Annual Member Meeting 2020 – Jonathan Armitage, Chief Investment Officer, MLC Asset Management

The obvious place for any investment review to start is with the market moves in this "pandemic year". But at MLC, we take a long-term view when we look at our investments. Dramatic as this year's events have been, investment markets are constantly impacted by different issues.

The good news, as we can see from the history on this chart, is that market corrections are usually followed by significant recoveries. This is what occurred again this year in February and March, as the correction was followed by a very strong recovery in the following months. As investment professionals, the ability to take this long-term view is crucial when managing your money.

At MLC, we focus on well-diversified portfolios. The more you diversify, the less impact any one investment, or type of investment, can have on the return of your overall portfolio. This example is representative of our approach to investing. Most of you will have at least part of your investments in this or a similar portfolio.

While it shows the handful of major asset classes you have exposure to, if you look under the hood of each asset class, you'd see many, many different investments. The portfolio has multiple levels of diversification - across different investment managers that are selecting the investments, different countries, regions, industries, and individual companies. In fact, the portfolio you see contains thousands of different assets and securities.

So in such a tumultuous year, it's worthwhile reflecting on how we positioned your portfolios. We positioned the portfolios for both defence and offence. That is that they were positioned to provide a cushion against the worst impacts of market downturns but also setting up to take advantages of opportunities as strong assets were oversold.

Some of the techniques we use to manage turbulence include active rebalancing of portfolios. When asset values change, your exposure to strong-performing investments increases. That means that if they then fall, as often happens after a strong period of performance, you'd be overexposed. Rebalancing reduces that risk significantly.

Active monitoring and management of liquidity-- that is how quickly we could move out of investments-- is also important. We initiated new protection strategies during the year to protect the portfolio against market falls. Some of the things that we benefited from were being overweight unhedged global shares. Investing in global shares is important for long-term growth.

Additionally, when share markets fell this year, so did the Australian dollar, so the overseas shares we held in your portfolios were worth more to you in Australian dollars. We were also underweight Australian shares, which worked well because the Australian market didn't rebound as quickly as other global share markets. During the period, we increased our exposure to selected emerging markets because of their strong long-term growth potential. We were also opportunistic in allocating money to investments that increased in attractiveness when share markets fell dramatically in the early part of the year.

One area that we think has been very important is our private equity investments. These are investments in companies which are not listed on stock markets. And in this particular area, we have a strong exposure to technology and health care companies. And the performance during the year benefited from that exposure.

One of the most important aspects of active investing is being able to identify great investment opportunities, buying them at a great price and hanging on to them until they've reached the price you believe is fair value and then selling them. Sometimes that usually involves going through periods where the price falls as other investors don't necessarily see the same value as us, but over longer periods of

time most of our investments play out as we'd expect. You need to be prepared to take investments over the long term and ride out short-term periods of turbulence.

Today, we're future-focused on portfolio risks, such as liquidity. We do limit how much we invest in unlisted assets, which are difficult to cash out of, because having too many unlisted assets can result in a lopsided portfolio, especially when markets are turbulent. That's why we were able to meet members' requirements for early super requests without any problems at all. This focus on liquidity also meant we were able to buy good assets at attractive prices while stressed investors were looking to sell them.

For most members, superannuation is a multi-year, even multi-decade investment. That means it's important your investments achieve returns that beat inflation.

As you'll see in this chart, the MySuper portfolio-- both the previous version, as well as the new, redesigned, age-based MySuper portfolio, introduced in March last year-- have delivered on their promise by achieving returns well ahead of inflation. In fact, one of the investment themes that we're acting on currently is the potential for global inflation to be higher than the currently extremely low expectations you see in markets. So we're investigating a diverse set of assets that may offer inflation protection at a reasonable price. And that includes our exposure to emerging markets.

The key immediate issue for markets and economies over the coming year will be the progress on containing the COVID pandemic. As you will be well aware, infections are rising again in the Northern hemisphere, and many countries in that part of the world have reimposed different types of lockdown.

Having said that, there has been encouraging news on vaccines. And it is likely that in the coming months, there will be several vaccines available to people. But the crucial issue here will be the ability for them to be produced in sufficient quantities so that they can be distributed globally, both to developed and emerging economies. If that happens in a timely manner, that will be a big boost for countries, communities, and also economies.

However, we do think that a little caution is required. We do believe that COVID-19 may never be completely eradicated, and we will have to live with the pandemic in some form, albeit our management of the virus will keep on improving. Thus, it's likely to be much less of a threat than it is today.

Turning to politics, a new US president is always a major issue for markets, given the importance of America to the global economy. Given the extent of political polarisation in the US, it's hard to be overoptimistic of a significant amount of cooperation between a Biden administration and the likely Republican Senate majority. Having said that, financial markets may well adopt a glass-half-full attitude because policy gridlock, for all its frustrations, will likely mean a continued extension of the Trump administration's low tax regime.

Turning to things closer to home, for the Australian economy, the outlook is interesting. In global terms, we have managed COVID well and our economy went into the pandemic in reasonable shape. Given these factors, our short- and medium-term outlook is quite positive.

There are three things that we think investors need to keep a close eye on-- firstly, any further controlled outbreaks of COVID, how quickly we can reopen the borders given the importance of tourism and the education sectors in our economy, and then the important balancing act that governments will have to undertake between the high debt that's been taken on and taking away the economic stimulus that's been provided too early. While these factors are interesting in terms of how we look at what's going on right now, as investment professionals, we need to cover issues that can impact longer-term returns. The rest tends to be just sort of noise because it probably won't really affect your investment value over 5 or 10 years' time.

Your investment options here range from “Conservative” to “Aggressive” depending on how much exposure they have to growth assets, like shares. As you can see, all our investment options here are comfortably exceeding their long-term investment objectives. These investment options aim to outperform inflation because we all need our superannuation savings to at least keep pace with the increases in prices in goods and services we use every day.

Having shares in your portfolio helps us generate a return above inflation over the longer term. But as we know, shares can move up and down, so we diversify across lots of different types of shares and invest in other asset classes to offset the fluctuations you can see in stock markets.

You may ask why our objectives are set over many years. It can often take several years for asset prices to reach what we believe is fair value. It doesn't mean that these portfolios won't achieve those objectives in a shorter time frame. But it can take several years in certain difficult market environments. That's why you need to be prepared to invest over the long term.

As investment professionals, we manage your money while taking account of both risks as well as returns. Some of those risks come under the terms of “ESG”, or Environmental, Social, and Governance, issues. There's been plenty of evidence over several years showing that assets that rate well on ESG criteria also tend to provide the most sustainable long-term returns for investors. We have a clear policy of actively engaging with companies to push improvements in nonfinancial factors, including their impact on the environment and climate change.

Here, we're just giving some examples of the investments we make that pass our ESG tests. So for example, in renewables, we have made investments in wind, solar, geothermal, and battery storage assets. If we look at the economy, particularly here in Australia, we invest in critical infrastructure, including assets like the Port of Melbourne.