Benign bond markets allowed equity markets to grind out continued gains despite the rising spread of the Delta strain. Policy makers have continued to reassure markets that support will be withdrawn in an orderly and well telegraphed way, and only when economies are fully able to cope with tighter monetary conditions. Many equity markets set record highs during the month. In the US, the S&P500 index rose for the ninth month in the last 10 months and notched its 53rd record close for 2021. While the risk of the eventual pull pack is increasing, the outlook remains solid as economies reopen, vaccines roll out, and corporate earnings hit record levels. We have continued to hold our elevated risk weights as markets appear likely to continue to eke out further gains in the coming weeks.

Policy Watch: The shift in central bank policy language is now more pronounced. Increasing confidence that economies will remain open despite the Delta variant have brought central banks to an inflection point. Most have now provided a timeline to a tapering in their quantitative easing programs or at least signalled that a shift in approach is looming. While interest rate increases are still seen as some way off in most developed markets, the risk of markets reacting poorly to a misstep is rising. Australia remains somewhat of an outlier, with most of the States still pursuing a zero Delta strategy through harsh lock downs and the RBA has maintained a very accommodative stance due to the uncertainty over the economic outlook.

Politics Update: Geopolitical tensions continue to influence markets, with the Chinese relations with the West partially taking a backseat to the unfolding issues with the withdrawal from Afghanistan. In Australia, the extent of the NSW outbreak and the rising cases in Victoria despite strong lockdowns, has seen a shift in the political narrative. Increasingly, Federal and some State Premiers are now talking about relaxing restrictions despite not having completely quashed the most recent outbreaks. The patchwork of approaches across the country is impacting business confidence and their ability to plan. While the National Cabinet had agreed a reopening plan based on 70 and 80 per cent vaccination rates, it now appears increasingly unlikely to be a consistent approach to the economy across State borders. The growing chorus for vaccination passports to allow more personal freedoms is challenging both civil liberties groups and employment laws across the country as businesses are being forced to make decisions about mandating vaccinations for staff and customers with little guidance from governments.

Vaccine Update: Additional supplies of the more popular Pfizer vaccine have arrived during the month and the broadening of the roll out to younger age groups has seen a dramatic increase in vaccination rates in some states.

Inflation Watch: Inflation numbers have remained relatively high during the month and many corporates have complained about rising input costs during results season. European inflation rose to a 10 year high in August. While some market commentators have predicted a more permanent increase in inflation, central bankers have remained wedded to the view that price pressures remain transitory and will ease as supply chains normalise.

Risk Budget: Our checklist of market risk indicators continues to point to a more moderate risk environment and volatility measures continue to bounce around at benign levels. With central banks commencing to wind back support, albeit well telegraphed and at modest increments, we expect some volatility to rise in coming months. While the latter months of Northern Hemisphere summer is usually a seasonally weak period for markets, we have maintained our relatively overweight level of risk.

Call to Action: While some pull backs in markets should be expected, larger pullbacks giving us an opportunity to add to risk positions appear less likely. Profit taking or risk off events should be well supported with plenty of liquidity remaining on the sideline. We continue to view price weaknesses in the Asian markets as a potential buying opportunity but have not yet added to our allocations to that region. We are still looking for a higher confidence around the China regulatory environment before adding to positions.

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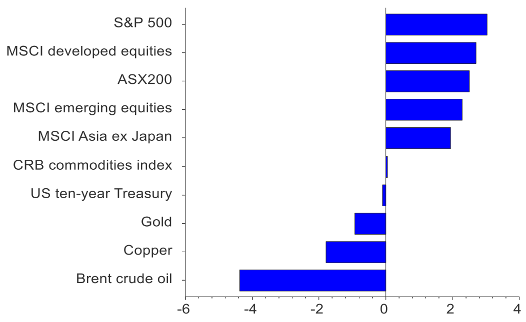
August Review

Copper, which had been incredibly strong run until May on the development of the vaccines and global reopening, has continued to slide and had another soft month in August. Most other risk-based sectors had relatively good months.

Chart 1: August Asset Class Performance
Percentage Change (total return in local currency)



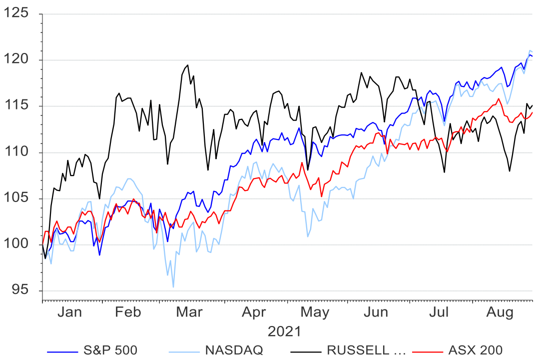
Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Equity markets continued to grind higher in August. The US S&P500 index posted its seventh straight monthly gain. Central banks have walked a careful line between signalling that policy stimulus will start to be withdrawn while not derailing confidence in the strength of economic recovery. Markets remain relatively sanguine about the transitory nature of price increases and the relative stability of bond yields is supporting the continued elevated level of equity valuations.

The S&P500 price index rose 2.9 per cent in August to be up a 20.4 per cent for the calendar year. Financials, information technology and utilities drove the market higher during August, while energy stocks had a weak month. The NASDAQ composite rose a strong 4.0 per cent in August to be up 18.4 per cent for 2021.

Small companies had a soft month on the back of investor concerns about rising Delta numbers. The Russell 2000 rose a modest 2.1 per cent for the month, with the gains for the calendar year just over 15 per cent. The European equity markets enjoyed more muted gains, with Germany rising 1.9 per cent and the French market putting on 1.0 per cent. The UK market, which has lagged the recovery in continental Europe, rose a 1.1 per cent and remains between 5-10 per cent below the calendar year gains in continental Europe.

Chart 2: US and Australian Equity Markets YTD Relative Performance (100 = 1 Jan 2021)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

The ASX200 rose 1.9% in August after a record high mid-month. Diversified financials (+7.0%), healthcare (+6.8%) and consumer staples (+6.5%) were incredibly strong but dragged down by materials (-7.9%) and energy (-5.1%). The market is up just over 14 per cent in 2021 with the strongest returns coming from financials, consumer, and healthcare stocks.

The Fed held its Jackson Hole conference during August and as largely expected, confirmed that they expected to begin tapering their bond purchase program by the end of the year. Fed Chair Powell confirmed the view that recent price hikes associated with the country's post-pandemic reopening should be transitory and will fade as supply chains bottlenecks are worked through.

Chart 3: 10 Year Bond Yields (%)

Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

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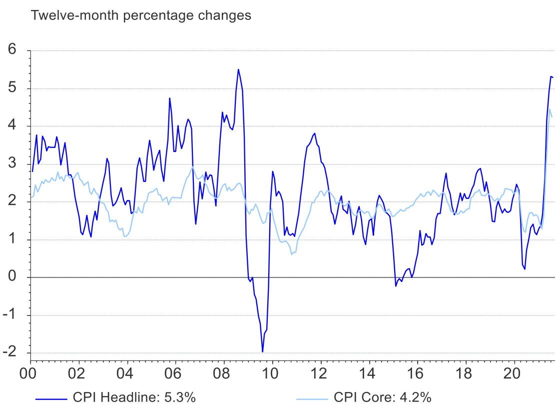
US Government ten-year bond yields traded in a relatively tight range in August and closed the month 8 basis points higher at 1.31 per cent. The market digested significant supply of long bonds during the month but continued to be reassured by policy makers pointing to the transitory nature of price increases.

US core inflation moderated in July at 0.3% m/m vs. 0.4% expected and 0.9% previously (the annual rate was 4.3% y/y). There was much less price pressure from the "re-opening" components that have driven the recent sharp rise in inflation with used cars +0.2% m/m (after 10.2% last month), airline fares -0.1% m/m (after 2.7% last month). However, accommodation costs still rose strongly at 6.0% m/m (after 7.0% last month). Much of the re-opening pressure has now abated with accommodation costs and airfare prices back to their pre-pandemic levels, while the used car market also appears to be slowing.

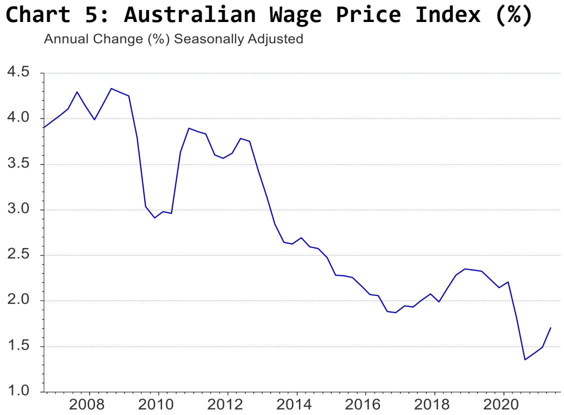
Chart 4: US Inflation (CPI)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Despite the lack of migration and a strong economic recovery in Australia, there remains a long way to go before wages hit the RBA target of 3% annual growth. The Wage Price Index (WPI) rose just 0.4% q/q and 1.7% y/y in the June quarter (Consensus +0.6% q/q). This number is backward looking and reflects the market before the lockdowns in NSW and Victoria, however it provides little evidence of broad based wage pressures.

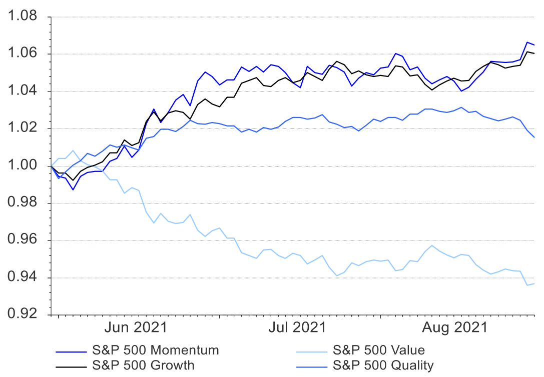
Chart 5: Australian Wage Price Index (%)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

With bond yields trending sideways, growth and momentum again proved to be the dominant factors through the month. Value was very soft, has now given up most of its gains from early in the year.

Chart 6: S&P500 Equity Factor Relative Performance (3 months)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

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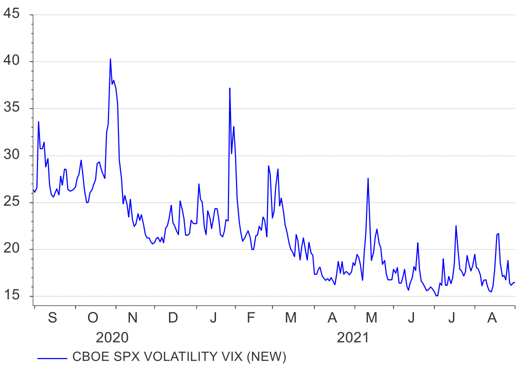
Risk

The CBOE VIX index — a measure of investors' expectations for future volatility — continues to bounce around at relatively benign levels. The cost of put protection has eased, signalling investors have become quite complacent on a market retracement following the relatively strong corporate earnings released in July and August.

Chart 7: S&P 500 Volatility Index (VIX)

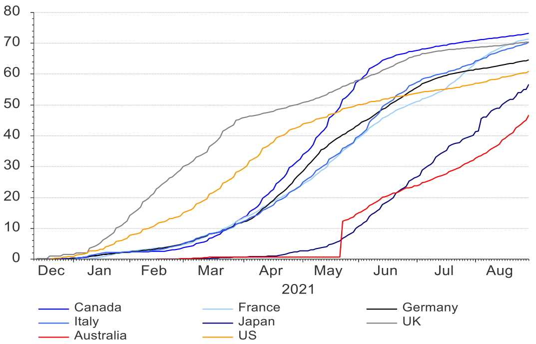


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Outlook

Policy makers in Australia are continuing to grapple with shutdowns and border closures to pursue a suppression strategy, while watching most of the Northern Hemisphere countries return to normal economic activity at various vaccination rates.

Chart 8: Vaccine Rollout (% of population with at least one dose)

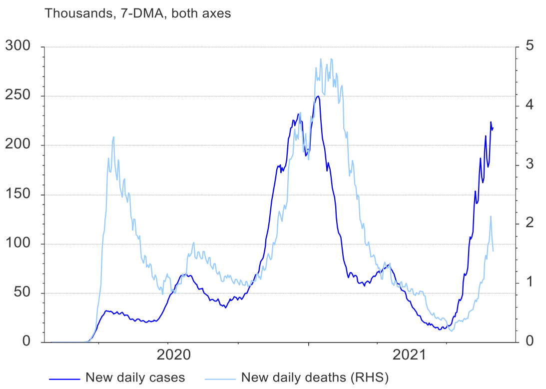


**When data are unavailable Refinitiv repeats previous data point ance is not a reliable indicator of future performance)*

While Covid continues to circulate in most developed markets, those with relatively high vaccination rates are experiencing manageable caseloads in hospitals.

China has been able to quash an outbreak showing success with its stringent lockdowns and restrictions.

Chart 9: US new COVID-19 cases and deaths

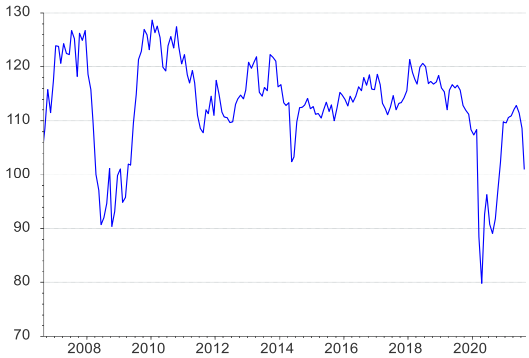


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

US Covid numbers remain elevated but there some positive signs pointing to the potential that a peak in infection rates has been or is very close to being reached. Numbers are falling in the original delta-variant hotspots such as Missouri and Arkansas, where new cases are down from their peak. There is also a slowing in new case numbers for Florida and Louisiana, two states that followed the initial delta wave. The rest of the US is seeing rising daily case numbers, but at a slower pace.

After prolonged lockdowns in Australia, the rhetoric appears to be shifting from targeting zero to living with Covid - although a more concerted reopening of the major states appears unlikely before November.

Chart 10: Australian Consumer Confidence (ANZ/Roy Morgan Survey)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

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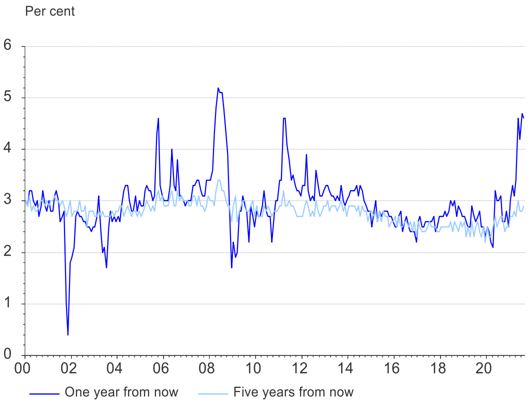
Australian Consumer Confidence has been impacted by lockdowns, but remains in positive territory, and well above 2020 lows. This shallower drop in sentiment to date potentially reflects expectations of a rapid recovery once restrictions have eased alongside the vaccine rollout. Any delay or an uneven reopening across the country has the potential to impact sentiment further.

The question over whether price increases are transitory or more persistent will probably not be answered for several months. However, while short term expectations about inflation have risen, longer term expectations have remained below 3 per cent and have softened in the most recent surveys.

Chart 11: US Uni. Of Michigan Inflation Expectations

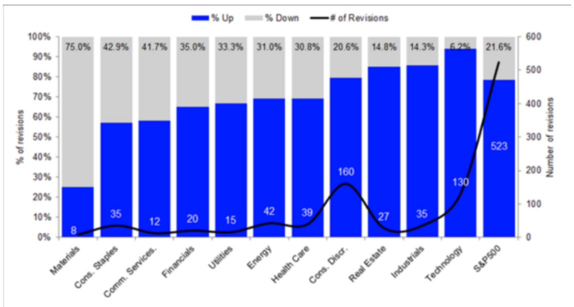


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

To date, 489 companies in the S&P 500 Index have reported earnings for Q2 2021. 87.7% reported earnings above analyst expectations and 9.4% reported earnings below analyst expectations. This is significantly higher than a typical reporting season. Since 1994 66% of companies beat estimates and 20% miss estimates.

In aggregate, companies are reporting earnings that are 15.9% above estimates, which compares to a long-term (since 1994) average surprise factor of 3.9% and the average surprise factor over the prior four quarters of 20.1%. The question now is whether equity markets have already priced in the economic and earnings recovery that is ahead and therefore earnings growth moderates from here, or whether this strong growth in corporate earnings can continue.

Chart 12: S&P 500 – Estimate Revisions by Sector



Source: Refinitiv, Past performance and performance forecasts are not reliable indicators of future results.

We expect that the path of inflation and the expected change to the Federal Reserve's quantitative easing program is likely to create more volatility, as fixed income markets try to predict the future path of interest rates and digest the withdrawal of purchasing support from central banks. We believe that the most likely scenario is for equity markets to grind higher on an improving economic backdrop over the remainder of 2021, despite the potential for rising bond yields. Our view is that offshore markets, such as the US are likely to outperform local markets as the threat of potential lockdowns still remains in Australia. We have maintained an overweight exposure to risk assets and are reviewing the pull back in Asian stocks as an opportunity to add to exposure to this growing region at the right time.

James Wright and Luke Hansen
Sayers Capital Solutions Group

2 September 2021