smart BUSINESS SOLUTIONS Financial Planning

Market wrap

June 2021

ECONOMICS OVERVIEW

There was little change to the overall market background during the month. Attention remained dominated by the risk of new waves of the virus, and the pace with which vaccines are being administered in major regions.

- Fixed income and equity markets registered positive returns in June, closing out a turbulent financial year.
- For bonds, the gains helped offset losses from the second half of 2020 and the first quarter of 2021.
- For shares, the appreciation extended earlier gains. In spite of the disruptions caused by the Covid pandemic, equity markets generated very pleasing returns for investors over the year.

Australia

Economic indicators have been generally positive recently, although the implementation of various lockdown restrictions nationwide are clouding the outlook.

- By month end, all eyes were on the Reserve Bank of Australia's meeting in early July. Officials have indicated that the Bank will outline its plans for the next phase of policy action at this time. For now, Australia's quantitative easing program is continuing, with the central bank buying around $5 billion of bonds per week on the open market to provide liquidity in the financial system.
- On the interest rate front, the Governor of the Reserve Bank reiterated that economic conditions are unlikely to be strong enough to warrant a rate hike until at 2024, at the earliest.
- The Reserve Bank of Australia's Term Funding Facility – a low cost source of funding for domestic deposit taking institutions – expired at the end of June. There was a strong drawdown of funds late in the month, to help shore up firms' financial positions.

US

Federal Reserve officials reassessed their forecasts for US interest rates. Policymakers are now indicating that interest rates could be raised before the end of 2023 if inflation continues to rise and if the economy continues to recover as anticipated.

- This latest guidance is in stark contrast to the previous rhetoric, which suggested policy settings would be unchanged until the end of 2023 at the earliest.
- Separately, there was some speculation that officials may be considering reducing the scale of the America's massive quantitative easing program; a move that could have implications for Treasury yields in the months ahead.
- Employment trends are encouraging. New job numbers were well up in May in the leisure and hospitality sectors, although there has been strength across the board. More than 22 million jobs were lost in the US in the first half of 2020, when the Covid shock hit. Thus far, nearly 15 million workers have been re-hired.

The Reserve Bank of Australia's Term Funding Facility – a low cost source of funding for domestic deposit taking institutions – expired at the end of June. There was a strong drawdown of funds late in the month, to help shore up firms' financial positions.

US CONTINUED

- Improving employment and wage prospects – as well as a strong 'wealth effect' owing to record high house price growth – are supporting consumer confidence. The proportion of consumers planning to purchase homes, automobiles, and major appliances has increased, according to the latest survey. This augurs well for economic activity levels going forward.

New Zealand

Arguably the most significant development was the release of GDP data for the March quarter. The economy rebounded after shrinking slightly in the December quarter and grew at an annual pace of 2.4%.

- Separately, despite authorities' efforts to cool appetite among investors, house price increases show no sign of abating. Prices are now more than 20% higher than a year ago; a record rate of growth. This has prompted some observers to call for the central bank to consider raising interest rates.

Europe

GDP growth in the Eurozone was revised up to -0.3% for the March quarter, from an initially reported -0.6% quarter-on-quarter print. Peripheral markets like Greece and Ireland performed a little better than expected.

- The strong rebound in services sectors appears to remain on track as restrictions are being lifted. Momentum in the manufacturing sector is also holding up better than expected.
- There is an increasing political focus in Europe too, with both France and Germany due to hold elections in the next 12 months.
- The UK economy shrunk by 1.6% in the March quarter from the previous quarter, but the outlook is much brighter. Social distancing restrictions are expected to be fully lifted in mid-July, with more than 85% of the adult population having received at least one Covid jab.
- The improving outlook for activity levels and growth is pushing both inflation and house prices higher, although for now there is no sign that officials are considering tightening policy settings.

Asia / EM

Asian economies still look set to recover strongly this year, following the sharp contraction in 2020.

- Recovery rates are likely to be boosted by an acceleration in vaccine rollouts. Using a vaccination target of 75% – perceived as a prerequisite for keeping the virus under control – China, Singapore and South Korea are on track to have the majority of their populations vaccinated in the next three months. Taiwan and Thailand will likely reach that landmark by the middle of next year, helping to support activity levels across the region.
- Elsewhere, the latest trade data in Japan showed sluggish growth in exports. A recovery in the value of goods shipped to the USA and Europe is encouraging, but a drop in exports to China is weighing on the total.

Australian Dollar

- The AUD weakened against the US dollar, primarily reflecting evolving interest rate expectations in the US. At the end of June, the 'Aussie' bought a little over 75 US cents, a decline of 3.0% over the month.
- The Australian dollar also depreciated by 1.3% against a trade-weighted basket of international currencies.

Australian Equities

- The re-emergence of the Covid virus in various State capitals was not enough to dampen investors' enthusiasm for equities.
- Optimism that the Australian Government or Reserve Bank will avert any economic downturn helped the S&P/ASX 100 Index rise 2.1%, to new record highs.
- All sectors bar one finished the month higher. IT (+13.4%) was the best performing area of the market, as Afterpay (+27.4%) reversed the previous month's losses.
- Most other sectors also posted healthy gains, including Communication Services (+5.6%), Consumer Staples (+5.3%), Real Estate (+4.8%), Consumer Discretionary (+4.5%), Energy (+4.0%), and Utilities (+3.5%).
- Financials was the only sector to finish lower (-0.2%), with some weakness in the 'big four' banks acting as a drag.
- Small caps fared even better than their larger peers, with the S&P/ASX Small Ordinaries Index returning 3.1%.
- Commodity returns were mixed. Brent Crude oil (+7.9%) and iron ore (+4.7%) were higher on a favourable global economic outlook on the back of unprecedented government stimulus, while gold (-6.9%) fell out of favour in the 'risk-on' environment. These moves had varying influences on Australian-listed mining and energy-related stocks.
- Despite the mayhem caused by the Covid pandemic and Australia's first economic recession in nearly 30 years, domestic shares performed very well in the FY21 year as a whole. The S&P/ASX 100 Index added 27.9%. Healthy risk appetite during the period enabled small cap stocks to perform even better – the S&P/ASX Small Ordinaries Index returned more than 30%.

Listed Property

- Global property securities posted meaningful gains in June. The FTSE EPRA/NAREIT Developed Index rose 4.0% in Australian dollar terms. Markets remained affected by the evolving Covid-19 pandemic to varying extents, but fared well on the whole.
- The best performing regions included Australia (+5.5%), Japan (+4.0%) and Canada (+3.8%), while the laggards included Spain (-7.4%), France (-3.2%) and Hong Kong (-1.7%).
- American Self storage names outperformed, continuing their strong run in the calendar year to date. Stocks in the healthcare sub-sector also performed well generally, driven by acquisition plays taking advantage of Covid-19-driven dislocations.
- The residential sector throughout Europe struggled. Coronavirus concerns have returned, following the gradual reopening of European markets over the past few months.
- In Asia, logistics names typically fared well.
- A-REITs returned 5.5%. The best performers included Ingenia Communities Group (+10.0%) and Goodman Group (+9.7%).

Global Equities

- Global shares were mixed in June. The bellwether S&P 500 Index in the US rose for a fifth consecutive month, which set the tone for some other markets.
- Technology stocks outperformed, partly due to the 'stay at home' theme as the spread of the 'delta' variant of Covid-19 prompted several countries to tighten lockdown restrictions. The tech-heavy NASDAQ added 5.5% over the month, hitting fresh all-time highs.
- Most European markets also closed in positive territory, although gains were typically a little more modest. The French, German and UK markets rose 0.9%, 0.7% and 0.2% respectively, for example.
- Major Asian bourses performed less well. China's CSI 300 declined 2.0%, Hong Kong's Hang Seng fell 1.1% and Japan's Nikkei 225 Index closed the month 0.2% lower.
- Like in Australia, the FY21 year was a good one for global shares. The MSCI World Index closed the year 36.9% higher, driven by a 40%+ return from US-listed stocks.
- Investors' healthy risk appetite extended to more speculative regions, and helped emerging markets register an impressive 38.1% return over the year.

Global & Australian Fixed Income

- Global bonds provided positive returns for investors, as yields moved lower in most major regions.
- The focus remained on the tug-of-war between vaccine rollouts and the spread of more contagious variants of the Covid-19 virus, and how the evolving pandemic might affect the pace of economic recovery in key regions.
- Despite suggestions that interest rates in the world's largest economy could be raised earlier than previously anticipated, US Treasury yields fell 13 bps, to 1.47%. This move set the tone for fixed income markets elsewhere.
- Japanese government bond yields fell to their lowest level since February, closing the month at just 0.05%.
- UK gilt yields also fell – by 8 bps to 0.72% - although German Bund yields were little changed.
- Australian yields fell even more substantially, by 18 bps to 1.53%. This move supported positive returns from the local bond market.
- Despite the gains made recently, bonds struggled in the FY21 year as a whole. Central banks lowered interest rates to record lows to help economies withstand the Covid shock, which saw yields on government bonds plummet globally. In most cases, they have not yet recovered to previous levels.

Global Credit

- Corporate bonds were buoyed by generally favourable sentiment towards equities and other risk assets.
- Investment grade credit spreads continued their steady downward move, closing June at 0.86%. Spreads have now tightened in eight of the past nine months, resulting in pleasing returns from the asset class.
- As well as generating positive returns, credit markets have seen very low levels of volatility. Analysis suggests 2021 could be the 'dullest' year on record for investment grade and high yield credit, in terms of spread movements. That will likely be a welcome development for investors in the asset class, who were forced to endure a year of unsettling volatility in 2020.
- Default rates have also fallen meaningfully, underlining the favourable conditions that exist currently for corporate borrowers.
- Moreover, current forecasts suggest the default rate in 2021 as a whole will be less than half the long-term average. Again, this appears to be reassuring investors that an allocation to credit can be attractive from a risk/return perspective, particularly with prospective returns from term deposits and government bonds remaining so low.

Smart Business Solutions Financial Planning Pty Ltd
Corporate Authorised Representative of Count Financial Limited
ASIC ID 001275904
ABN 15631281822
Level 1, 328 Main Street Mornington VIC 3931
P (03) 5911 7000
www.smartfinancialplanning.com.au

smart
BUSINESS SOLUTIONS
Financial Planning