WHITEHELM ADVISERS

MONTHLY UPDATE ON THE INVESTMENT ENVIRONMENT

March 2021

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MARKET UPDATE

The first quarter of 2021 was an overall positive one for the global economy, with vaccine rollouts contributing to a decline in COVID-19 cases and increasing economic optimism. The increasingly sanguine health and economic picture prompted the IMF to upgrade its 2021 global GDP growth forecasts. Nonetheless, material risks remain; vaccine production and supply chain concerns have constrained inoculation rollouts in some regions, while more aggressive strains have passed through a number of European nations. By early April, over 130 million cases had been confirmed globally, with deaths nearing 3 million.

Risk assets rallied over the quarter. Australian equities returned 4.2% on a total return basis, while the S&P/ASX 200 Index passed the 7,000 point barrier in early April; a level only previously seen briefly in early 2020. Meanwhile, global equities soared 6.1% on a currency hedged basis, with the US S&P 500 Index hitting a new record, passing the 4,000 point barrier for the first time on 1 April. Volatility gauges have also declined to levels not seen since the pandemic commenced in February 2020.

By contrast, fixed interest faced multiple headwinds over the quarter. The unprecedented fiscal and monetary stimulus implemented to mitigate the pandemic's economic impact has proven successful thus far, however with conditions now improving there remains limited signalling that policy settings will be tightened in the near-term. As a result, inflationary concerns have started to emerge, with market participants contemplating whether central banks will be forced to tighten rates sooner than indicated. The increasingly risk-on sentiment also triggered a sell down in bonds as investors tilted away from safe harbour assets. Additionally, a change in regulatory capital treatment from the US Federal Reserve as at 31 March has further contributed to a sell down in US Treasury bonds. The overall impact of these factors saw bond yields increase materially over the quarter, sending prices down. The US 10-year Treasury bond yield increased from 0.9% to 1.7% over the quarter, while its Australian equivalent went from 1.0% to as high as 1.9%; a level last seen in early 2019. Perhaps unsurprisingly, both local and overseas fixed interest returns posted negative returns for the quarter.

Commodities returns also mirrored rising optimism; oil prices increased as manufacturing and supply chain activity picked up, iron ore prices surged amid strong Chinese demand, while gold, considered a defensive hedge, declined in price as investors shifted to a 'risk-on' stance.

The IMF released revised growth forecasts in early April. The successful vaccine rollout in a number of regions and unprecedented fiscal stimulus led to a higher 2021 global GDP growth forecast, rising from 5.5% in January to 6.0%; the fastest global rate in over forty years. While the upward revisions are due to broad-based growth across regions, nations in which the virus has been, or is likely to soon be, contained fared best in the revisions. The US saw the biggest upward adjustment among major economies, with GDP growth raised by 1.3% and 1.0% for 2021 and 2022 to 6.4% and 3.5% respectively. China's 2021 GDP growth was also adjusted upward moderately to 8.4%. By contrast, the Eurozone's 4.4% 2021 forecast was only 0.2% above the January estimate as the region struggles with vaccine production.

AUSTRALIA

There were a number of positive data prints over the quarter for the Australian economy, with the COVID-19 virus seemingly contained. Australia's fourth quarter GDP print, released in February, grew 3.1%, well ahead of market forecasts. Household consumption, which accounts for around 60% of the national economy, improved 4.3% as rising optimism saw household savings fall and spending rise. Home building and business investment also provided a tailwind for the economy, as did a surge in commodities prices, particularly iron ore amid strong Chinese demand.

Employment data also beat forecasts, with the unemployment rate falling to 5.8%; a new pandemic-era low. The fall reflects soaring employer optimism as minor outbreaks of the COVID-19 virus continue to be successfully contained and front-line workers continue to be vaccinated. The NAB business survey for February saw business confidence hit its highest level since 2010, while the Westpac-Melbourne institute consumer sentiment survey equalled its highest level in a decade.

House prices, meanwhile, continue to surge, rising in March at their highest monthly rate in over thirty years. Housing finance approvals are up nearly 50% by value over the last twelve months, while dwelling approvals increased by 22% for the month of February alone. A trifecta of ultra-low rates, relaxed lending requirements and high household savings have contributed to the spike. Whether the RBA or APRA decide to take action to stem the rise remains to be seen, however, with neither noting concerns thus far.

Despite the improving economic picture, the RBA continues to signal ongoing accommodative policy settings. In February it announced a further round of A$100 billion in quantitative easing, noting limited scope for policy tightening until inflation substantially improves; a challenge given current spare economic capacity and weak wage growth.

UNITED STATES

The March quarter was characterised by robust progress by the new Biden Administration, both in implementing economic stimulus and in rolling out COVID-19 vaccination programmes; to date over 100 million Americans have been inoculated.

In January, President Biden commenced his term by reversing some of his predecessor's policies, including the US re-entering the Paris climate accord. With the Democratic Party unexpectedly winning a majority in both houses of Congress, a US$1.9 trillion fiscal package was passed in early March, providing $1,400 cheques for most individuals, extended jobless benefits, and increased aid to state and local governments. A few weeks later the Biden Administration proposed a fresh US$2.25 trillion package to be spent over eight years on transport, manufacturing and renewals, and will be funded by corporate tax hikes. While the US Federal Reserve made no changes to its monetary policy settings over the quarter, it did increase its GDP and inflation forecasts for 2021, now expecting slightly above-target inflation by the end of the year.

CHINA

There was good news for the Chinese economy in January, with fourth quarter GDP print taking the country's annual GDP growth rate to 2.3%; an impressive result in a calendar year when most economies contracted. The improvement was the result of a combination of domestic consumption and export demand.

Nonetheless, geopolitical tensions between China and western nations remain elevated. Following the imposition of sanctions by the US, UK and the EU on Chinese officials in relation to treatment of Uyghurs in Xinjiang, China responded with retaliatory measures against European Parliament officials and academics. Western firms – chief among them retailer H&M – have also been punished for voicing concerns on the issue. The US also decided to continue to withhold preferential trade status for Hong Kong following a clampdown of democratic freedoms last year, while recent posturing in the South China Sea led to Chinese warplanes entering Taiwanese airspace to undertake a simulated attack.

EUROPE

In Europe, a supply shortage of COVID-19 vaccines has worked in tandem with a spike in aggressive strains of the virus, dampening sentiment on the continent. The UK's outlook is, however, somewhat more sanguine given its success in inoculating its citizens.

While the continent grapples with a spike in COVID-19 cases and renewed lockdown restrictions, economic sentiment has improved for segments of the economy despite ongoing lockdown restrictions. This has especially been the case in manufacturing, which remains relatively immune to the social distancing measures to contain the virus.

The Eurozone's December quarter GDP print reflected the region's protracted battle with COVID-19, as lockdown restrictions led to a quarterly contraction of 0.7%, driving down the annual print to -5.1% and rendering a double-dip recession highly likely. While inflation surprised to the upside, rising to 0.9%, it was attributable to temporary factors.

Table: Index Returns to 31 March 2021

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	2.3	4.2	18.4	38.3
S&P/ASX Small Ordinaries Accumulation Index	0.8	2.1	22.8	52.1
International Equities				
MSCI World (ex Australia) Index (hedged A$)	4.3	6.1	26.2	48.7
MSCI World (ex Australia) Index (unhedged A$)	5.1	6.3	16.6	23.5
MSCI Emerging Markets Index (unhedged A$)	0.1	3.6	21.3	27.3
Property				
S&P/ASX 200 A-REIT Accumulation Index	6.6	-0.5	20.6	44.7
Australian Fixed Interest				
Bloomberg AusBond Composite Index	0.8	-3.2	-2.3	-1.8
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	-0.2	-3.1	-2.2	-1.3
Barclay's Global Capital Aggregate Bond Index (hedged A$)	-0.4	-2.5	-1.1	1.1
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.0	0.0	0.1
Commodities				
Gold (US$ per ounce)	-3.0	-10.4	-4.4	5.1
Copper (US$ per metric tonne)	-3.2	13.1	46.1	77.4
WTI Crude Oil (US$ per barrel)	-3.8	21.9	50.6	188.9
RBA Index of Commodity Prices (A$)	1.3	9.0	20.9	7.8

Table 1: Australian Dollar versus Foreign Currencies to 31 March 2021

AUSTRALIAN DOLLAR VERSUS	AS AT 31 MARCH 2021	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.76	-1.6	-1.3	10.6	24.4
British Pound Sterling	0.55	-0.3	-2.2	-0.9	11.8
Euro	0.65	1.6	2.8	5.7	16.2
Japanese Yen	84.16	2.0	5.6	13.3	27.4