers a balanced portfolio that allows diversification to play its role as a modifier of risk, and includes income assets, like corporate and selective high yield bonds, that provide cash-flow stability. This is especially true with rates and yields sitting at the bottom of the curve, and we expect it to remain this way for several years.

Equities remain an important part of asset allocation and will form an increasing percentage of a portfolio as the recovery gains traction. However, it's likely many investors are sitting on equity portfolios built up in the previous economic cycle, and require adjustment to suit the next set of anticipated thematic trends.

In the current market we remind investors to remain open-minded to adding cyclical and value-driven stocks to their portfolio, particularly if they are under-allocated to equities after selling down their portfolios in response to the chaos caused by the virus.

We reiterate our long-maintained stance to remain allocated through the investment cycle, as sitting on the sidelines means you miss out on the best days in the market, which may mean forgoing initial recovery periods that can often include healthy indices increases.

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Britain amid COVID and the pain of the final exit talks

Michael Collins

The allegations went like this. The now-defunct UK arm of the US political consultancy Cambridge Analytica employed a Russian-born computer whizz to make an app-based survey. The app was placed on Facebook. When 300,000 people used the app, data was secretly gathered on 87 million, mainly US, users. The political consultancy bought more data and boasted of models and analysis that could 'change audience behaviour'. The Russians meddled in some way. Lo and behold, 1.8 million more UK voters opted to leave rather than stay in the EU in the 2016 referendum (to give a 52%-48% split), in defiance of the business, cultural, financial, political and technocratic elite.

Did this activity 'change behaviour'?

The Information Commissioner's Office launched a probe. Over three years and armed with search warrants, the body that enforces data-protection laws in the UK examined 42 laptops and computers, 31 servers, 700,000 gigabytes of data, more than 300,000 documents, other material in paper form and still more data on cloud-storage devices.

And it found nothing.

Well, that's one Brexit controversy resolved. But others need addressing even though the UK left the bloc on 31 January 2020, an action that ended the first phase of the post-vote saga. That period was essentially a rerun of the referendum.

'Remainers' sought to nullify the 2016 result while pushing for a 'soft' or token Brexit, where the UK effectively stayed under EU control within the common market.

'Leavers' pushed for a 'hard' Brexit, where the UK recouped its sovereignty and faced conditional access to the common market. They feigned calm about a 'no-deal' Brexit, a world of border controls, customs inspections, quotas and tariffs as the UK suddenly sat outside the common market (as countries such as Australia do), thus a likely economic blow epitomised by truck queues, shortages and rising prices.

Even after Brexit, options remain

The triumph of Prime Minister Boris Johnson's Conservative party in the 2019 elections torpedoed the Remainer campaign. The UK left the EU and moved to the second part of the post-vote saga. That comprises an 11-month 'transition' phase during which the UK stays a member of the EU common market while Brussels and London settle on their future relationship. The options are a hard or no-deal Brexit.

Most of the details are agreed on how to manage EU-UK trade and security but three disputes prevent an agreement:

1. One is over fishing rights. The UK eyes restoring a distinct aquatic zone while the EU seeks to maintain a quota system across connecting waters.

2. The second quarrel is over state aid to companies.

3. The third is on how to resolve disputes. Other disputes of note that could flare up include the UK territory of Gibraltar, data protection and the status of the City of London.

These issues are almost distractions compared with the problem of Ireland, an EU member. No one has solved how Northern Ireland adheres to UK laws while staying within the EU customs union to ensure a frictionless border and political calm across Ireland. London's latest proposal, the Internal Markets Bill, violates the Northern Ireland Protocol attached to the Withdrawal Agreement of 2019 that demands an invisible border across Ireland. The conundrum for London is that a seamless EU-UK border across Ireland splits the UK as an economic entity because Brussels won't countenance an ex-member staying in the common market. It's possible the impasse over which laws and legal system apply to Northern Ireland could lead to border barriers and political violence that could push the province to reunite with the south.

The EU has warned it will take legal action against the UK if the Internal Markets Bill becomes law. The threat is mixed up with the ambit claims, bluffs, brinkmanship, broken deadlines, fruitless summits, theatrics and ultimatums between Brussels and London that are reviving a more-pressing existential threat to the UK. The Brexit saga is fuelling support for Scotland to depart the UK to rejoin the EU.

An economic and political shock amid COVID

The year-end deadline could soon force decisions and a messy divorce is possible, though more out of miscalculation than desire. Some last-minute fudge that all hail as satisfactory and final is likely. But whatever the shape of any deal, Brexit will be an economic and political shock that will reverberate through the UK for years and could even break it.

Some caveats. Brexit is a secondary issue since the coronavirus escaped from China. Given the economic damage of the pandemic, a no-deal Brexit holds fewer concerns for many than before. Hard Brexit covers a range of outcomes that include a soft-enough exit that disappoints Leavers. Would Scotland really flee the UK and trigger the mayhem involved? Would Ireland unite after a century of partition? These were possibilities before the Brexit vote and could take years to occur.

Even so, the Irish problem appears unsolvable and Brexit has marked UK politics for the foreseeable future by making identity politics around Remainers versus Leavers the country's biggest political tear. The latter manifests in issues from immigration and inequality to the environment and, ominously, in pushing component nations to leave a UK troubled by however visible or invisible is the border across Ireland.

All because of that vote in 2016 when enough UK voters, for some reason not linked to Cambridge Analytica, Facebook or Russia, defied the elite.

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