Frontier MFG Global Sustainable Fund – Institutional Class (FMSGX)
Sub-advised by MFG Asset Management – Sydney, AU

Global stocks rose for a fourth consecutive quarter in the three months to December after the Federal Reserve cut its key rate for the third time in four months to help an economy extend its growth record well into 2020, China and the U.S. eased up on their trade war, U.S. companies on average reported better-than-expected earnings for the September quarter and the UK election victory for the Conservative party settled that the country would leave the EU and meant the UK avoided the radical policies proposed by Labour. During the quarter, all 11 sectors rose in US-dollar terms. Information Technology (+14%) rose the most while Real Estate (+1.2%) rose the least.

U.S. stocks rose to record highs over the quarter. In October, the Fed reduced its key lending rate by a quarter point to between 1.5% and 1.75% and signaled no more imminent reductions. Financial research and data company FactSet said that for the third quarter, 75% of S&P 500 companies reported earnings per share above estimates, a 'beat rate' that is above the five-year average of 72%. In December, Chinese and U.S. trade officials justified optimism when they came to a 'phase one' pact on trade that de-escalated a tariff war, notwithstanding that tensions between Beijing and Washington rose when U.S. Congress in November passed almost unanimously a bill compelling Washington to support the protesters in Hong Kong. Economic news released during the quarter was largely upbeat. Reports showed the U.S. economy expanded at 2.1% in the third quarter, U.S. factory production rebounded by 1.1% in November to post its biggest monthly increase in two years, and the jobless rate fell to a 50-year low of 3.5% in September and November. In political news, almost all Democrat lawmakers in the House of Representatives voted to impeach President Donald Trump for abuse of power and obstructing Congress, but failed to gain any Republican support during the two votes. Lawmakers in December passed spending measures that avoided a government shutdown as numbers released in October showed the U.S. federal deficit widened to a seven-year high of US$984 billion in fiscal 2019, the fourth straight annual increase.

European stocks reached record highs on the UK election victory for the Conservatives and signs emerged the eurozone economy had stabilized. In the UK, parliament passed the measures required to ensure the country left the EU on January 31. In economic news, the eurozone's GDP rose 0.2% in the third quarter although industrial production fell 0.5% in October from September.

The Fund recorded a positive return in the partial quarter. The biggest contributors included the investments in Alibaba, Apple and HCA Healthcare. Alibaba surged after the Chinese conglomerate reported a 40% jump in revenue for the third quarter, its Singles Day online retail promotion reaped a record 268 billion yuan (US$38.3 billion), and the company raised US$11 billion via an IPO in Hong Kong. Apple gained after the company boosted sales forecasts, citing the popularity of the latest iPhone 11, new services such as Apple TV+ and items such as AirPods, and the easing of trade tensions between Washington and Beijing meant iPhones avoided tariffs in China. HCA Healthcare jumped on higher inpatient and outpatient surgeries for the third quarter that removed doubts about the U.S. hospital chain's outlook raised by a disappointing second-quarter result.

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The biggest detractors included the investments in Yum! Brands and Danone. Yum! Brands fell as the owner of Pizza Hut, KFC and Taco Bell reported a slightly lower-than-expected rise in same-store sales of 3% for the third quarter and lower margins. Danone slid after disappointing yoghurt sales in the U.S. and weak bottled-water numbers in Europe prompted the company to lower its full-year sales forecast.

Global share markets started 2020 around record highs though there are many risks investors need to assess to judge how equities will perform this year.

Global growth slowed in the past year, hampered by trade tensions and the waning of fiscal stimulus. In response, the Fed cut rates three times in 2019 and ended quantitative tightening, the ECB cut rates once and resumed quantitative easing and China cut lending rates. These actions should reduce the likelihood of a pronounced slowdown.

We see three broad scenarios for equity markets in the coming few years. The first, which we rate about a 50% probability, is that there is no significant increase in U.S. inflation or a sharp slowdown in global growth. However, authorities might loosen monetary policy a little if previous stimulus proves insufficient. Under this outcome, broad equity indexes would most likely provide satisfactory returns.

In the second scenario (about a 30% probability), global growth slows to a level that forces central banks to respond quickly knowing that political partisanship will prevent a timely U.S. fiscal response. Needless to say, the more economic growth slows, the worse it is for equity prices though 'defensive' stocks are likely to outperform.

The final scenario (about a 20% probability) is that interest rates rise on inflation concerns. A jump in interest rates would weigh on the growth outlook and potentially trigger a 20% to 30% fall in equity prices. Slower economic growth would reduce the likelihood of this outcome.

Due to the risks confronting equities, the Fund held approximately 14% in cash at the end of the December quarter. Even amid the uncertainty hovering over stock markets, we are confident about the long-term outlook for the investments selected for our portfolio and the portfolio's risk profile. Many of the stocks in the portfolio benefit from being leading digital platforms, the shift to a cashless society, having a stronghold on the enterprise software market, consumption growth in China and other emerging markets, or the dynamics of ageing populations.