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2020 Review

December 22, 2020 FAT-AUS-1001

A year like none other

To say that **2020 was** 'interesting' would be a gross under-statement, with the year clearly **unprecedented on a host of counts**. For Australia it was a year when t**he market reached a record high in late February, before the onset of the global pandemic**, saw one of the fastest and deepest sell-offs in history.

The responses were equally unprecedented both from a health and financial perspectives. Mounting infection and death rates saw lockdowns implemented, movements restricted, and borders closed. The financial 'remedies' came quick and sizeable in the form of government assistance (JobKeeper and the like in Australia), and central bank stimulus - both in the form of even lower interest rates and the RBA even embarking on a quantitative easing program.

While a vaccine has brought cause for cheer, as we round out 2020, the current outbreak in Sydney is a stark reminder that the virus very much remains with us for now. And this provides a significant backdrop for markets as we head into 2021. **We will provide our view on how we see markets shaping up in our usual outlook pieces**, with our Top 10 Predictions for 2021, in early January.

This week however **we reflect on the year that was, and what went right, what went wrong,** and generally make sense of a period when **very few (if any) could claim to have '20/20' vision on what was about to transpire at any point.**

For Fat Prophets it was a 'big' year, even without the pandemic. We notched up 20 years as a company in October, while we recently produced our 1000th Australasian equities report. We couldn't have done any of this without our subscribers, and our Annual survey is a reminder that our Members remain as engaged as ever!

We pride ourselves of making the big calls (trying to get as many right as possible), and taking a view, and clearly 2020 was a year when these were needed in spades.

Somewhat fittingly, our **calling of the bottom following the Covid Crash in March and a subsequent 'V' shape recovery is right up there with our very best work.** Times of panic more often than not require 'cool heads,' and bring the greatest opportunities. And on that note, **we upgraded a multitude of stocks back to buys during the pandemic lows and continued to make selective recommendations on any weakness, as the year wore on.**

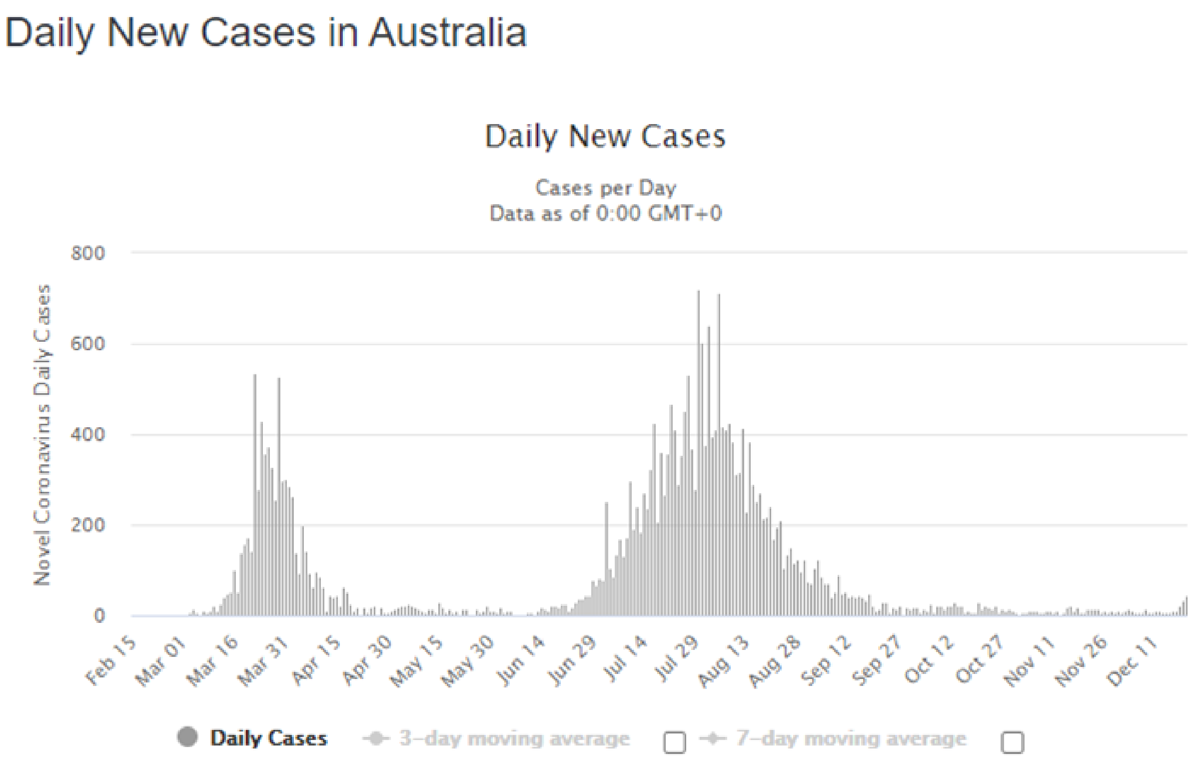
Whilst volatility was running high, we took the view that Covid-19 was not going to spell Armageddon for the world economy or stock markets. We believed that an unprecedented crisis would see an unprecedented response (health wise and financially), and the massive sell-off and fastest crash in history was not the time to capitulate, but conversely, represented a buying opportunity. We did not go along with the view that a protracted recession or even a Depression awaited, and <u>**we made an early call on a 'V' shaped recovery scenario.**</u>

This was a consistent message running through our research reports from late March through to April, and even now.

In Australia, the 'V' shaped market recovery has very much been alive and well since March/April. After hitting a peak of 7162 on the 21st February, the market fell around 37% during the depths of despair in late March. The rebound was even more startling, and the ASX200 is currently up around 46% from those lows, and only 150 points from where it started the year.

While there was a 'slip-up' Melbourne, (and the recent outbreak in Sydney) the health outcome and response to Covid has been integral to the economic rebound. **Businesses**

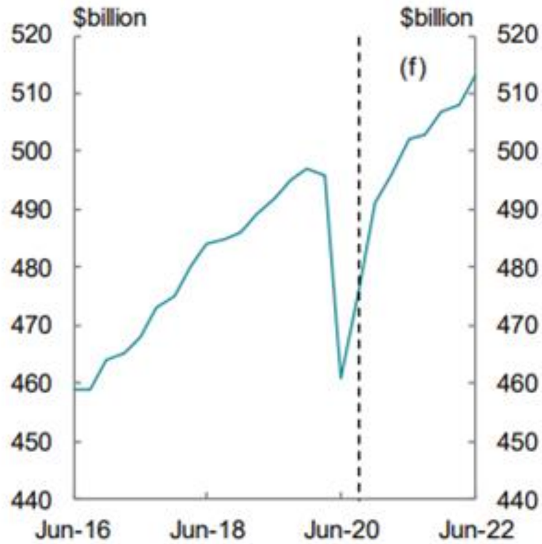
are operating, and consumers are out spending, whereas in many parts of the world lockdowns continue to weigh on activity and freedom of movement. **We need to remember how 'lucky' we are** and remain vigilant. A vaccine is on the horizon, but it could take well into next year before it works its way through the population, and it is not certain how quickly herd immunity will be achieved.



Source: worldometers

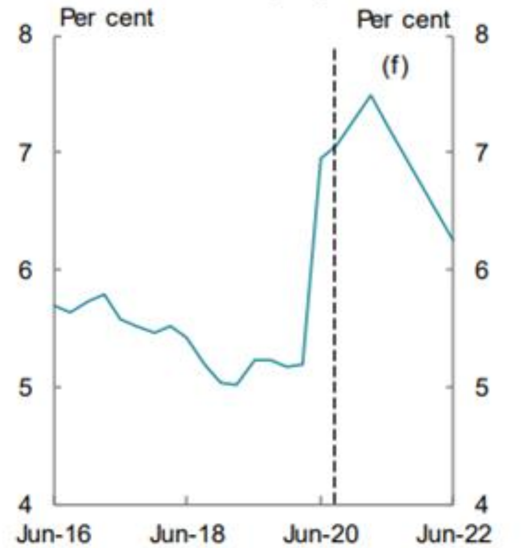
Australia has gone into, and then out of recession, with Government and central bank stimulus playing a big part in the equation, and has ensured that we in a much better place than feared even a few months ago. The unemployment rate for one is expected to fall below 6%, a year ahead of government forecasts. **November's unemployment rate has fallen to 6.8%**, beating expectations of 7%, following the creation of 90,000 new jobs,

Chart 2.2: Real GDP levels



Source: ABS Australian National Accounts: National Income, Expenditure and Product and Treasury.

Chart 2.3: Unemployment rate



Source: ABS Labour Force Survey, Australia and Treasury.

The fact that the pandemic has been an event driven health 'shock,' as opposed to a systemic financial one partly explains why the economic recovery this time around is expected to be faster than that from previous recessions in the 80's and 90's. The Treasury now expects unemployment to fall to 5.75% by the 2023 financial year.

This has not been without cost, which is to be expected. Australia's gross debt is set to reach 42.5% of GDP by June 2021, and some $1.8 trillion or 53% of GDP later this decade. But that is not bad all things considered – given that the US, by comparison, is expected to top 100% early next year!

Certain sectors have very much kept the economic engines running, including iron ore, which is now approaching US$180 a tonne. This is as demand for the steel-making ingredient has accelerated as countries (led by China, our largest customer) are literally trying to build their ways out of the Covid-inspired downturn. This is also while our many producing rival Brazil has had supply interruptions (and more, recently) of its own.

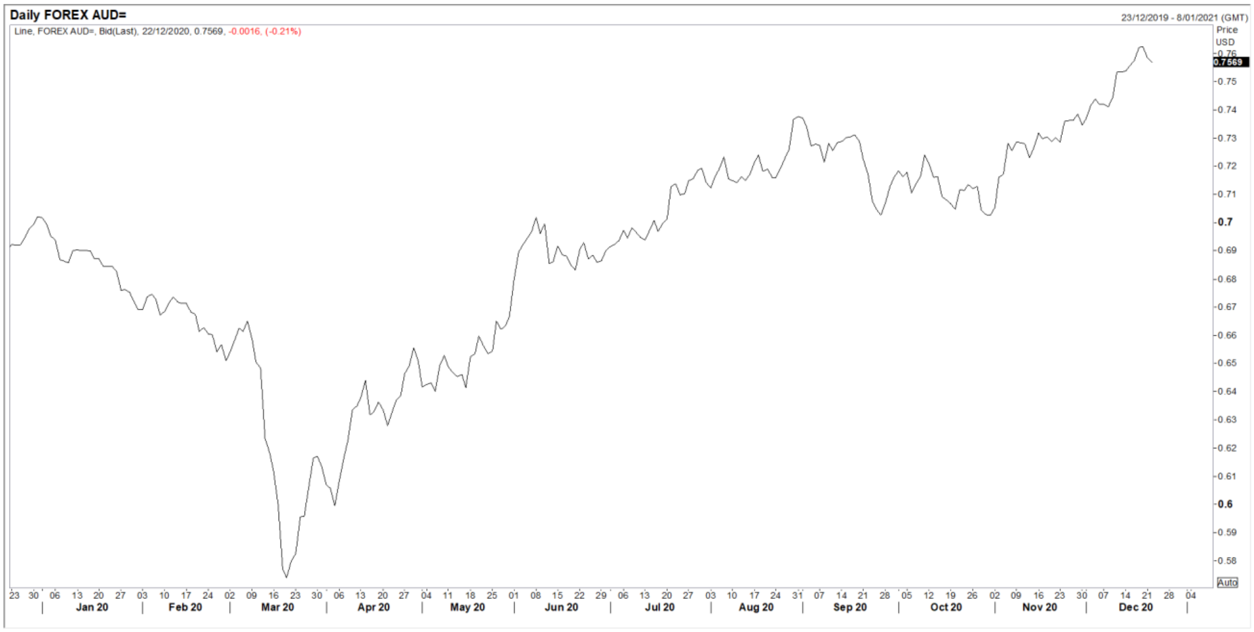
<u>Iron Ore</u>

This **has all worked out very well for the likes of BHP and Rio which we put back to 'buys' near the lows in March** (and after issuing take profits recommendations near the 2019 peaks almost 18 months ago). China's need for iron ore has also 'trumped' fear over rising political and trade tensions generally been the two countries.

On that point we believe there are more economic tailwinds to come, and there **are plenty of upside risks in the Treasury's economic forecasts.** The government is forecasting that prices of the steel-making ingredient will fall by two-thirds to US$55 a tonne by September next year. It is har to see this happening, with the global infrastructure investment rollout only getting started, and inflation coming onto the horizon.

And we round out the year, Australia generally, is in relatively great shape economically. This is reflected in our currency which has rallied from a low of 57 US cents in March to around 76 cents recently.

A$



The country is 'making it through to the other side' much better than most, and this has been to the benefit of a number of recommendations which we have made in 2020, and which we delve into further detail on below.

Portfolio movements in 2020

We certainly weren't perfect, **but clearly one of our biggest calls this year, was in March, and that economic Armageddon was not upon us, and that a 'V' shaped recovery would ensue.** This shaped a host of recommendations we made in March/April, and the months since.

We were active as usual across the resource space and in March we issued 'top-up' buy recommendations for all Members in **BHP** and **Rio** around $28.20 and $83.00 respectively. This followed 'half sells' around 9 months earlier at $41 and $104. Today BHP and Rio stand at $43 and $115 respectively, up around 50% and 40% since we urged buying the dynamic duo at the pandemic lows.

BHP

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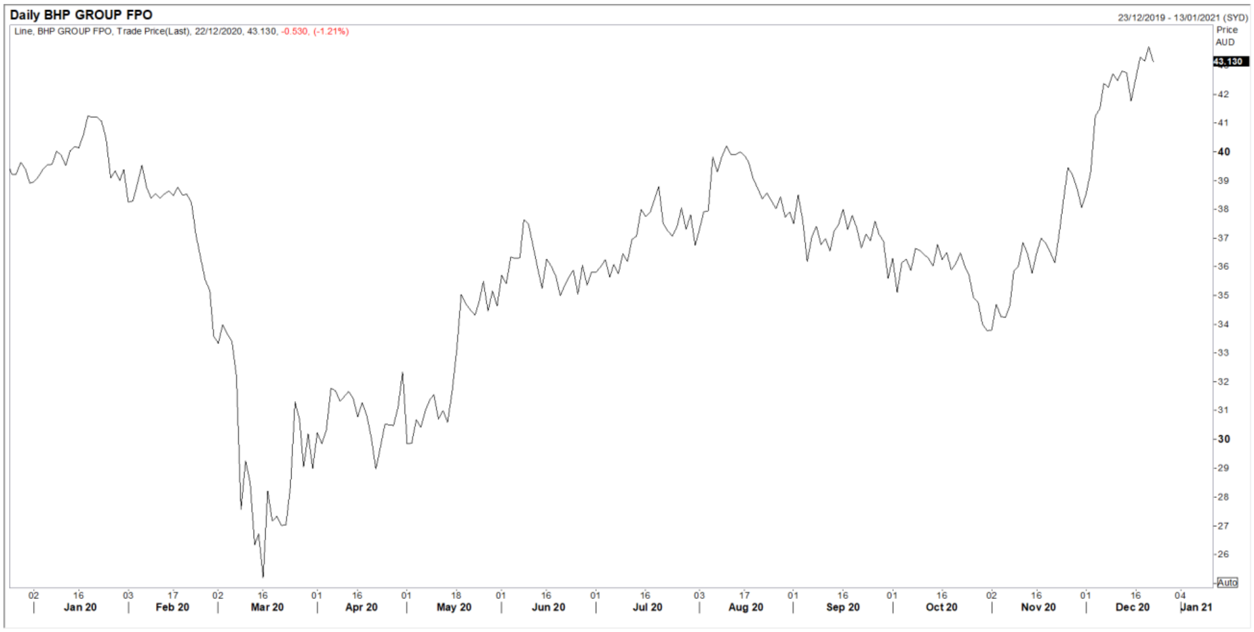
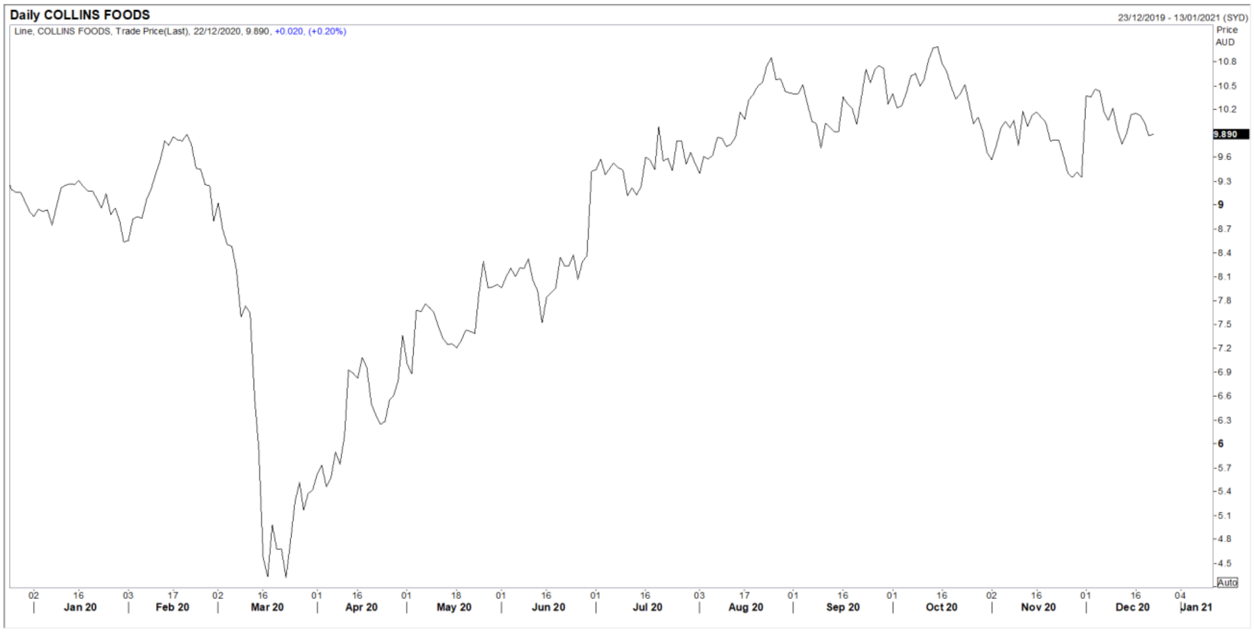


Energy stocks were even more volatile, with an OPEC cartel which was in some disarray adding to the mix. We however urged Members to remain calm, and amongst our recommendations was a call to take up the rights issue from **Oil Search** at $2.10. In the context of the company's current $3.50 share price, that looks to have been the right call.

It wasn't of course just the resource space where we were recommending Members to increase exposure. **We appreciated fairly early on that some companies could even do quite well during the pandemic, including our favoured QSR operators Domino's and KFC/Taco bell operator Collins Foods.** We made multiple buy recommendations on both stocks around the pandemic lows, and in the months following. This worked out well, with their respective delivery/takeaway businesses seeing sales turbo-charged by the pandemic.

Collins Foods



We remained positive on other 'defensive' plays including **Amcor** and **Sonic Healthcare** which both rebounded strongly from their lows, and from the buy recommendations we issued at much lower levels. It was a similar story for most of the telcos, with **Vocus** the clear standout. We see 5G as a big earnings driver for the sector in the years ahead, including for **Telstra**, which has been knocked around in 2020.

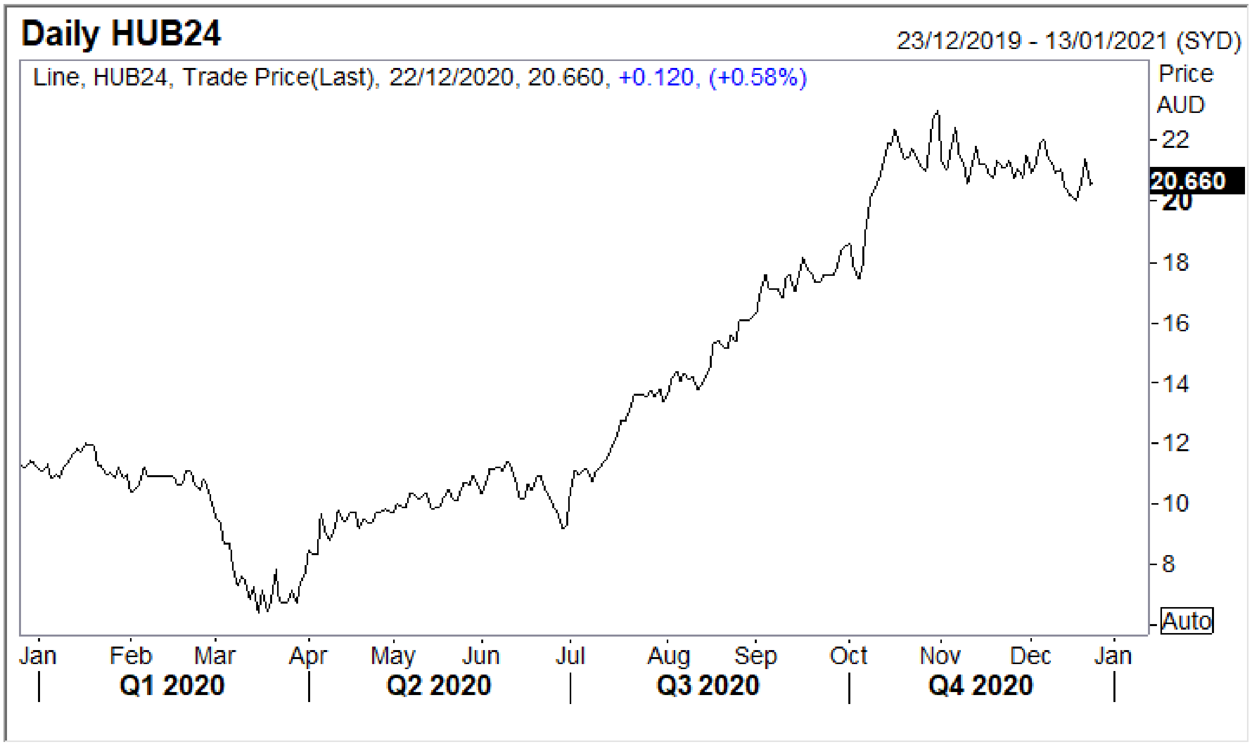
The banks were a little bit late to the 'V' shaped recovery story share price wise, but through the middle months of the year we stuck to our view, that all the billions of dollars of Covid provisions would not be needed, and this would ultimately driver a recovery in earnings and dividends. We had buys on **ANZ, NAB** and **BOQ** throughout this period, and a sharp upward re-rating in the sector was welcome,

ANZ

Outside of the banks we were positive on the insurers, although **QBE** was one that hasn't worked out to date. The shares hit a peak above $15 in February, and currently stand under $9. We continue to see rising premiums and investment income as being tailwinds to earnings next year.

In the FinTech space we didn't go chasing the Afterpay and Co, but continued to back the financial service platform stocks, which gained altitude, as the year went on and the market rebounded ever higher. We said goodbye to OneVue following a takeover, but companies in this space, including **HUB24, Praemium, and Mainstream** continue to have a great operating leverage thematic.

HUB24



As part of our 'V' shaped scenario were upbeat about the property segment as well, and on this note **James Hardie,** and **Domain** did not disappoint. Domain's 60% shareholder **Nine** ratcheted higher as well, with the company's digital businesses (including Stan) performing well during the pandemic, and a positive update on the advertising markets recently suggesting there is further brightness to come.

We stayed true to out agricultural tilt, and with the ending of the drought providing respite but countered by the pandemic. **Nufarm** did it fairly tough, but **Elders** had a strong year. We see tailwinds coming through for both ag plays in 2021.

Back to the mining sector, and the gold stocks pushed higher for much of the year, before correcting from early October. There remains vast appeal in the space, and the need for scale, as highlighted by the merger which **Saracen** became involved in. We see appetite for gold returning with some force in 2021 as the inflationary repercussions from the Covid fiscal and monetary splurge come onto the horizon.

On the subject of property stocks, **BWP** was one of only two sell recommendations we made during the year, with a partial take profits recommendation in early March. Our other sell was on OneVue, as we recommended parking capital in other opportunities following the takeover approach.

We initiated sell or 'sell half' recommendations just twice in the Fat Prophets Australasian Equities Portfolio over the year. 2020 was however not the year to be bailing out on stocks in our view, with many of those that did sell out in March/April looking back with some resentment as the market continued to grind higher.

We have discussed the reasons for taking profits or losses on these stocks in a separate report (refer to the report titled 'Where we took Profits and losses in 2020').

New Recommendations

We made 11 new introductions to the portfolio this year, a larger number than normal but consistent with the value we saw amidst the pandemic.

Amongst the most recent were the airlines, **Qantas** and **Air New Zealand**. Despite a recent 'wobble' over the latest outbreak, both are off to a good start in the portfolio. We saw Qantas as a strong play on a domestic 'reopening' and the shares are nearly 30% above our initial buy recommendation

Qantas

Other reopening' stocks added were Westfield mall owner **Scentre Group** and the more Melbourne focussed **Vicinity**. Both trade at a significant discount to net asset value, and we see good things 'in store' for both in 2021.

After some great success with Bellamy's last year, the addition of infant milk plays Bellamy's and BUBS hasn't quite worked out in 2021. The thematic of rising Chinese demand remains very much in play in our view, as does an increasing need for 'wellness' products.

Speaking of stocks, dollar discount chain **The Reject Shop** is our most recent addition. The company has done well during the pandemic and is well positioned to expand in a relatively under-penetrated market.

Our decision to get kitted out with sports-wear technology company **Catapault** in February wasn't the best timing, as the pandemic hit, and global sports went into lockdown. The company is a high quality one and is bounced back since. Catapault was another one of the many stocks that we re-recommended at the pandemic lows, which would have made for an astute entry for some Members.

On the resource side we added lithium play **Orocobre** at the pandemic lows around $2.15 in April. The shares have almost doubled since, and we believe the 'electric vehicle' thematic has much further to run. This scenario would also be positive for nickel miner **Mincor** which we added in August and has risen strongly since.

Orocobre

We added gold producer **St Barbara Mines** as well this year, with the shares currently fairly flat on our initial entry. As noted above we are expecting big things from the gold sector next year.

With interest rates continuing to fall amidst the pandemic, but dividends also being cut by many companies, **our updates on the income Report were particularly well received**. We provided updates on the Fat Prophets 'Income Portfolio' each quarter, and the income yield since inception in March 2012 to 12th October 2020, stands at 23.4%, which is in addition to the capital growth of 15.3%. This makes for a total return of 38.7% since the portfolio was constructed in March 2012.

Overall, we remain comfortable with the performance of the Fat Prophets Income Portfolio, noting that to date it has delivered on its mandate. That is to construct and maintain a concentrated basket of stable, well-managed, and financially sound companies that distribute strong, sustainable and defensive income streams.

Looking at the research portfolio more broadly, performance-wise, **the Australasian equities report continues to track well.** This is also a reflection of the fact we generally get it right more often than we get it wrong (and raise our hands when we don't.) The annualised return since inception on the Australasian Equities Report was 18.5% as at 30th November 2020, versus 8.0% for the All Ords over the comparable period.

The feedback from Members

If the results from our Member Survey for 2020 are any indication, our stock recommendations, in combination with our big picture analysis, continue to be appreciated in what has been a year like none other.

The daily email from Angus Geddes is a vital part of our communication with Members and a channel through which Fat Prophets provides clarity on our views on macro and micro-economic developments, and the implication for stock markets, in a timely manner. This was the year when the big (and the right) calls were appreciated more than ever.

The daily email was separately graded and received an 'A- '. This was a higher grade than last year, and a testament to the value placed on the daily note by many Members in a year which was an unprecedented one for volatility, and the various ' moving parts' associated with the pandemic.

Our efforts on the Australian Equities research service have been awarded an 'A-' grade from Members for 2020, which we find a pleasing result given the challenges which the markets faced this year.

Our weekly research webinars continue to be well received. These sessions give Members the chance to hear direct from our Head of Research Greg Smith, of our view on market events and developments. The forum style with a Q&A session at the end has also been a great way for us to engage with Members and the feedback here continues to be positive.

Members also remain receptive towards our weekly fatWRAP which summarises the ideas from across the Fat Prophets suite of research products. We continue to put plenty of thought into our covers and design, so it is pleasing that feedback here remains positive. In addition, **it was great to reflect on our Top 20 covers** in the daily note as well, as we ran our 'Countdown' in October, and the lead up to our 20th anniversary as a business.

Having turned 20 years old this year, we look forward to the next 20! Nearer term we remain committed to providing our Members with the best possible offering and striving for improvements in the coming year.

We will be publishing our predictions for 2021 in the next reports to be published in two parts; the first in the week beginning 4th January 2021, and the second in the week beginning 11th January 2021.

As usual, these predictions will cover a range of topics, but clearly will be set against the backdrop of the pandemic which remains rampant in many parts of the world, and despite the prospect of a vaccine working its way through the populous over the course of next year. This is also while the financial medicine as a result of the pandemic will continue to be dished out.

Signing off on 2020, and a year no-one will forget in a hurry, we would like to once again thank all Members for their continued support, and wish all a safe and happy Christmas and a prosperous New Year.

Best regards,

Fat Prophets

Disclosure: Interests associated with Fat Prophets hold shares in BHP, Rio, Domino's Pizza Enterprises, Collins Foods, Qantas, Vicinity, Scentre Group, Saracen, ANZ, NAB, Bank of Queensland, Oil Search, Amcor, Sonic, Vocus. Telstra, HUB24, Praemium, Mainstream, QBE, James Hardie, Nine, Domain, Nufarm, Elders, BWP, Orocobre, Mincor and The Reject Shop.