WHITEHELM ADVISERS

MONTHLY UPDATE ON THE INVESTMENT ENVIRONMENT

September 2021

Prime Super

MARKET UPDATE

The September quarter was characterised by positive global economic developments, with countries continuing to benefit from ongoing re-opening of economies locked down as a result of the COVID-19 pandemic. That said, rising concerns about a number of issues, such as the persistence of elevated inflation, looming tapering by central banks and regulatory crackdowns in China all served to temper optimism as the quarter drew to a close.

While vaccination rollouts continue to contribute to a decline in the rate of deaths from COVID-19 globally, the highly virulent Delta strain has led to an uptick in deaths in regions with low vaccination rates, such as the southeast US and many developing nations. Confirmed global deaths now approach five million and, as the northern hemisphere's winter approaches, countries are bracing for a potential increase in cases among the unvaccinated. Authorities in some countries are introducing measures such as vaccine passports to encourage uptake from those still hesitant to be inoculated. New issues have also started to arise around vaccine efficacy, which has been found to weaken over time. While booster jabs may resolve this issue, it highlights the significant uncertainties regarding the pandemic, including the risk of more virulent COVID-19 strains emerging.

Both developed overseas and Australian equities recorded an overall positive quarter, with key indices reaching fresh record highs before declining over September. Despite the late-quarter sell-off, year-on-year returns for both developed overseas and Australian equities remain at around 30%; a remarkable level benefitting from both the base effects of depressed markets last year and unprecedented policy stimulus during the pandemic. The late-September sell-off in equities was the result of a conflation of factors, with rising concerns that inflation may remain at higher-than-expected levels once supply bottlenecks ease, while a number of central banks have indicated a willingness to taper asset purchases and/or raise rates. These factors have also impacted fixed interest returns, with sovereign bonds pricing in tapering and rising inflation through higher yields (and lower prices).

Commodities markets experienced mixed performance. Falling Chinese demand for iron ore due to a slowdown in its property sector and a drive to lower greenhouse gas emissions saw prices fall from over US$210 to just US$110 per tonne over the quarter. By contrast, a global shortage of energy commodities saw oil prices surge – West Texas Intermediate crude oil reached a seven-year high of US$78 per barrel.

AUSTRALIA

While parts of Australia grappled with COVID-19 Delta strain outbreaks over the quarter (particularly the two largest cities of Sydney and Melbourne), outlook remains relatively optimistic - consensus suggests the economic impacts are expected to be temporary, and the national economy will promptly recover. The sharp uptick in the pace of vaccinations nationally over the quarter means over 80% of Australians 16 years of age and older had received first doses by early October, with projections suggesting 80% will be double dosed by November.

Indeed, the expected swift post-lockdown recovery prompted the RBA to decide against delaying its tapering of government bond purchases during the quarter, instead deciding to proceed with an A$1 billion weekly reduction in purchases to A$4 billion per week through to February 2022. The central bank has, however, reiterated that it does not expect to hike rates until 2024 given the material progress required for inflation to hit its 2% to 3% target range.

Australia's second quarter GDP, released in August, grew at a quarterly rate of 0.7%. The figure surprised to the upside thanks to strong household and government spending, and renders the likelihood of a technical recession in 2021 unlikely.

Local unemployment fell over the quarter, with the jobless rate falling to a 13-year low of just 4.5%. That said, the figure masks a less favourable labour market picture, with the fall due to both a sharp drop in the participation rate (as fewer people actively sought work amid lockdowns) and nearly 250,000 Australians counted as employed but working zero monthly hours.

There are also rising concerns about the nation's housing market, with ultra-low rates helping drive national price growth to 20% year on year. The surge in prices prompted regulator APRA to attempt to rein in speculation by raising the serviceability buffer for banks in evaluating borrower limits in early October.

On the geopolitical front, Australia entered into a new military treaty with the United States and United Kingdom. Labelled 'AUKUS', the alliance will see Australia become one of a handful of nations to own nuclear submarines, as well as receiving long range guided missiles and other military technology. While the treaty is expected to shore up Australia's naval defences should regional tensions escalate, it comes at the expense of damaged relations with ally France, with Australia having terminated its original contract with a French firm for the submarines.

UNITED STATES

In the US, the Federal Reserve struck a hawkish tone at its September meeting, with Chair Powell noting that its inflation target had been reached and its labour market goals were likely to be 'all but met' soon. An announcement on tapering is now anticipated in late 2021, while the Fed's updated 'dot plot' suggests a more pronounced rate hike trajectory over the next three years. US inflation surged during the quarter, with headline CPI hitting a 13-year high of 5.4% per annum in August, while the Core PCE deflator, the Fed's preferred inflation measure, reached a 30-year high of 3.6% per annum. While there are signs some sectors are experiencing an easing in prices pressures, others, such as housing, are now experiencing a firmer rise in costs.

The US Government's debt ceiling was a key issue as the quarter ended, with Congress at an impasse despite forecasts the government will run out of cash by 18 October 2021. There is a degree of brinkmanship involved – while Democrats could unilaterally permit a suspension or increase in the debt ceiling, the process is somewhat complex and politically less palatable.

EUROPE

In Europe, easing lockdown restrictions led to an above-expected second quarter Eurozone GDP growth figure of 2.2%, supported by strong household consumption growth in Italy, Spain and Portugal.

The ECB revised its policy framework, changing its inflation target from 'below, but close to 2%' to just 2%, a move that will allow it more leeway to hold back on tightening policy when inflation rises. At its September meeting, the ECB flagged that its December 2021 meeting would be a 'live' one regarding a decision on tapering of bond purchases, noting improving economic conditions. Nonetheless, the language construes the tapering in dovish terms, suggesting more of a recalibration of purchases rather than an outright tightening. The guidance comes as inflation soared to a 13-year high of 3.4% in the Eurozone (and a 29-year high in Germany.

The Bank of England, meanwhile, will be ending its asset purchases at the end of 2021, with markets now largely pricing in a rate hike in early 2022.

CHINA

In China, second quarter GDP growth improved to 1.3%, being 0.9% higher than that for the March quarter, with growth in construction and industrial output the key drivers. Nonetheless, in July the Chinese central bank announced a 0.5% cut in required bank reserve ratios, representing a more accommodative stance aimed at encouraging lending activity to businesses.

Meanwhile, regulatory risks came to the fore, with a sudden ban on for-profit activity in China's enormous private education sector. This was followed by further crackdowns on sectors such as online gaming and property, with authorities noting a broader goal to reduce inequality. A likely casualty of the crackdown is expected to be major real estate developer Evergrande, which has A$400 billion in liabilities and has fallen foul of regulatory measures to curb excessive leverage in the sector.

Table 1: Index Returns to 30 September 2021

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	-1.9	1.8	1.8	30.9
S&P/ASX Small Ordinaries Accumulation Index	-2.1	3.4	3.4	30.4
International Equities				
MSCI World (ex Australia) Index (hedged A$)	-3.8	0.6	0.6	28.3
MSCI World (ex Australia) Index (unhedged A$)	-3.0	4.0	4.0	27.8
MSCI Emerging Markets Index (unhedged A$)	-2.8	-4.5	-4.5	17.3
Property				
S&P/ASX 200 A-REIT Accumulation Index	-2.2	4.2	4.2	29.8
Australian Fixed Interest				
Bloomberg AusBond Composite Index	-1.5	0.3	0.3	-1.5
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	-1.2	-0.1	-0.1	-2.3
Barclay's Global Capital Aggregate Bond Index (hedged A$)	-1.0	0.1	0.1	-0.8
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.0	0.0	0.0
Commodities				
Gold (US$ per ounce)	-4.0	-1.2	-1.2	-7.6
Copper (US$ per metric tonne)	-6.1	-4.7	-4.7	33.9
WTI Crude Oil (US$ per barrel)	9.5	2.1	2.1	86.5
RBA Index of Commodity Prices (A$)	-7.2	-5.1	-5.1	36.7

Table 2: Australian Dollar versus Foreign Currencies to 30 September 2021

AUSTRALIAN DOLLAR VERSUS	AS AT 30 SEPTEMBER 2021	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.72	-1.2	-3.8	-3.8	0.8
British Pound Sterling	0.54	0.9	-1.4	-1.4	-3.4
Euro	0.62	0.7	-1.5	-1.5	2.0
Japanese Yen	80.60	0.4	-3.3	-3.3	6.6