House View

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April 2021

The selloff in bonds continued into the first few weeks of March, but yields stabilised after reassuring words from the Federal Reserve. The vaccine rollout was not enough to prevent further lockdowns in Europe and travel bans being put on UK citizens. Brisbane was forced into a three-day lock down at the end of the month. Oil prices, which had been strong due to reopening, spiked temporarily on the news of a freighter blocking the Suez Canal.

Policy Watch: The new US administration successfully passed its $1.9 trillion "American Rescue Plan" despite fears the package may get watered down. Central banks across the world spoke to reassure investors that interest rates aren't changing any time soon. The Fed said it expected that growth would need to be well above trend for a couple of years before they would contemplate reversing the stimulus. The Job Keeper program finished in March and we are now watching to see the fallout on unemployment and activity. The government is in the early stages of planning for the Federal Budget (released in May) and has reaffirmed the potential for more targeted assistance.

Politics Update: Premier McGowan was returned in Western Australia with an expanded majority and the Federal Government has lost its majority with several members being forced to the cross benches. A cabinet reshuffle has been announced after a series of damaging allegations impacted the government's approval rating and severely compromised key ministers' ability to deliver in important portfolios. Mathias Cormann was elected the Secretary General of the OECD. He is the first Australian to lead this organisation which will play a critical role in coordinating global tax reform and climate policies across developed economies.

Vaccine Update: The US surpassed President Biden's initial goal of 100 million vaccines into arms in his first 100 days, reaching that tally on day 58. The AstraZeneca roll out was paused intra-month after fears of blood clotting were raised – although health authorities quickly declared the vaccine safe after the number of experiences found were very small and consistent with numbers experienced normally. There has been rising tensions in Europe about the export of vaccine to other nations, including Australia, while the European community is not fully covered. Australia has entered into 4 separate agreements for the supply of COVID-19 vaccines and $3.3 billion to provide free COVID-19 shots to every citizen over 16. To date, the roll out in Australia has been modest due the lack of delivered vaccine from Europe but we still expect a significant proportion of the population to be vaccinated by the fourth quarter of 2021 with onshore vaccine production ramping up.

Inflation Watch: Energy prices pushed higher in the early weeks of March before easing somewhat. The tightness in oil markets was further challenged when the Ever Given, a 400-metre-long freight carrier, became wedged in the Suez Canal on Tuesday 23 March and cut off supply from the Middle East to Europe. Almost 12 per cent of global trade passes through the canal and will add 10 days to a trip for carriers if they had been forced to travel around the bottom of Africa. The ship was freed on 29 March and normal shipping has resumed.

Risk Budget: Volatility measures eased during March to relatively benign levels. Reassuring central bank rhetoric and the stabilisation in bond markets and has comforted markets in the short term. We have maintained an active exposure to risk assets, with a preference to emerging markets international equities.

Call to Action: Risk assets are still performing, but the incentive to take some profits is increasing.

Portfolio

Our decision to maintain relatively high levels of risk assets in March was vindicated as risk measures eased and developed market equities outperformed more defensive asset classes of bonds and gold.

The debate about rising inflation as economies reopen continues to dominate the investment discussion. Developed market equities were able to sustain rising bond yields during the month as investors gained comfort that the rise in real yields was more associated with the reopening up of economies and became less worried about rising inflation undermining valuations.

Supported by renewed stimulus, particularly in the US, we are confident that corporate earnings will continue to recover towards pre pandemic levels and offset the normalisation of equity multiples over time.

The $A dollar weakened over the month and added to returns of our unhedged international equity exposures. Our view that the currency would struggle as it flirted with $US80 cents has played out and we continue to favour holding our global equity holdings unhedged. Credit spreads have been resilient and should hold relatively tight levels as corporate earnings recovery.

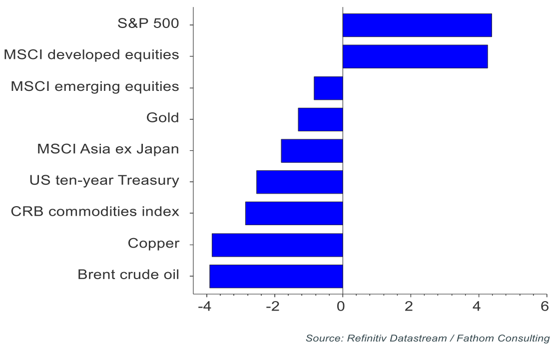
March Review

March was dominated the debate between the positive effects of the reopening of economies and the potential impacts of overheating economies and rising inflation. Oil rose sharply in the early part of the month, before weakening and finishing lower.

Developed market equities were the standout performer as cyclical and value stocks continued to perform strongly. The technology heavy NASDAQ was broadly unchanged over the month. Developing market equities struggled as the US dollar strengthened against the market consensus view.

Chart 1: March Asset Class Performance

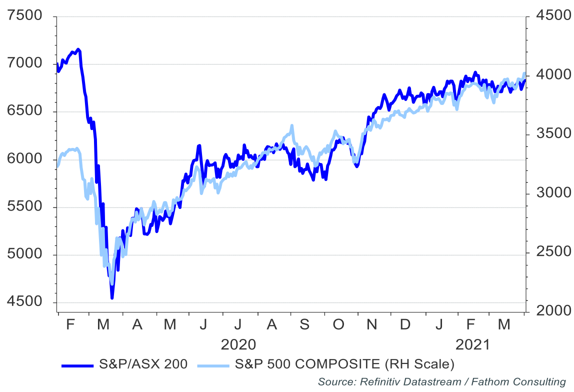
Percentage Change



The S&P500 index rose 4.2 per cent in March to be up a touch over 7 per cent for 2021. NASDAQ composite finished up a modest 0.4 per cent but remains about little over 4.5 per cent up on the year. Both the S&P500 and the Dow Jones Industrial Average set new highs towards the end of the month before easing slightly on the last day. After a very strong February, small companies took a bit of a breather with the Russel 2000 adding 1 per cent in the month to be up 12.7 per cent for the year. The major European stock markets were very strong, rising between 6 and 8 per cent over the month.

In the Australian market, consumer discretionary (+7%), financials (+4%) and the more defensive utilities (+7%) and property (+6%) sectors performed strongly over the month. Materials was the biggest underperformer, falling 5 per cent. Value continued to be the main factor driving equity returns globally and continued to outperform growth factor in March by over 5%. Momentum and other related growth factors underperformed significantly over the month, particularly in North America, and the quality factor also performed strongly compared to growth factors.

Chart 2: US and Australian Equity Markets



US Government ten-year bond yields rose 20 basis points in the early part of the month before stabilising somewhat. There was plenty of comments from the Federal Reserve during the month reaffirming the commitment to keep rates low for an extended period until the US economy is fully recovered – likely to be after 'a couple of years' of above trend growth. The Reserve Bank also reinforced that rates were on hold for an extended period.

Chart 3: 10 Year Bond Yields (%)

Risk

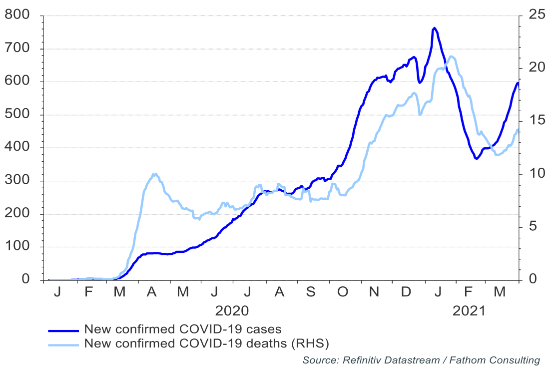
The CBOE VIX index — a measure of investors' expectations for future volatility — eased over the month and closed below 20.

Chart 4: S&P 500 Volatility Index (VIX)

Outlook

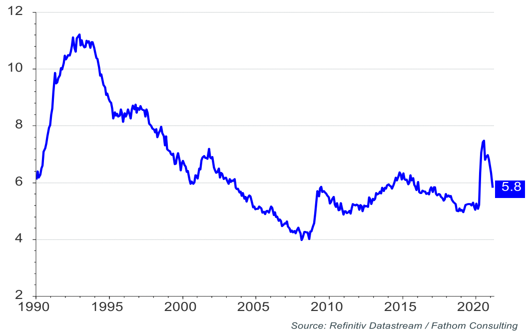
The countries where the vaccine rollout is continuing at pace, particularly the UK and Israel is showing very solid results in the reduction of confirmed cases and deaths. However, the number of cases globally is rising as a third wave sweeps Europe, case numbers escalate in some US states and many developing countries struggle to get supplies of the vaccine and administer extensive roll out programs.

Chart 5: Global COVID-19 Cases and Deaths (1000s, one week moving average



Despite the increase in global cases, economies continue to reopen and experience better than expected growth. In Australia, the unemployment rate has fallen to 5.8 per cent in February, a staggering result given that a forecast of around 15 per cent was expected a year ago.

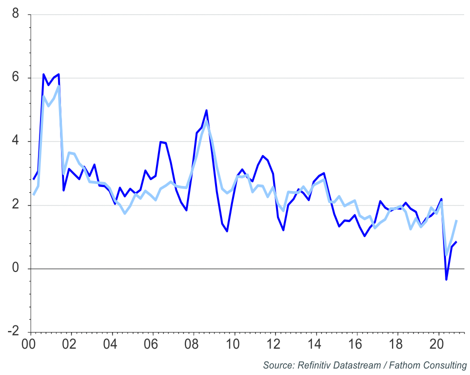
Chart 6: Australian Unemployment Rate (% of labour force)



With the Job Keeper program concluding in March, there will be a focus on whether additional support will be required to support jobs. The Federal Budget will be released in May and the Government retains significant fire power to support certain sectors of the economy should further assistance be required.

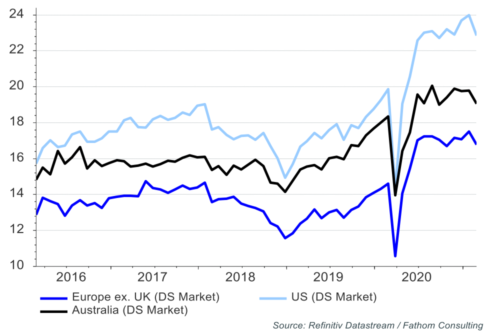
Despite some shortages of goods and labour in certain sectors of the economy, the overall price level remains well contained. Central banks are convinced that the trend in prices will return to pre-pandemic levels and inflation rates will rise modestly towards their targeted bands. Nervous investors are predicting a more aggressive rise in prices fuelled by unprecedented liquidity injections into the economy. We believe that inflation is likely to reach central bank targets, but not much higher, given the pressure in so many supply chains from technology disruption.

Chart 7: Australian Inflation Rate (4 quarter percentage change)



The rise in bond yields has also driven a change in thinking on overall equity valuations and driven a significant rotation in equity sector performance. Long duration technology stocks have struggled somewhat as value stocks have performed more strongly. Overall, the multiple of the market has reduced somewhat but remains at elevated levels.

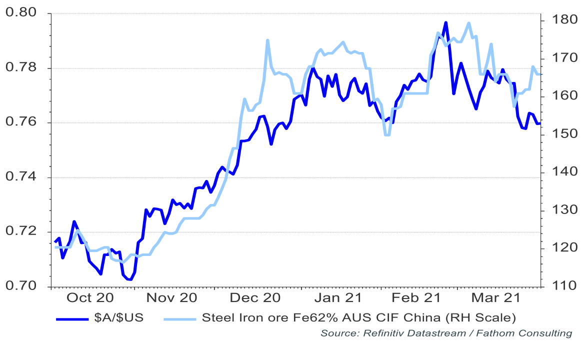
Chart 8: Twelve-month forward PE Ratios



We have maintained our overweight exposure to risk assets into April. Liquidity in the system is still finding its way into real assets and equity markets. Corporate earnings continue to improve, and the market multiple will moderate through 2021 as corporate profits recover to pre pandemic levels. With gains in risk assets expected to be harder fought from these levels, we are closely watching risk indicators in order to de-risk our portfolios should the need arise.

After rising strongly in February, the $A moderated through March to close around US$0.76. Iron ore prices continued to ease in the early part of March before finding some support late in the month. The US dollar strengthened over the month, with the dollar index increasing by 2 to 93.2, largely against the consensus view in the market.

Chart 9: Australian Exchange Rate and Iron Ore Prices ($US)



Despite the softer $A, we continue to favour holding our international assets unhedged. It is unlikely that iron ore prices can stay at these elevated prices for very long as many Chinese steel mills are unprofitable at current levels and a supply response from Brazil is expected to moderate prices.

James Wright, Chief Investment Officer