financiallyspeaking

summeredition 2020

Economic outlook

Global economy

A global economic recovery remains underway as indicated by The JP Morgan Global Composite PMI which rose 5 points to 52.1 in September. Generally, readings above 50 points indicate activity expanding across both the manufacturing and services sectors globally. The end of September quarter economic growth numbers confirm the beginning of economic recovery with China growing 2.7% in the September quarter and 11.7% in the June quarter.

A key challenge to the economic recovery has been new waves of COVID-19 infections. Europe was among the hardest hit, while cases in the US have not abated. These new infections raise the risks of new restrictions by governments, which will have ongoing negative impacts on all businesses, including both local and international trade. We have begun to see this occur in Europe with curfews introduced across much of France and Italy, in a bid to limit evening gatherings to reduce virus transmission. These increased restrictions point to the heightened risk of another quarter of negative economic growth in Europe.

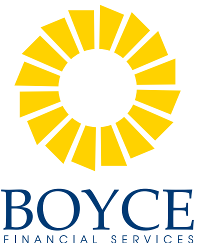
Australia

An Australian recession was officially confirmed with economic activity falling -0.3% in the March quarter and -7% in the June quarter. This prompted the government to respond with the JobKeeper and JobSeeker programs which were designed to subsidise workers' wages and temporarily boost income support for those unemployed due to the COVID-19 fall out. Further support has been outlined in the October Federal Budget with tax incentives to encourage businesses to spend and subsidies for businesses adding younger staff. However, a second wave of COVID-19 cases in Victoria prompted state-wide lockdowns, severely impacting businesses and workers.

Looking ahead, we have seen a recovery in business conditions and confidence via the NAB Monthly Business surveys. Conversely, we note retail sales weakened in late September as households reduced their spending with the tapering of the JobKeeper program from October onwards. Victorian lockdown restrictions are being eased gradually and New South Wales is also relaxing its social distancing measures. Border restrictions between States are lifting. This will be important for economic growth as more businesses re-open to interstate tourists and hire more workers.

In this issue

- Economic outlook
- Recovery watch: When will growth return?
- Which are you – a saver or investor?
- How to seek out positivity and improve your wellbeing
- How younger members can make the most of market volatility
- The real benefit to retirees of financial advice
- Big Tech's market might in 5 charts



Boyce Financial Services Pty Ltd

44 Fitzmaurice Street
Wagga Wagga NSW 2650

(02) 6925 9044

info@boycefs.com

Economic outlook continued

Shares

The S&P/ASX 200 index fell -1.4% on a price basis during the September quarter with Information Technology the top performer (up 12.3%) followed by Consumer Discretionary (up 7.7%) and Property (up 6.7%). Gradual reduction of lockdown measures across most of Australia and exceeding expectations in reporting season were notable drivers for the Consumer Discretionary and Property sectors. In particular, home improvement companies such as Nick Scali and Beacon Lighting saw strong growth.

Most sectors had negative returns, with Energy (-15.2%), Utilities (-9.5%) and Financials (-6.9%). The Utilities sector fell due to lower electricity prices and the rise of alternative energy sources. Financials suffered the speculation of another RBA rate cut by 10bps and lockdowns in Victoria. This acted as a drag on economic growth. In addition, it poses challenges to the health of bank mortgages as the lockdowns force business shutdowns impairing worker and employee incomes, making it harder to keep up with mortgage repayments and other debts.

Fixed income and currencies

Bond prices rose, driving bond yields lower both here and overseas during the quarter. Rising COVID-19 cases, particularly in Europe, became a concern for markets late in the quarter prompting a sell off in shares and a move to bonds.

In Australia, the RBA left interest rates on hold. Speculation remains of a further cut of 0.15% to support economic activity (this occurred in early November). This will likely be followed by additional bond purchases to reduce bond yields. These actions would lower the cost of borrowing for both the Federal and State governments, an important source of support as both government bodies contribute substantially to the economies. To the extent that banks pass on a rate cut it also helps borrowers increase their income by reducing their borrowing costs.

Important Information

This report has been prepared by the IOOF Research team for Lonsdale Financial Group ABN 76 006 637 225 AFSL 246934 ("Lonsdale Financial Group"). Lonsdale Financial Group is a company within the IOOF group of companies consisting of IOOF Holdings Limited ABN 49 100 103 722 and its related bodies corporate.

This report is current as at the date of issue but may be superseded by future publications.

The information in the report may not be reproduced, distributed or published by any recipient for any purpose without the prior written consent of Lonsdale Financial Group. This report may be used on the express condition that you have obtained a copy of the Lonsdale Financial Group Financial Services Guide (FSG) from the website **www.lonsdale.com.au**

Lonsdale Financial Group and/or its associated entities, directors and/or its employees may have a material interest in, and may earn brokerage from, any securities or other financial products referred to in this report or may provide services to the companies referred to in this report. This report is not available for distribution outside Australia and may not be passed on to any third person without the prior written consent of Lonsdale Financial Group. Lonsdale Financial Group and associated persons (including persons from whom information in this report is sourced) may do business or seek to do business with companies covered in its research reports. As a result, investors should be aware that the firms or other such persons may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as a single factor in making an investment decision.

This report has been prepared in good faith and with reasonable care. Neither Lonsdale Financial Group nor any other person makes any representation or warranty, express or implied, as to the accuracy, reliability, reasonableness or completeness of the contents of this document (including any projections, forecasts, estimates, prospects and returns and any omissions from this document). To the maximum extent permitted by law Lonsdale Financial Group, its related bodies corporate and their respective officers, employees, representatives and associates disclaim and exclude all liability for any loss or damage (whether foreseeable or not foreseeable) suffered or incurred by any person acting on any information (including any projections, forecasts, estimates, prospects and returns) provided in, or omitted from this report.

General Advice Disclaimer: The information in this report is general advice only and does not take into account your financial circumstances, needs and objectives. Before making any decision based on this report, you should assess your own circumstances or seek advice from a financial adviser. Where applicable, you should obtain and consider a copy of the Product Disclosure Statement, prospectus or other disclosure material relevant to the financial product before you acquire a financial product. It is important to note that investments may go up and down and past performance is not an indicator of future performance.

For information regarding any potential conflicts of interest and analyst holdings; IOOF Research Team's coverage criteria, methodology and spread of ratings; and summary information about the qualifications and experience of the IOOF Research Team please visit **https://www.ioof.com.au/adviser/investment_funds/ioof_advice_research_process**

Source: IOOF

Recovery watch: When will growth return?

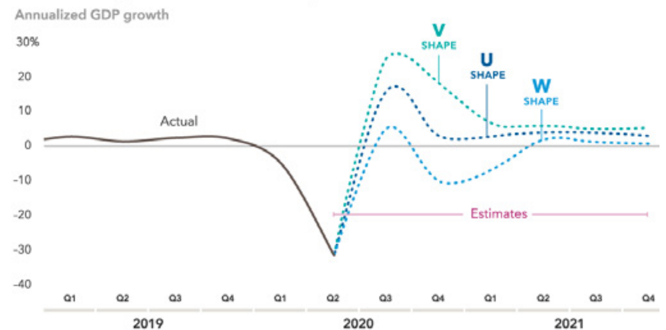
COVID-19 has forced economists to become students of virology.

“The virus is the economy,” says Capital Group U.S. economist Jared Franz. “All economic growth forecasts depend on the trajectory of the virus — whether it gets better or worse, whether we can develop an effective vaccine and whether government stimulus measures will continue to help bridge the income gap for workers who have been displaced by this unprecedented downturn.”

So when is growth likely to return to pre-pandemic levels? By the middle of 2021, Franz expects the U.S. economy to grow at an annualized rate of roughly 2% to 3%, fuelled by pent-up demand from months of sheltering in place, as well as the growing likelihood of a pandemic-ending vaccine becoming available to the public.

Due to the high level of uncertainty, Capital Group’s economic team has put together a scenario analysis of V-shaped, U-shaped and W-shaped economic recoveries. However, the authors suggested “K-shaped” – or moving in two different directions – might be appropriate, as well, given the disparity between sectors that have benefited from the pandemic and those that have been crushed by it.

U.S. economy: The road to recovery remains uncertain

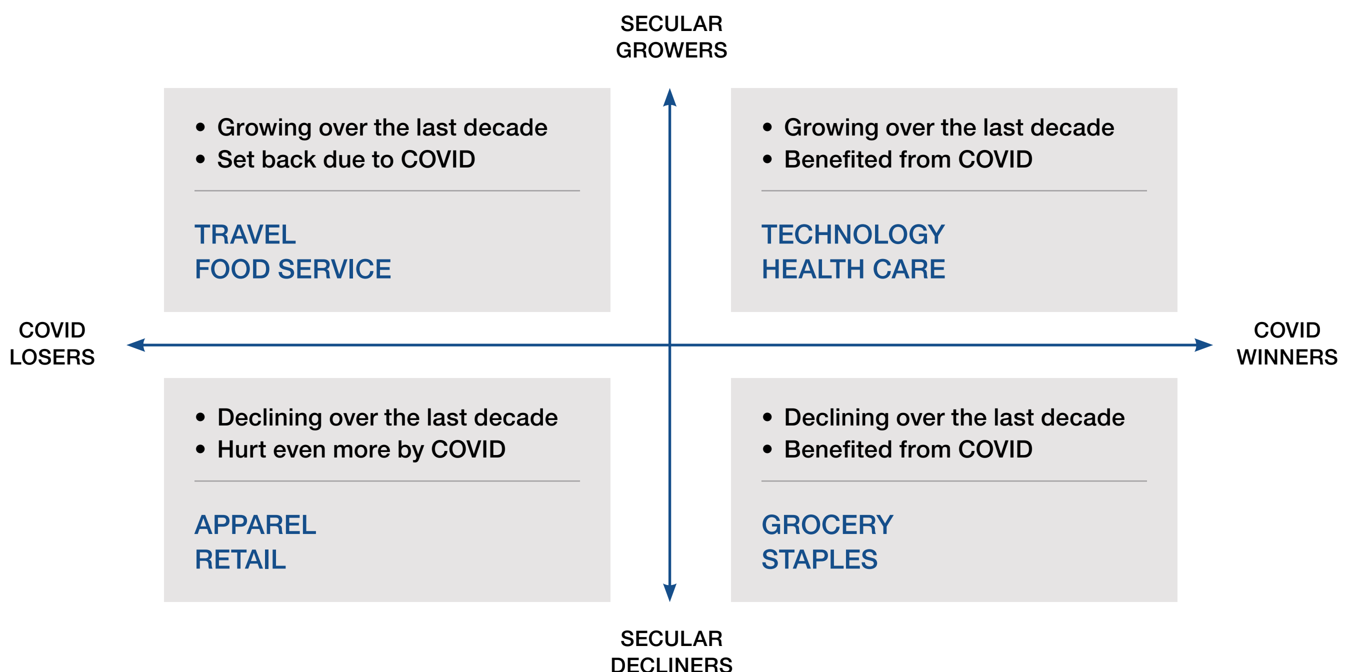


Sources: Capital Group, Bureau of Economic Analysis, Refinitiv Datastream. As of 8/10/20. Data for the three recovery scenarios are based on estimates from Capital Group U.S. economist Jared Franz.

COVID causing a great divide in the US economy

One perplexing element of the 2020 downturn is how uneven it’s been. For some areas of the U.S. economy, it has reached Depression-era levels: restaurants, hotels, retailers, airlines and, perhaps the hardest hit of all, thousands of small businesses that have closed and may never come back. But for others, it has been quite literally the best of times: e-commerce, cloud computing, video streaming and home improvement stores have skyrocketed in the stay-at-home era.

Winners and losers in the COVID economic downturn



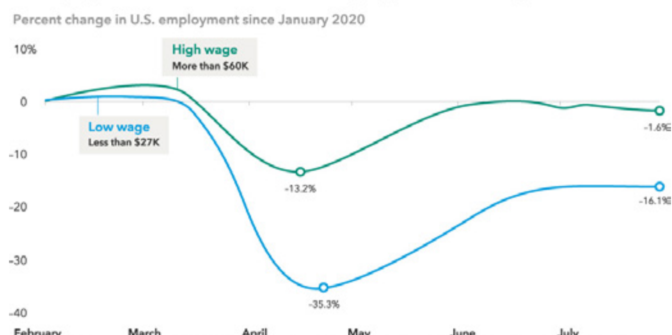
Source: Capital Group

The same can be said for high-wage workers versus low-wage workers. From a job loss perspective, the 2020 downturn has been much more severe for workers earning less than $27,000 a year – many of who cannot work from home – compared to those making $60,000 or more. This disparity, of course, raises societal questions with no easy answer.

"The post-pandemic U.S. economy is probably going to be very different than the economy we had in February 2020," the author says. "It's going to be more efficient and more dynamic than before, but there will be winners and losers. Historically speaking, we have not done a good job of addressing the societal problems that arise from such disparate outcomes."

Unemployment levels are uneven among high- and low-wage workers

Percent change in U.S. employment since January 2020



Source: "The Economic Impacts of COVID-19: Evidence from a New Public Database Built from Private Sector Data," by Raj Chetty, John Friedman, Nathaniel Hendren, Michael Stepner and the Opportunity Insights Team. September 2020. Available at: https://opportunityinsights.org/wp-content/uploads/2020/05/tracker_paper.pdf and https://tracktherecovery.org/. As of 28/7/20. Values in USD.

Expect a grinding recovery near term

Economists have also looked at the risks to a near-term recovery. What if we don't get a vaccine right away? What if the federal government cannot agree on a new stimulus package? What if more job losses come in the months ahead?

These fears have already been underscored by recent economic data and a series of layoff announcements from major American corporations. Personal income fell by 2.7% in August, according to the U.S. Commerce Department, largely due to reductions in enhanced unemployment benefits. Allstate, American Airlines, United Airlines and Walt Disney all announced major layoffs last week as the White House and Congressional leaders failed to reach agreement on a new stimulus bill.

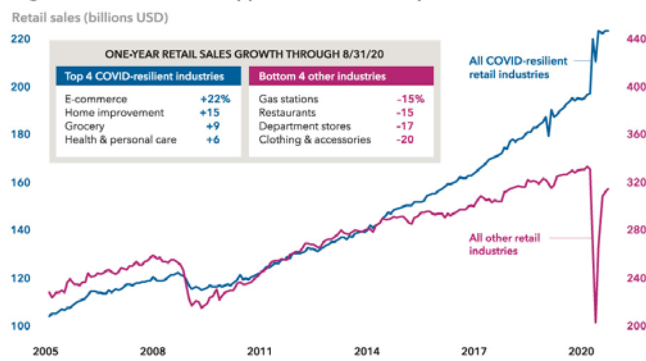
"I think we are going to see more of a grinding recovery in the near term," says Capital Group economist Darrell Spence. "Since March, we've done everything we needed to do except get the virus under control in a manner that lets us return to some sense of normality. Now the fiscal stimulus is running out and, if the federal government doesn't act soon, we could be looking at a much more difficult income profile in the months ahead."

In the second quarter of 2020 – the latest data available – the U.S. economy contracted by 31.4% on an annual basis, the biggest decline in 70 years. However, since that data reflects the worst of the downturn from April to June, the third quarter GDP reading is expected to show a dramatic bounce back as many U.S. states partially or fully reopen their economies. That report is scheduled to be released on October 29, five days before the U.S. presidential election.

With one of the hot topics this year being the Election, perceptions about the U.S. economic outlook will likely have an impact on the outcome. A recent Washington Post-ABC News poll confirmed that the economy is the most important issue to voters — more important than COVID by a 2-to-1 margin.

Digital divide has created opportunities for stock pickers

Retail sales (billions USD)



Sources: Refinitiv Datastream, U.S. Census Bureau. As of 31/8/20. COVID-resilient retail includes e-commerce, health & personal care, grocery, alcohol and home improvement. Top and bottom retail industries do not include those that had not reported 31/8/20 sales growth as of 7/10/20.

Investment implications

For investors, the pandemic-induced downturn has produced perhaps the biggest contrast of all. Amid the worst economic recession since the Great Depression, U.S. stock prices recovered quickly from the lows of March and hit new record highs in September.

Leading the way have been those companies with a solid "digital advantage," including e-commerce giant Amazon, microchip maker NVIDIA and social media titan Facebook. Apple, meanwhile, became the first U.S. company in history to reach a $2 trillion valuation.

"The market is saying this has been a disastrous year, but things are going to get better," says Capital Group portfolio manager Steve Watson. "Given the exceptional nature of 2020, I think we need to brace for more volatility ahead, but we can still find good, compelling investments for the long term."

Source: Jared Franz, Darrell Spence & Steve Watson https://www.capitalgroup.com/apac/capitalideas/article/recovery-watch-when-will-growth-return.html

Which are you – a saver or investor?

Whether you are a saver or investor could make a major difference to your lifestyle in the long run.

To determine if you are a saver or investor let's look at the characteristics of the two categories.

What does a saver look like?

- Almost by definition the money you put in bank accounts, Cash Management Trusts or Term Deposits are **short-term savings**. You may use these to save for a short-term goal like a holiday or home deposit.
- Your savings are **accessible**. You can go to the bank (or your laptop) and get your money back pretty much immediately.
- The returns are low. Low interest rates and low deposit rates have become the order of the day, and it doesn't seem as though things are going to change any time soon. In fact, the Reserve Bank of Australia, Governor Philip Lowe has said that interest rates are likely to stay low for an extended period.[1]

Why be a saver?

As you can see from the above, there are a range of reasons we save. Sometimes it's to accumulate cash towards a bigger purchase (like a holiday). That's often a sensible alternative to credit card borrowing.

Sometimes it's for security. Financial experts suggest having a rainy-day fund equivalent to around six months of your salary.[2]

So, what does an investor look like?

- Investing is more typically a **long-term pursuit**. It can last for decades – think superannuation or investing in shares or residential property.
- Invested money is **less accessible**. Lots of investment choices either lock your money away (such as super) or take months or even years to turn into a profit (such as a house).
- **Historically, returns have been higher**. In general terms, longer-term investments like shares and property generate better returns than cash savings.
- Sometimes but not always, investment assets can be more tax effective, depending on your tax circumstances.

The good news – you're already an investor

As you can see, saving is important for security and to start you towards being an investor.

Investing – putting money into potentially higher-returning, long-term investment products – is what could eventually enable you to replace your work income with investment income.

The good news is you're already doing it. Almost all working Australians are investors thanks to compulsory super.

1 Interest rates to stay low but unlikely to go 'negative' says RBA boss Philip Lowe. By business reporter Nassim Khadem, Tuesday 26 November 2019. https://www.abc.net.au/news/2019-11-26/interest-rates-to-stay-low-but-unlikely-to-go-negative-says-rba/11739728. Accessed 14 August 2020.

2 How to protect your rainy-day fund when it rains a lot. If you have a rainy-day fund but it always seems to be raining, here's how you can save for a more secure financial future. Tim Falk, 27 April 2020. https://www.finder.com.au/how-to-protect-your-rainy-day-fund-when-it-rains-a-lot. Accessed 25 September 2020.

Important information and disclaimer

This article has been prepared by NULIS Nominees (Australia) Limited ABN 80 008 515 633 AFSL 236465 (NULIS) as trustee of the MLC Super Fund ABN 70 732 426 024. The information in this article is current as at October 2020 and may be subject to change. The information in this article is general in nature and does not take into account your objectives, financial situation or needs. You should consider obtaining independent advice before making any financial decisions based on this information and before investing in a financial product read the relevant Product Disclosure Statement. You should not rely on this article to determine your personal tax obligations. Please consult a registered tax agent for this purpose. Opinions constitute our judgement at the time of issue. In some cases information has been provided to us by third parties and while that information is believed to be accurate and reliable, its accuracy is not guaranteed in any way. Subject to terms implied by law and which cannot be excluded, NULIS does not accept responsibility for any loss or liability incurred by you in respect of any error, omission or misrepresentation in the information in this communication. Past performance is not a reliable indicator of future performance. The value of an investment may rise or fall with the changes in the market.

How to seek out positivity and improve your wellbeing

In times of uncertainty, it's more important than ever to take care of your emotional wellbeing and find ways to stay positive.

In April 2020, online searches for "good news" spiked to a five year high[1]. Amid all the uncertainty in the world right now, people are actively searching for uplifting stories to act as a counterbalance to all the negative news we're hearing.

It's normal to feel anxious about what the future might look like for you, your loved ones and your community. However, if you feel like it's impacting your emotional wellbeing, it may be a good idea to take active steps to add some more positivity to your life. And by putting your own wellbeing first, you'll be better able to help those around you during this challenging period.

How to manage worry

While it's important to stay informed about what's happening in the world, if you're constantly glued to the news cycle it's easy to feel overwhelmed. It can be helpful to take breaks from watching, reading, or listening to news stories – including social media.

Instead, you could allocate a specific time of the day to keep up with the news, and then switch off your news feeds and alerts for the rest of the day. You could also schedule time in your daily routine to step away from your screen altogether and do something to unwind and de-stress, such as reading, gardening or going for a walk.

If you're feeling excessively worried, you could make a list of the things on your mind and have a plan for how to respond should the worst happen – for example, losing your job or falling ill. This will give you some peace of mind that you understand the possible risks and are prepared for them. It will also help you accept the risks that are beyond your control.

During times of crisis, we often get bogged down in what's happening at the moment and forget that this period will eventually pass. Try to focus on the future and make plans for six months or a year from now.

Adding positivity to your life

If you feel yourself getting weighed down by all the negativity in the world right now, there are small steps you can take to improve your wellbeing and make a difference in your daily life.

Here are some helpful tips to consider:

- Create a daily routine that schedules in time for physical exercise, activities you enjoy and plenty of sleep.
- Set a purpose for each day so you don't feel like you're filling in time until life returns to normal.
- Write a to-do list and celebrate your accomplishments as you tick things off, no matter how large or small they may be.
- Do good deeds for others, such as a friend, relative or neighbour who needs help. Or, you could support a charity you believe in by making a donation or volunteering your time.
- There are countless social issues and causes vying for our attention right now. Rather than investing your energy in every issue, decide how you can make a difference in one area and focus your attention there.

The importance of connection

Social distancing and government lockdowns – while necessary to prevent the spread of the virus – have increased feelings of loneliness for many people. That's why it is essential to stay connected with your friends, families and communities, so your physical isolation doesn't have to make you emotionally isolated as well.

Now that these restrictions are gradually being lifted, it is a great opportunity to reconnect with loved ones that you may not have seen for some months – or even longer. After countless video calls, now could be the time to cherish the ability to catch up with friends and family in person once again.

The future may still be uncertain, but it helps to open up to others about how you're feeling. Discussing your fears with people you trust may help you to work through them, rather than having them play over and over in your own head.

1. Wunderman Thompson Intelligence, *The Future 100*, May 2020

Source: Colonial First State

How younger members can make the most of market volatility

In unprecedented times, market volatility and the news headlines that follow can often be a cause of concern for members – particularly when it comes to superannuation. After all, the money you save during your working life could have an impact on your lifestyle in retirement.

Recent developments may have made you more engaged with your super fund than ever before – leading you to wonder what you could be doing for your investments at this time. As a Millennial with a typically longer investment horizon to retirement, is there anything you need to do to help you make the most of your wealth-creation journey? We share some considerations below.

It's important to remember that **markets often experience volatility** – and for various reasons, whether political, economic, social or environmental. The Coronavirus outbreak is also a factor – but one that will likely pass in time, as history shows us that markets do eventually recover from such disruptions. For example, since the Global Financial Crisis, global share markets have delivered returns of 10% to investors. In 2019 alone, global shares delivered strong returns of roughly 27%.

Super is likely one of the biggest (and longest-term) investments you will ever make – meaning, it **can require a long-term view**. Thankfully, time is on your side. As a younger member with decades of wealth accumulation ahead, you will likely have more time to ride out changeable market conditions to generate investment returns over the long term. By the same token, this can also mean that you will likely experience future periods of volatility over the course of your working life.

But while investing for super can require a long-term view, **that doesn't mean super is a set-and-forget scheme**. It may feel like a long time away, but being more engaged with your fund now – even in simple ways, such as regularly reading fund updates, staying up to date on the latest market developments, or thinking about your long-term wealth objectives and how your super fund could help you achieve your goals – can be helpful to you later on as you approach retirement.

While market volatility could present investment opportunities, it is also sensible to **continue budgeting and saving** for a rainy day. For example, when maintaining a long-term view of investing, buying into share markets when markets are down (and cheaper) could mean the value of those investments rises when markets recover over time. However, it's all about balance. In the current environment where day-to-day lives may be disrupted as a result of the Coronavirus, having a separate savings fund could offer some peace of mind in uncertain times – particularly for younger members who are working towards financial independence or who are kick-starting their careers.

As you keep your long-term goals top of mind, remember to speak to your Financial Adviser.

Disclaimer

Colonial First State Investments Limited ABN 98 002 348 352, AFSL 232468 (Colonial First State) is the issuer of super, pension and investment products. This document may include general advice but does not take into account your individual objectives, financial situation or needs. You should read the relevant Product Disclosure Statement (PDS) and Financial Services Guide (FSG) carefully, assess whether the information is appropriate for you, and consider talking to a financial adviser before making an investment decision. The PDS and FSG can be obtained from colonialfirststate.com.au or by calling us on 13 13 36. Past performance is no indication of future performance.

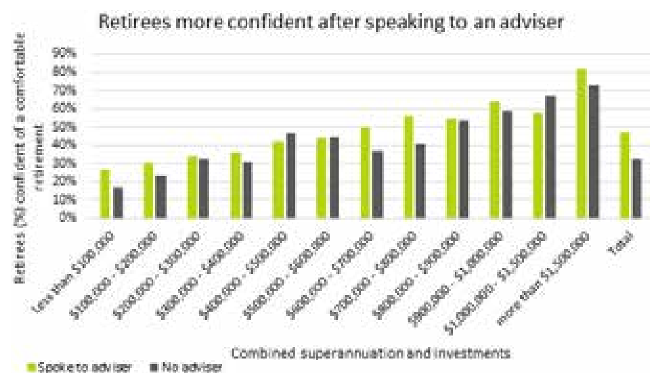
Source: Colonial First State

The real benefits to retirees of financial advice

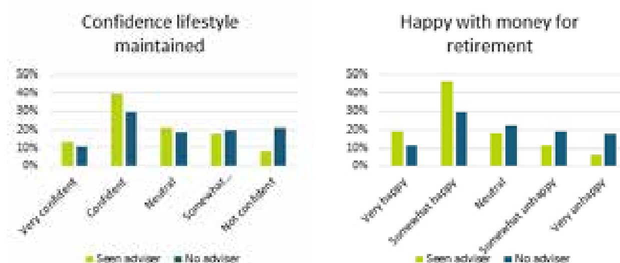
For many, the market volatility of 2020 has been difficult to navigate. Some people only realised that they had too much exposure to risk in their investment portfolio after markets fell dramatically.

A survey conducted by YourLifeChoices and Challenger in the middle of the first wave of the Coronavirus pandemic in April 2020 considered just how retirees were coping with share market shocks to their finances. Retirees were more concerned about share market performance than usual. This was the highest rated concern, with 43% of retirees including it in their top three financial issues.

Effects of receiving financial advice on retirement confidence



With all the additional concerns of retirees currently, and the limited ability to generate new savings after working, it is not surprising that retirees worry about their future finances. This is an area where retirees benefit from good financial advice. It's not that advisers necessarily remove all the uncertainty. They can't. But they can increase the confidence of retirees to manage their needs through the uncertainties of retirement. This was evident in two questions from the survey.



Retirees who had spoken to an adviser were more likely to be confident or very confident that they would be able to sustain their lifestyle for as long as they live. They were also much more likely to report being happy with their money for retirement. The higher level of happiness was not just reported by those with more money. Some of the largest differences in the impact of advice were again present in retirees with less than $200,000 in overall savings.

The improvement in happiness does show the power of a well advised retirement income plan across all wealth levels. Presumably, the advisers will have been able to provide constructive ideas for these retirees to put into place, increasing their confidence in managing retirement and providing the essential peace of mind that many retirees seek.

Summary

Managing your finances in retirement can be a real challenge and financial advisers can help find the best outcome for you and your circumstances. However, the largest benefit might not be through any financial advice specifically but rather the power of a well-developed plan. If a retiree has a comprehensive income plan to deal with retirement uncertainties, they are more likely to be more confident with their finances and happier with their personal situation.

If you need help please talk to your financial adviser.

The information is general only and has been prepared without taking into account any person's objectives, financial situation or needs. Because of that, each person should, before acting on any such information, consider its appropriateness, having regard to their objectives, financial situation and needs. Each person should obtain and consider the Product Disclosure Statement (PDS) for the relevant product offered by Challenger before making a decision about whether to acquire or continue to hold the relevant product. A copy of the PDS can be obtained from your financial adviser, our Investor Services team on 13 35 66, or at www.challenger.com.au The information in this document does not constitute, and is not intended to constitute, social security or tax advice. Neither Challenger, nor any of its officers or employees, are a registered tax agent or a registered tax (financial) adviser under the Tax Agent Service Act 2009 (Cth) and none of them is licensed or authorised to provide tax or social security advice. Before acting, we strongly recommend that you obtain financial product advice, as well as taxation and applicable social security advice, from qualified professional advisers who are able to take into account your investor's individual circumstances. You may also wish to contact Centrelink or other government agencies regarding eligibility for relevant benefits. To the maximum extent permissible under law, neither Challenger nor its related entities, nor any of their directors, employees or agents, accept any liability for any loss or damage in connection with the use of or reliance on all or part of, or any omission inadequacy or inaccuracy in, the information in this guide.

Source: Challenger

Big Tech's market might in five charts

How would the US market have performed without Big Tech? How do their profits compare? Our charts reveal the market dominance of the "FAMAGs".

The largest US technology stocks – Apple, Microsoft, Amazon, Facebook and Google (Alphabet) – known as the "FAMAGs", tumbled sharply at the beginning of this month, after supercharging the US stock market from the depths of the Covid-pandemic in March.

These "superstar" firms have largely benefitted from the economic fallout of the crisis, as more people rely on their technology to work and shop from home. However, their increasing dominance is raising concerns about the top-heavy composition of the US equity market and the sustainability of the tech rally.

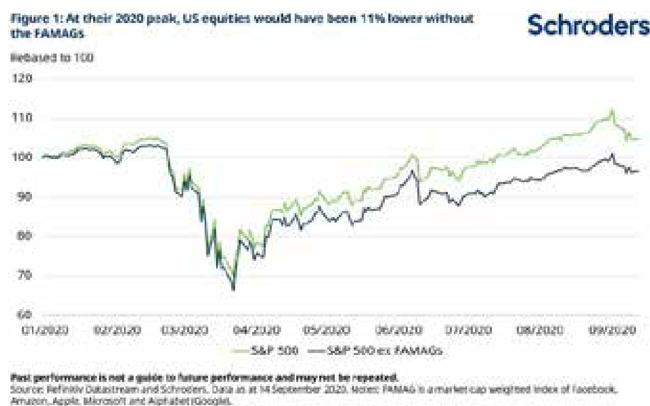
Here are five charts that demonstrate the FAMAGs' growing size and influence.

1. How Big Tech is propping up stock market returns

With Apple briefly becoming the first US company to be valued at US$2 trillion, more investors are turning their attention towards the impact of the tech sector on market returns.

As at 14 September, the S&P 500 was up 6% this year, while the FAMAGs were collectively up 42%.

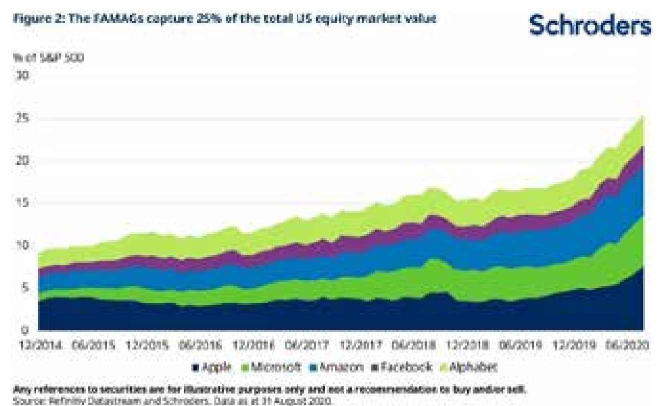
If we exclude the tech giants, the index return drops to -2%. In other words, US equities would be 8% lower this year without the FAMAGs (or 11% when measured at their peak on 2 September). This is how important these firms have become.



2. The US market is increasingly concentrated

One reason why these firms have become so influential is because they are the most heavily weighted stocks in the index.

Investors' rush into tech this year has propelled the weight of the FAMAGs in the S&P 500 Index to a record high of 25%, more than double their weight from five years ago.



This means that the performance of the FAMAGs will clearly impact the performance of the overall market more than a small cap company will.

To illustrate this, let's suppose hypothetically that the FAMAGs collectively fell by 10%. That would mean that all remaining 495 stocks in the S&P 500 would need to increase by at least 3.3% just for the whole index level to stay the same.

Figure 3: Top five stocks rarely all come from the same sector

Schroders

Largest US companies by market capitalisation

Rank	1960	1970	1980	1990	2000	2010	2020
1	AT&T	IBM	IBM	Exxon	Microsoft	Exxon Mobil	Apple
2	General Motors	AT&T	AT&T	General Electric	General Electric	Microsoft	Amazon
3	Dupont	General Motors	Exxon	IBM	Cisco	Walmart	Microsoft
4	Exxon	Eastman Kodak	General Motors	AT&T	Walmart	Apple	Facebook
5	General Electric	Exxon	Amoco	Philip Morris	Exxon Mobile	Johnson & Johnson	Alphabet
Index weight	**27%**	**24%**	**17%**	**13%**	**15%**	**11%**	**25%**

Any references to securities are for illustrative purposes only and not a recommendation to buy and/or sell.
Source: Refinitiv Datastream, S&P Dow Jones and Schroders. Notes: weight based on S&P 500 as at start of year, except for 2020 as at 31 August 2020. Green shading denotes companies from tech sector.

3. Unprecedented dominance of a single sector

The five largest members of the S&P 500 are now all from the tech sector. The last time the US equity market was as concentrated as this was back in the late 1960s. So it is not unusual for the market to be concentrated in a handful of stocks (see table). Although the extent of concentration at present is greater than normal, what is more unusual is for the top five stocks to be all from the same sector – tech.

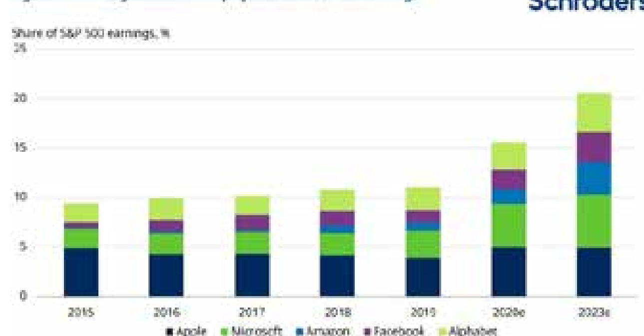
This lack of sector diversification should not be taken lightly. Any pullback in tech sentiment can have an outsized impact on overall market moves, as was recently the case.

4. Big Tech's dominance reflects the companies' profits

So are stock market valuations ringing alarm bells? This is the question that confronted investors at the height of the dotcom bubble in 1999 before it burst.

However, comparisons between the 1999 dotcom and today are often oversimplified. They often ignore the fact that many of the fast-growing internet companies back then were not generating significant profits or cash flows.

In contrast, the current tech giants are highly profitable. They account for 15% of trailing 12-month S&P 500 earnings and an even higher proportion of forecast earnings, e.g. 20% of projected 2023 earnings. When benchmarked against their market cap weight of 23%, which reflects all future earnings, their valuations no longer look as extreme.

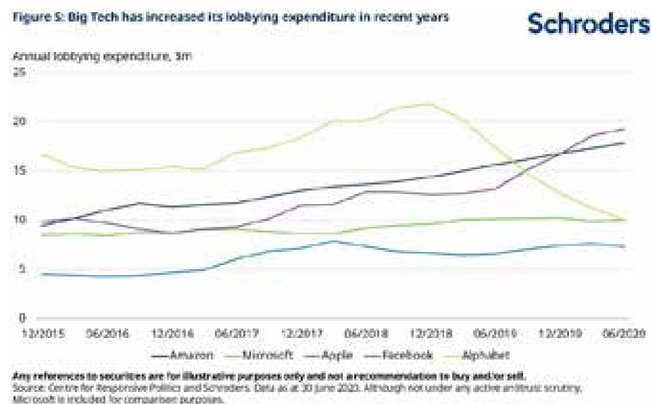


5. Big Tech has ramped up its political presence to protect its business interests

Faced with the threat of regulatory action to limit their market dominance, Amazon, Facebook, Apple and Alphabet's Google are spending millions of dollars each year trying to influence regulators and politicians on policy issues ranging from data privacy to taxes.

For example, according to the Centre for Responsive Politics, Amazon and Facebook spent a record $17 million each in 2019. This was more than any other US company. This is not just a tech phenomenon, however. Academic studies show that corporate lobbying has been a key explanation for the decline in competition across numerous US industries.

In a recent Bloomberg interview, the chairman of the US House Antitrust panel, which is leading investigations into Amazon, Facebook, Apple and Alphabet's Google, stated that these firms were abusing their market power to maintain their industry dominance. The chairman was critical of the government's track record on policing anti-competitive behaviour, such as Facebook's acquisition of Instagram.



Investors should stay on guard if decisive regulatory action is taken against the tech giants. Given their high benchmark weights, it could drag returns for the overall US market lower if confidence in them deteriorates for any reason. The closer a portfolio's weights are to the benchmark, the bigger this risk. Passive strategies are most exposed.

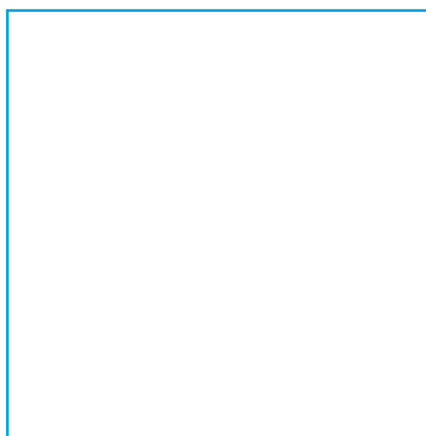
Big tech has grown ever more influential, whether through index concentration, stock price performance, earnings generation, and money spent lobbying.

At a minimum, investors should at least be aware of the risk they are running in a portfolio, whether they are comfortable running those risks, and ideally, whether they are being rewarded for taking those risks.

Any references to stocks/companies are for illustrative purposes only and not a recommendation to buy and/or sell. Reliance should not be placed on any views or information in the material when taking individual investment and/or strategic decisions. If you are unsure as to the suitability of any investment speak to an independent financial adviser.

The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

Source: Schroders



Boyce Financial Services Pty Ltd

44 Fitzmaurice Street
Wagga Wagga NSW 2650

(02) 6925 9044

info@boycefs.com

WMA-28839 (50722) 1120

Disclaimer: The information contained in this document is based on information believed to be accurate and reliable at the time of publication. Any illustrations of past performance do not imply similar performance in the future. To the extent permissible by law, neither we nor any of our related entities, employees, or directors gives any representation or warranty as to the reliability, accuracy or completeness of the information; or accepts any responsibility for any person acting, or refraining from acting,on the basis of information contained in this newsletter. This information is of a general nature only. It is not intended as personal advice or as an investment recommendation, and does not take into account the particular investment objectives, financial situation and needs of a particular investor. Before making an investment decision you should read the product disclosure statement of any financial product referred to in this newsletter and speak with your financial planner to assess whether the advice is appropriate to your particular investment objectives, financial situation and needs.