Count

Market Wrap

August 2021

Economic and market overview

- There was a fair amount of scrutiny on the Jackson Hole Symposium, an annual gathering of central bank policymakers, government officials, academics and financial market participants. Specifically, investors were keen to see whether Jerome Powell, Chair of the Federal Reserve, would indicate any likely changes in US central bank policy.
- Powell noted that “substantial further progress” has been made with economic metrics like employment and inflation, and that the Federal Reserve might start tapering its economic support program later this year.
- Bond yields rose slightly over the month – at least offshore – and acted as a headwind for fixed income markets. That said, Powell suggested interest rates are unlikely to be increased even when the bond purchase program starts to be scaled back.
- Equity markets continued to perform well, buoyed by favourable returns from US-listed shares.
- In spite of the generally positive mood investors remained concerned by the ongoing spread of the Delta variant of Covid-19, and whether it could derail the recovery in major economies.

US: At an annual rate of 5.4%, the headline level of inflation in the US was little changed in July. The Personal Consumption Expenditure deflator – the Federal Reserve’s preferred measure of inflation – is currently at its highest level in nearly 30 years.

- The Covid pandemic has undoubtedly resulted in a sharp spike in prices, but it remains unclear whether higher inflation will persist, or be more transitory in nature. Price rises have been most extreme in goods and services categories most severely affected by virus-related disruptions. As a result, officials continue to suggest inflation will moderate as bottlenecks and other supply restrictions ease.
- All of this remains important for financial markets globally; the inflation outlook will guide interest rate expectations in the world’s largest economy, in turn prompting investors to recalibrate their return projections for major asset classes.
- 943,000 new jobs were created in July, which comfortably exceeded consensus forecasts. Unemployment fell to 5.4% as a result. The jobless rate is well below the 14.8% level seen in April 2020 but remains significantly above pre-pandemic levels.
- Despite improved job prospects, consumer confidence was lower than expected in August. This suggests Americans remain concerned about the Delta variant of Covid-19, and whether high inflation will continue to erode their purchasing power.

Australia: It became apparent that lockdowns in large parts of Australia would persist for longer than initially anticipated. As a result, economists downgraded economic growth forecasts and pushed back their expectations of when the Reserve Bank of Australia might start to raise interest rates.

- Commentators are now suggesting GDP growth could be negative for one, if not two quarters due to the latest disruptions.
- Inflation could also moderate further, from the existing subdued level. Nationally, wages rose by just 1.7% in the year ending 30 June. This was below consensus expectations and suggests inflation could remain below target for the foreseeable future.

New Zealand: New lockdowns have clouded the outlook for New Zealand too. It appears increasingly unlikely that New Zealand – or any other country – will be able to successfully eliminate Covid-19. It is therefore concerning how few New Zealanders have been vaccinated against the virus; the country has the lowest vaccination rate of any developed nation.

- In spite of the lockdown, in the Governor of the Reserve Bank of New Zealand suggested an interest rate rise remains possible as soon as October. Inflation is running above the Bank’s target and unemployment has fallen to 4.0%, the lowest level in 13 years.

- **Europe**: The Eurozone economy grew more than 13% in the year to June, underlining the strength of the rebound after social distancing restrictions were lifted across the region.
- Inflation has risen too, with consumer prices 1.6% higher over the past year. Whilst still below the European Central Bank’s official target, inflation has not been higher in more than a decade.
- That said, wage growth in the region is tepid and suggests inflation may not rise much further. The latest wage demands from large German unions appear relatively modest, for example.
- Towards month end, European Union officials announced they were introducing tougher restrictions on inbound travel. This does not augur well for the region as a whole, particularly for countries that are most reliant on tourism and related sectors.

Asia/EM:

- Amid all the focus on monetary policy globally, it was interesting to see the Bank of Korea raise interest rates. South Korea is the first country in Asia to raise borrowing costs since the Covid pandemic began.
- Conditions in the industrial powerhouse have improved markedly over the past year or so; exports are running 35% above 2020 levels, unemployment is at a two-year low and retail sales are 13% up on last year. With inflation having risen sharply against this background, policy settings were tightened in an effort to cool the economy.
- Several other central banks in the region remain focused on currency stability – making interest rate hikes less likely – but it will be interesting to see whether borrowing costs are raised elsewhere in Asia if activity levels in the region improve further.

Australian dollar

- The prospect of extended lockdowns is adversely affecting the growth outlook and employment prospects, and resulted in further currency weakness. The Australian dollar depreciated by 0.6% against the US dollar and by 0.7% against a trade-weighted basket of international currencies.

Australian equities

- More than a year after the coronavirus crash, the August reporting season gave investors insight into how Australian companies have performed as the broader economy has recovered. Overall it was a broadly positive earnings season, with around a third of companies positively surprising the market.
- Like the August 2020 reporting season, most companies were hesitant to provide forward guidance given ongoing uncertainty surrounding lockdowns and the economic outlook.
- Several merger and acquisition announcements and around $38 billion of dividend payments boosted investor sentiment, and helped push the S&P/ASX 100 Accumulation Index 2.3% higher. This was the 11th consecutive monthly gain for the Australian share market; its best run since 1943.
- WiseTech Global and Afterpay, the two best-performing stocks in the Index, helped push the IT sector 16.8% higher. A strong FY21 result drove WiseTech 57.0% higher as the global logistics software company beat consensus earnings expectations with impressive cost reductions, margin improvements and new contract wins. Afterpay rallied 39.2% after announcing it had received, and subsequently accepted, a takeover bid from US payments giant Square, which valued the Australian Buy-Now-Pay-Later company at around $39 billion.
- An uncertain outlook for Chinese iron ore demand hampered the Materials sector (-7.9%), and large constituents including Fortescue Metals Group (-15.7%), BHP Group (-14.7%) and Rio Tinto (-8.4%). Iron ore prices fell more than 20% in AUD terms over the month, as China announced it would reduce its 2021 steel output in an effort to lower carbon emissions.
- All but one constituent of the Energy sector (-5.1%) posted negative returns, as forward earnings expectations deteriorated amid the growing number of Delta-variant coronavirus cases. Brent crude oil prices ended the month 4% lower in AUD terms.
- Australia's small cap companies fared very well, with the S&P/ASX Small Ordinaries Accumulation Index rising 4.8%. More than two thirds of Index constituents appreciated, with Blackmores (+37.4%), Clinuvel Pharmaceuticals (+35.6%) and ioneer (+34.2%) among the best performers.

Listed property

- Global property securities posted small gains in August, with the FTSE EPRA/NAREIT Developed Index rising 1.9% in AUD terms.
- The best performing regions included Australia (+6.3%), Sweden (+5.7%) and the UK (+4.4%). The laggards included Hong Kong (-3.8%), Singapore (-2.2%) and France (-0.9%).
- Although global vaccination rates continued to rise, the status of Covid-19 is still affecting global real estate markets, particularly in assets reliant on higher mobility.
- Defensive growth sectors such as logistics, data centres and self-storage were favoured over the month, as investors continued to look through any short-term volatility in assets that are likely to be essential in a new world economy.
- Unforeseen regulatory changes in the school tutoring sector in China resulted in subdued performance from firms with Chinese exposure. Whilst largely immaterial to the underlying fundamentals of property assets, investors appeared concerned about potential higher levels of regulatory risk.
- Locally, the A-REIT market increased 6.3%. The top performers included Arena REIT (+17.8%) and Scentre Group (+12.6%).

- **Global equities**
- Corporate earnings releases for the June quarter were closely scrutinised to see how companies had fared as major economies gradually reopened. On the whole, investors were encouraged by results released by US and European firms.
- Collectively, global equities rose over the month and hit fresh all-time highs. The MSCI World Index returned 2.7% in local currency terms, buoyed by the favourable performance of US shares. The bellwether S&P 500 Index added 3.0%, registering its seventh straight month of gains.
- In the US, shares in companies exposed to engineering and construction typically fared well after the US Senate approved a new US$1 trillion infrastructure package. At the same time, a modest increase in US Treasury yields provided a tailwind for banking stocks.
- European markets also registered gains, with Switzerland and Italy among the best performers.
- Performance was mixed in Asia. Japanese shares rose quite sharply, but those in Singapore, Hong Kong and China lost ground. Chinese authorities announced new measures targeting a crackdown on inequality, which eroded sentiment towards retailers of luxury goods and other firms exposed to high-end discretionary expenditure.
- Investors' generally healthy risk appetite enabled emerging markets to perform well – the MSCI Emerging Markets Index added 2.4%, recovering some of its lost ground from July.

Global and Australian Fixed Income

- Government bond yields in the US and Europe edged higher, despite assurances from Federal Reserve officials that interest rate increases in the US are still not on the radar. These moves hampered returns from global fixed income markets.
- History suggests 'tapering' – the process whereby central banks wind back their economic support programs – could have important implications for bonds in the months and years ahead. US Treasury yields soared in 2013 during the so-called 'taper tantrum', after the Federal Reserve announced it would be reducing the scale of its quantitative easing program following the Global Financial Crisis. Nobody is currently suggesting there will be a repeat this time around, but comments from central bank officials are nonetheless being very closely scrutinised.
- Australian government bond yields bucked the global trend, and moved slightly lower. This primarily reflected the extension of lockdowns, and the associated impact on the growth outlook.

Global credit

- Investment grade credit spreads were little changed in August, which supported steady positive returns from corporate bonds.
- As we have noted previously, volatility in credit markets has been very low this year – depending on how the next four months go, perhaps even the lowest on record.
- Conditions were a little uncertain in Asia as Chinese authorities continued to make various regulatory changes, but sentiment was much firmer in Europe and the US. Credit benefited from favourable corporate earnings releases for the June quarter.
- Like in the equity space, investors' healthy risk appetite enabled more speculative areas of the market to perform well – while investment grade spreads were little changed, those in the high yield sub-sector tightened.