Count

Market Wrap

October 2021

Economic and market overview

- Investors remained focused on rising inflation and the possibility of policy settings being tightened worldwide.
- Bond yields continued to rise – particularly in Australia – as investors brought forward their expectations for interest rate hikes. This hampered returns from fixed income markets.
- Equity markets performed much more strongly, aided by the release of pleasing corporate results for the September quarter.

US: At an annual pace of 2.0%, growth in the world's largest economy fell short of expectations for the September quarter.

- Pandemic-related supply shortages and bottlenecks continued to hamper manufacturers. Car production fell around 7% in September, for example, due to a shortage of semiconductors.
- Services sectors are enjoying better operating conditions, as consumers continue to increase spending following months of lockdowns and disruptions.
- There were mixed signals of the jobs front – new payrolls were lower than expected, but the unemployment rate dropped 0.4%, to 4.8%.
- All of these data releases were overwhelmed by comments from Federal Reserve officials on the outlook for inflation and, in turn, potential changes to interest rate policy. The Federal Reserve is still expected to start tapering its quantitative easing program during November, likely reducing its monthly purchases of Treasuries and mortgage-backed securities.
- Afterwards, attention is expected to increasingly shift to the likely timing of interest rate hikes. Inflation remains very high and whilst officials continue to suggest this will prove temporary, pricing pressures owing to supply disruptions seem likely to persist into 2022 and longer-term inflation expectations are rising due to elevated energy prices.
- Consequently, some investors are now anticipating two interest rate hikes in the US before the end of next year.

Australia: The latest surveys indicate conditions have improved modestly for both manufacturers and services companies, although backward-looking economic data were largely ignored given recent restrictions in NSW and Victoria. Instead, like elsewhere, the main focus was on potential changes to central bank policy.

- In early October the Reserve Bank of Australia reiterated its yield target of 0.1% on 3-year government bonds. Later in the month, market movements had pushed the yield on these securities above 1.0%, seemingly with limited effort from the Reserve Bank to defend the target. This prompted investors to question whether officials were changing their stance on policy settings.
- At an annual rate of 3.0%, headline inflation for the September quarter printed in line with consensus forecasts. The Reserve Bank's preferred measure of inflation – the trimmed mean – rose at a more modest 2.1% over the year. Official interest rates are unlikely to be changed for the foreseeable future.

New Zealand: As had been widely anticipated, official interest rates were raised by 0.25%, to 0.50%.

- Reserve Bank of New Zealand officials appear to be concerned about quickening inflation – consumer prices rose by more than 2% in the September quarter alone, and are nearly 5% higher on a rolling 12-month measure.
- As a result, some commentators are suggesting interest rates could be raised by a further 0.75% at the Bank's next meeting in late November.

Europe: The latest GDP data in the Eurozone beat expectations. The region's economy grew by 2.2% in the September quarter, meaning overall activity levels have rebounded to 99.5% of pre-Covid levels. The upturn has been attributed to an encouraging recovery in services sectors.

- The increase in discretionary spending is being reflected in higher inflation; consumer prices rose 0.8% in October alone. Like elsewhere, this prompted suggestions that the European Central Bank might have to raise official interest rates.
- Less encouragingly, the latest data highlighted a slowdown in industrial production in Germany; Europe's largest economy. Moreover, ongoing reports of supply shortages suggest weakness in the manufacturing sector could persist through the December quarter and, potentially, into next year.
- In the UK, forecasters are split as to whether the Bank of England will raise official interest rates at its meeting in early November. Members of the Bank of England's Monetary Policy Committee may even be divided on whether interest rates should be raised.
- Either way, officials are undoubtedly focused on inflation – during October the Bank's new Chief Economist indicated consumer price inflation could reach 5%, partly owing to sharply higher energy prices. If so, it seems likely there will be a policy response sooner or later.

Asia/EM: In China, large property developer Evergrande Group avoided a bond default following a last-minute coupon payment. This failed to calm investors' nerves, however; high yield credit spreads in Asia widened sharply over the month, resulting in disappointing returns from the region's credit markets.

- In Japan, there was an unexpected upward revision to economic growth forecasts for 2022. Officials expect growth to rebound back towards pre-pandemic levels in the next 12 months or so.

Australian dollar

- The dollar reversed its recent weakness and strengthened by 4.0% against the US dollar. The 'Aussie' appreciated similarly against a trade-weighted basket of international currencies.
- Performance relative to the Japanese yen was particularly impressive. At month end the Australian dollar bought nearly ¥86, an increase of 6.6% over the month.
- The dollar was buoyed by rising commodity prices – coal and oil increased, which offset slightly lower iron ore prices.

Australian equities

- The local share market started October on the back foot, as concerns about rising inflation drove the S&P/ASX 200 Index more than 2% lower on the first day of the month.
- Equities quickly recovered and had moved nearly 2% higher towards the end of the month thanks to positive trading updates from the start of the AGM season. A sudden jump in bond yields on the last day of the month saw these gains reverse, however, and caused the Index to finish the month close to where it started, with a total return of -0.1%.
- At the sector level, the IT (+2.1%) and Health Care (+1.0%) sectors were the best performers, while Industrials (-3.3%) and Consumer Staples (-2.3%) were among the underperformers. The IT sector benefited from positive performances from cloud-based accounting platform Xero (+7.6%) and electronics design software company Altium (+3.4%).
- The Energy sector fell 2.7%, despite higher oil prices (Brent oil rose 7.5%). Energy companies struggled late in the month as news releases indicated oil supplies could soon increase, given a surprising jump in US inventories and the possibility of a resumption in Iranian oil exports.
- Weakness among iron ore miners drove Materials stocks -0.5% lower. Iron ore prices fell around 5% due to Chinese steel production restrictions and weakening demand expectations.
- In contrast, Materials stocks helped drive the S&P/ASX Small Ordinaries Index 0.9% higher thanks to strong performances from several gold and rare earth mining companies.

Listed property

- Global property stocks fared well, with the FTSE EPRA/NAREIT Developed Index increasing by 1.9% in Australian dollar terms.
- The best performing regions included Sweden (+14.0%), USA (+7.8%) and Hong Kong (+6.1%), while laggards included Germany (-0.3%), Japan (-0.3%) and Australia (+0.4%).
- Developed nations throughout the Asia-Pacific region that have lagged global peers in reopening their economies, are now emerging from lockdowns and experiencing improving mobility rates in retail assets, driving strong share price performance. Similarly, those nations that have experienced longer sustained periods of time without any material increases in Covid-related deaths also saw strong performance within the retail sector.
- Elsewhere, continued demand in sectors benefitting from decentralisation within cities and the growing adoption of e-commerce supported self-storage and industrial stocks.

Global equities

- Several major share markets enjoyed their strongest month of performance of the year. The S&P 500 Index in the US closed October 7.0% higher, for example. Technology stocks continued their good form, enabling the NASDAQ to perform even better; up 7.3%.
- In Europe the Stoxx 50 added 5.0%, while in Asia Hong Kong's Hang Seng and Singapore's Straits Times rose 3.3% and 3.6%, respectively. Japan was the only major market not to participate in the rally, with the Nikkei closing the month 1.9% lower.
- Returns from all major markets were diluted for Australian investors due to the strength of the dollar. Nonetheless, global shares made a positive contribution to diversified portfolios over the month.
- Sentiment was boosted by a sixth consecutive quarter of corporate results that beat consensus forecasts. Firms in various industry sectors have benefited from a rebound in discretionary spending and an improvement in activity levels as social distancing restrictions have been lifted.
- Electric carmaker Tesla was a standout performer, adding around 50%. This move pushed the market capitalisation of the company to more than US$1 trillion.
- Among other high profile names, earnings from Apple and Amazon disappointed a little – supply chain disruptions were blamed for the subdued results.
- Elsewhere, investment banks including Bank of America, Goldman Sachs and Morgan Stanley performed strongly after reporting increases in advisory fees – in general, companies are well capitalised and are considering potential merger and acquisition activity.
- As well as the strong results, forward-looking earnings estimates increased, providing an additional tailwind for share markets.

Global and Australian Fixed Income

- Bond yields rose in most major regions, as investors continued to focus on high inflation and the possibility that interest rates could be raised earlier than previously thought.
- The moves were most extreme on short-dated securities. In the US, for example, yields on 2-year Treasuries rose by 0.22%, while those on 30-year equivalents actually moved lower.
- The yield on 10-year Treasuries rose 6 bps over the month, to 1.55%. Similar moves were seen on 10-year yields in other countries (Germany +9 bps, Japan +3 bps and the UK +1 bp).
- The most significant yield movements were seen in Australia, where 10-year yields skyrocketed by 60 bps and closed the month above 2% for the first time in more than two years; well before the Covid pandemic began.
- There was even more significant action at the front end of the Australian curve – yields on 3-year Commonwealth Government Securities nearly quadrupled, from 0.31% at the start of October to 1.22% by month end. This was a particularly dramatic move, as the Reserve Bank of Australia had been targeting a yield of 0.10% on 3-year securities as part of its yield curve control program.
- With yields moving sharply higher, returns from Australian bonds were poor. The benchmark Bloomberg AusBond Composite 0+ Year Index closed the month down 3.6%.

Global credit

- Spreads on investment grade and high yield credit were little changed in October, at least in the US and Europe. Asian markets were a little weaker, partly reflecting ongoing concern about high leverage in the Chinese property sector. Consequently, returns from global credit markets were broadly neutral over the month.
- Most new issues were well supported, underlining the strong underlying demand for good quality, higher yielding corporate bonds.
- Looking ahead, sentiment towards some individual issuers could be affected by COP26, the United Nations' 26th Climate Change Conference being held in Scotland in early November. With investors increasingly aware of companies' carbon emissions, their management of climate change risks and other ESG considerations could affect the relative performance of credit securities over the medium to long term.