# Market Wrap

## January 2021

- Volatility associated with November's US election should finally be over, enabling investors to refocus on economic prospects and the outlook for corporate profitability and central bank policy.
- Joe Biden was sworn in as the 46th President of the US. The transition of power was far from smooth, however, with pro-Trump demonstrators storming the Capitol ahead of Biden's inauguration. This caused some temporary alarm. Calm had been restored by month end, but America appears to be deeply divided, potentially presenting Biden with some unwanted distractions over the next four years.
- Otherwise there were few key developments in financial markets. Central banks kept policy settings unchanged and governments remained focused on administering the rollout of Covid vaccines.
- Encouragingly, the International Monetary Fund increased its global GDP growth forecast for this year by 0.3%, to 5.5%. The upward revision reflected the expected positive effects of vaccinations, additional policy support in major economies including the US and Japan, and an expected rise in contact-intensive activities as the pandemic eases.

- **US**: There was little change to the big picture in the US. Activity levels remained subdued, with restrictions in place across large parts of the country.
- Forecasts had suggested the US economy might have added 50,000 jobs in December. The actual data revealed 140,000 jobs were lost over the month, providing a reminder that the pandemic is far from over. The unemployment rate has fallen sharply from the high in April 2020, but remains almost double its pre-Covid level.
- Retail spending in the pre-Christmas period was below expectations, suggesting consumers may be concerned about the expiration of support payments this year.
- Business confidence has also deteriorated again. The number of firms expecting an improvement in the economy has plunged, partly due to anticipated policy changes under the new Biden administration.
- Against this background, Federal Reserve officials indicated that the current, ultra-loose policy settings are likely to remain in place for an extended period.
- The Federal Reserve is also continuing with its *quantitative easing* program, encouraging lending and helping maintain stability in financial markets. The central bank is pumping US$120 billion into the US financial system every month.

- **Australia:** Australian inflation printed at 0.9% in the 2020 calendar year, almost double what the Reserve Bank of Australia forecasted in November's *Statement on Monetary Policy*.
- The employment picture is also less bleak than previously forecast. At 6.6%, the unemployment rate was more than a full percentage point below the Reserve Bank's November forecast.
- Considered together, these encouraging indicators suggest the economy might be performing better than previously expected. If data released over the next three months affirms this, the Reserve Bank of Australia will likely start to taper its *quantitative easing* program in April.

- **New Zealand:** Inflation was also above expectations over the Tasman. Consumer prices rose 0.5% in the December quarter, and 1.4% in 2020 as a whole.
- The persistent pricing pressure will likely affect policymakers' thinking on monetary policy. Just a few months ago, many commentators expected interest rates to be lowered below zero in early 2021. Such a move now appears less likely.
- House prices in New Zealand also continue to increase quite rapidly, partly due to low borrowing costs. Residential property prices rose more than 11% in 2020, the fastest pace in more than three years.

- **Europe**: Conditions in the European manufacturing sector continue to improve, providing an important pillar of support to the region's economy.
- Unsurprisingly, conditions in services sectors are much less buoyant, with social distancing restrictions in place across most of the continent.
- In other news, the Italian government was in turmoil (again!) after the Prime Minister tendered his resignation. This did not seem unduly concerning for financial markets, however; Italy has had 65 governments in the past 70 years or so.
- In the UK, the latest data indicated the economy likely shrank by around 8% in 2020.
- Manufacturing output in Britain has been particularly weak recently. This partly reflects virus-related disruptions and friction around trading with the European Union, although the downturn appears to be more structural in nature; output has now been deteriorating for more than two years.

- **Asia/EM:** An improvement in export demand has enabled growth in China to rebound to pre-Covid levels. GDP rose 6.5% in the December, taking year-on-year growth to 2.3%. This was the slowest annual rate in 40 years. Nonetheless, China was the only major economy to eke out any growth at all in 2020; further increasing the country's importance on the world stage.
- A state of emergency was declared in Tokyo and surrounding prefectures, following a sharp increase in the number of Covid cases. This resulted in downgrades to Japanese growth forecasts for the March quarter.

**Australian dollar**

- The Australian dollar was little changed in January, after appreciating by nearly 10% in November and December.
- The 'Aussie' was similarly flat against other majors, moving by less than 1% against the Japanese yen and a trade-weighted basket of international currencies.

**Australian equities**

- Much like December, Australian equities rallied strongly through the early weeks of January as domestic economic data improved and as certainty over the US election revitalised optimism that a new stimulus program would be approved.
- However, broad-based profit taking, combined with concerns of slowing iron ore demand, drove the local share market lower in the final week of January. As a result, the S&P/ASX 100 Accumulation Index finished the month just 0.4% higher.
- Strong performances from IDP Education, Wesfarmers and JB Hi-Fi helped the Consumer Discretionary sector (+5.7%) to outperform.
- International education organisation IDP Education was among the best performers, adding 15.8% on expectations of market share gains and growth opportunities in the US.
- Consumer goods retailer JB Hi-Fi (+6.5%) benefited from a trading update that reported continued strong demand for electronics and home appliances.
- The rise in oil prices – which was driven by a surprise cut in crude oil production from Saudi Arabia – helped the Energy sector rise 1.8%.
- Conversely, the poor performance of iron ore miners – driven by concerns of declining Chinese demand given rising iron ore inventories – dragged the Materials sector -1.0% lower.
- The Industrials sector (-3.5%) was among the poorest performers. Travel-exposed companies, such as Sydney Airport (-10.8%) and Qantas (-7.2%), struggled given the possibility of prolonged international border closures.
- Australia's smaller companies underperformed their large cap counterparts, with nearly two-thirds of constituents in the S&P/ASX Small Ordinaries Accumulation Index (-0.3%) losing ground.

**Listed property**

- Global property securities were flat in January, with the FTSE EPRA/NAREIT Developed Index closing the month -0.2% lower in Australian dollar terms.
- Asian markets typically outperformed, led by Japan (+2.5%), Hong Kong (+1.2%) and Singapore (+0.3%).
- At the other end of the scale, European property names weighed on the broader sector. The worst-performing markets included Germany (-6.7%), Sweden (-4.4%) and France (-4.0%).
- Real estate markets remained largely subdued amidst the countervailing forces of a dreary near-term Covid-19 outlook and optimism around a potential return to 'normal' conditions in the second half of 2021 on the back of several vaccines being rolled out.
- Locally, the A-REIT market declined -4.1%, with the Industrial and Office sub-sectors falling most significantly.
- Among individual names, Stockland (+6.5%) and Ingenia Communities (+2.0%) both outperformed against the backdrop of an improving housing market.

**Global equities**

- Emerging markets led performance over the first month of 2021, with the MSCI Emerging Markets Index rising 3.7%.
- Less positively, developed markets – represented by the MSCI World Index – returned -0.4%, both in Australian dollar terms.
- Asian bourses generally maintained their recent positive momentum. The Hang Seng Index in Hong Kong and China's CSI 300 Index rose 3.9% and 2.7%, respectively, both in local currency terms.
- In the US, the last week of January saw a modest spike in volatility due to the influx in retail trading. Selected names – most notably Gamestop – saw extraordinary share price increases, but several large cap companies slid downward. This dragged the S&P 500 Index 1.1% lower for the month.
- Encouraging company results for the December quarter appeared to prevent the market from falling more significantly. Earnings in the banking sector were ahead of consensus expectations, for example.
- European markets also had a miserable start to the year, troubled by low vaccination rates and a shortage of vaccine supplies, at the same time as the number of Covid infections continued to rise. The Euro Stoxx 50 Index returned -2.0% in local currency terms.

**Global and Australian Fixed Income**

- US Treasury yields rose meaningfully. Ten-year yields closed the month 15 bps higher, at 1.07%.
- This move primarily reflected election results in the State of Georgia, where Biden's Democrats won two additional Senate seats. This was important, as it means the Democrats now control the Senate. This should make it easier for the new President to get new legislation passed, potentially including proposals for sizeable increases in fiscal spending. In turn, higher spending would likely result in greater issuance of government bonds, requiring higher yields to entice investors.
- The move higher in Treasury yields set the tone for other major bond markets globally. Yields rose similarly in the UK and Australia, and by a smaller margin in Germany and Japan.
- These moves resulted in negative returns from global bonds.
- At the same time, fixed income investors continued to dissect commentary from central bank officials, looking for clues regarding future interest rate policy. With that in mind, releases of inflation and GDP growth statistics will remain closely scrutinised in the weeks and months ahead.

**Global credit**

- Credit spreads were little changed in January, remaining close to their lowest level in the past year or so.
- Investment grade spreads closed the month a single basis point lower, at 0.99%, while high yield spreads drifted 6 bps wider.
- There was a fair amount of attention on financial names. In the US, major investment banks reported pleasing full year results, partly on the back of strong trading revenues. A pickup in merger and acquisition activity also supported advisory revenues in the second half of the year.
- The performance of Industrial names has been more mixed. Many companies continue to battle Covid-related headwinds, which appear likely to affect profitability for the foreseeable future