

July 2021 — Over the Horizon Market Commentary by David Offer

July was the 10th positive month in a row for the Australian share market. The All-Ordinaries Index closed up 79 points to finish the month at 7,664 points. For the month to date, August has seen our share market up a further 3%, as reporting season delivers positive results for many Australian companies.

With valuations stretched in many areas of the Australian share market, we consider the best risk return trade at the current time as being those companies that stand to bounce back strongly once Australia, as a Nation, successfully addresses Covid. Given half the Country is in lockdown, it would appear Covid is presently gaining the upper hand.

Australia appears to have been caught napping, perhaps spending too much time congratulating ourselves with respect to the success we have enjoyed to date on suppressing the virus rather than focusing on the future. In this respect, the rest of the developed world has been getting on with ensuring as high as possible vaccination rates as quickly as possible across respective populations. This is to not only reduce the rate of spread of the virus but, more importantly, mute the severity of the virus once contracted.

Those nations with high vaccination rates are slowly getting back to normal, with Covid in the community and a part of life. The UK is a good example. While high daily case numbers are reported, it is not stopping a return to mass gatherings such as open-air concerts, sporting events and a return to air travel for those who are vaccinated. It appears that the health effects of Covid for people who have been vaccinated are minimal.

At seven weeks, residents in Sydney have been in the current round of lockdowns the longest. Through their suffering, they are giving the rest of the country along with our Politicians and those in charge of vaccine rollouts a strong reminder of the consequences of not getting on with the job.

Contrary to the Federal Government's view earlier in the year, NSW is now most definitely in a race that much of the rest of the Nation will subsequently be faced with. Lane 1 is the 'Virus', and is a proven fast starter. Lane two is 'Authorities Charged with Vaccine Rollout' along with the 'Population Yet to be Vaccinated'. Still to be proven and off to a shockingly slow start – maybe they keep tripping over each other – but at least some momentum is building here! Lane 3 is the untested 'Patience of Residents Already Vaccinated'.

The rules of this race say that Lane 3 can't win and so has been ignored by the media and experts in general. However, it is a good bet that Lane 3 becomes tired of being taken for granted over the withdrawing of basic rights and freedoms (current Race rules) due to the actions of too many in a congested Lane 2. Lane 3 can definitely influence the outcome for Lane 2. For example, by swerving into Lane 2 by getting on with life and starting to again circulate within their communities. If this eventuates, this will throw a real spanner in the works for Lane 2 and give a short-term boost to Lane 1!

The result of this NSW race will probably be a dramatic mess! There will likely be needless sickness and death incurred in Lane 2, and Lane 3 will remain angry about the whole thing. The ever-unpopular Lane 1 will keep performing and spread further into the community. The unfolding race drama will give commentators plenty to talk about and will be continual front-page news. Eventually, the track will be cleared (for the NSW race probably in October and a little ahead of the rest of the nation) with Lane 2 and 3 replaced with 'Largely Vaccinated Population'.

With a band-aid on their shoulder and a newly found attribute called 'resolve', this late entrant should finally run-down Virus in Lane 1, as has occurred in other countries. Virus reserves the right to try to do a baton change with a new dark horse called 'Mutation' but equally 'Largely Vaccinated Population' will be allowed performance enhancing supplements in the form of booster shots. While Australia continues to apply initial jabs, these will soon be applied in other countries more advanced in their own Covid race.

With Covid now entrenched in NSW, it is now just a question of when it starts to spread more rapidly through the broader NSW community and ultimately the rest of the Nation. Like the rest of the world, all Australians will have to ultimately confront Covid at a personal level. Australia's successful suppression strategy was purely to buy time to develop a vaccine. It was not the answer to defeating Covid and this seems to have been forgotten for now. Lockdowns are neither economically or socially sustainable. Vaccinations need to be the 1st, 2nd and 3rd priority of State and Federal Governments and the urgency and importance of vaccine rollout needs to be better communicated to the broader population. Particularly so in states like Western Australia, which have not had to endure the severe consequences of repetitive, prolonged lockdowns and consequently are arguably more apathetic towards vaccinations. Without a highly vaccinated population the two alternatives are a needless rate of death or lockdowns, which unfairly penalise those who have done the right thing as well as saddle future generations of Australians with even more Federal Government debt.

Notwithstanding the short-term pain likely to come, longer term we are optimistic towards Covid being overcome as evidenced elsewhere globally. This will come when a largely vaccinated population learns to accept that Covid exists within the community and we are likely at some point to contract it like other sickness such as flu. We consider the major opportunity in our share market being those companies that will benefit when relative normality returns. An example is Qantas, where 96% of Qantas frequent flyers surveyed are expecting to travel in the next 12 months once allowed. Other examples of companies that will benefit strongly as the effects of Covid gradually subside include Flight Centre, Tassal, Oil Search, United Malt and Crown, notwithstanding Crown's other material challenges presently faced.

There is no doubt that the current round of lockdowns will have an adverse impact on corporate profitability in the year ahead. Time will tell as to what extent. However, one 'positive' is that these lockdowns may take out some of the excessive heat that was building in the economy and hence dampen evidence of inflation. The emergence of genuine inflation would be a material headwind for all investment markets including share markets.

Unrelated to Covid, a new investment we are starting to add to portfolios for both income and growth is Aurizon, an Australian rail freight operator. Aurizon provides access to, operates and manages, the 2,670km Central Queensland Coal Network. The majority of coal hauled is coking coal, used in the production of steel, from globally competitive mines. Likewise, Aurizon provides above rail haulage services including road transport of commodities to train lines as well as ports in Qld and NSW. It also transports by rail iron ore and agricultural products throughout Qld and WA. Supported by a 7%, 70% fully franked dividend yield and about to go ex-dividend 14.4 cents on 23/08/2021, we think Aurizon will offer both income and growth going forward as its rolling stock fleet is gradually redeployed to further diversify into new bulks such as iron ore and grain.

Finally, reporting season is presently underway and thus far results have been positive. Of note, CBA has announced a \$6 billion off-market share buyback. For investors who will benefit, we will be in contact in due course. Pleasingly, insurers Suncorp and QBE have reported strong results, giving long suffering shareholders something to smile about. We will make mention of other notable profit announcements in next month's monthly letter.

Please do not hesitate to contact our office should you wish to discuss any of the above in further detail.

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