Five questions for the Chief Investment Officer

Video transcript

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Michelle Jones, Employer Partnership Manager, UniSuper (MJ): I'm here today to talk with our Chief Investment Officer, John Pearce, to have a quick chat in terms of what's been happening in the markets lately. So John, 2015—we had some good solid returns and I can see in the market reports that 2016's had a bit of a bumpy start. Is it really as bad as what we think it is?

John Pearce (JP): Well, January was terrible. Think about the Dow Jones Index, which covers the American stock market. It's been around since 1896. The first two weeks of this year was the worst in the Dow Jones history. The Australian market down 5.5% for January—worst since the GFC. February it didn't get any better, market lost more. Fortunately, we've had a bit of a recovery in March. So the market is still down, but it's certainly not as bad as January would have us start.

MJ: So in the February investment market update, I read that you discussed the fall in oil prices was one of the key drivers in terms of the current recent turbulence. I thought the fall in oil prices was good for the market. Is that true?

JP: Well, firstly have a look at this graph. Blue line, we have the oil price. Green line we have the SMP, which is once again the American market, the largest stock market in the world. We see that since November last year, these two markets moved in tandem. Now back to your question. It is very confusing, isn't it? That when we had oil going through $100 a barrel, we had every economist in the world saying how dire it was for the economy. Oil falls by $30 a barrel, and every economist in the world is saying how dire it is for the economy. How do you reconcile these things?

The reality is that a fall in oil price is going to be unequivocally good for consumers. It's just like a tax cut, as you know. However, in the short-term, we've got a lot of uncertainty. In particular, the sector that's most affected by it, the energy sector—oil producers, coal producers, gas producers—some of these are going to go out of business. Who's going to be left standing?

And then we have the other industries such as particularly the banks, their exposure to this industry through their loan books. How much have banks lent to these energy companies? All this uncertainty is pervading the market and that is what's driving the volatility at the moment.

MJ: So I assume UniSuper hasn't been able to escape the market woes—so do we have a large exposure to the oil industry?

JP: It's true that we haven't escaped the woes of the market. Our Balanced option, which is the option where most of our [Accumulation] members are invested, is down slightly for the calendar year to-date. But bear in mind that over the last five years, the Balanced option has returned 9% compound per annum. Over the last three years, 10% compound. So I think we can expect a bit of a correction. This is not unexpected.

Importantly, we don't have huge exposures to the energy sector itself. If you have a look at another table here, this table shows you all of our investment options and direct exposure it has to shares and companies in the energy sector. You'll see 13 out of 17 of the options actually have less than 2% of their portfolios exposed to the energy sector. The option with the greatest exposure is our Australian shares option with 4.6%. And this is largely concentrated in two companies, BHP and Woodside, which we believe are very strong companies and will survive this fallout.

MJ: So will we look to change our investment strategy based on the recent market volatility?

JP: The short answer is no, Michelle. We're a long-term investor and volatility certainly doesn't scare us. Markets, business cycles, market cycles, they don't die. Cycles change in magnitude, but the pattern stays broadly similar and this latest cycle is the same in terms of its pattern.

It's all about China really. If you think about the lead-up to China's emergence as a power, nobody really predicted, once again, the magnitude and the speed at which this country was going to industrialise. So there was a lot of underinvestment leading up to this emergence and we couldn't actually keep up with demand. Now what happens in that situation? Prices skyrocket.

As economists say, the best cure for high prices is high prices, because then companies start extrapolating that these prices are going to continue forever, and then they start over-investing, flooding the market and prices fall. And that's exactly what we're seeing now. But low prices are also a cure for low prices, because we're seeing now cutbacks in production, cutbacks in investment. And once again supply will end up being a shortage, and we expect that equilibrium price will rise. The companies standing at the end of this will be more efficient and less competition. So they're the companies we have to stick with.

MJ: And, John, in the recent investment market update, there was a discussion in regards to the recent company reporting season. So [are] there any takeaways for UniSuper members from that season finishing?

JP: Quickly, Michelle, so the reporting season around February, around August each year—companies listed on the Australian Stock Exchange will report their financial results and their balance sheet and provide outlook statements. Obviously, we have some pretty bad news from the resource companies, the mining companies—massive cuts to profits, massive cuts to dividends. The market, however, was anticipating these, so ironically, you actually saw some share price increases on the days of these announcements because they weren't as bad as the most pessimistic scenarios.

Generally, however, the reporting season was positive news, because it painted a picture of an Australian economy that's growing steadily. Not spectacular, but steady. And this is in contrast to the wild gyrations of the market. The market would have you believe that the economy was actually falling

in a bit of a hole, but it's not. This disconnect between the market and the economy is something that members should keep in mind. It happens quite often.

Once again, let's refer to a graph. Bear with me—on the vertical axis, we have the stock market, and on the horizontal axis we have economic growth. Now, if there was a correlation between the economy and the stock market in the short-term, you'd have these dots scattered pretty tightly in an upward-sloping line. What we see there is no pattern at all. As a matter of fact, if you look at that bottom right-hand quadrant, there are quite often times when the economy is growing pretty well, but you see negative returns in the stock market.

So I think the key message for our members there is, don't get too concerned about the falls in the stock market. It's not necessarily a signal of gloom and doom.

MJ: Okay that's really good information. Thank you, John. If you found this update useful and you have some of your own questions you'd like us to look at, you can email them to **superinformed@unisuper.com.au** and we'll be able to consider those for future editions. Thank you.

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