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# Market wrap

May 2021

## ECONOMICS OVERVIEW

Overall news flow remained supportive of risk assets including equities and credit and enabled most major share markets to make positive progress.

- Technology stocks tended to underperform, drifting lower from recent all-time highs. The technology-heavy NASDAQ in the US closed the month lower.
- Bond yields were little changed in key regions, meaning returns from fixed income markets were close to neutral.
- May saw an increase in volatility in cryptocurrencies. Bitcoin had risen above US$63,000 in April, for example, but closed May more than 40% below this peak.

### Australia

As part of the 2021/22 Federal Budget, the Treasurer reiterated the importance of border reopenings. This will enable the Australian economy to benefit from tourist spending, and should lift migration levels. There is a concern that it might not be possible to maintain strong economic growth without the arrival of highly-skilled immigrants.

- As part of the Budget, the Government committed at least $311 billion to fight the Covid-19 pandemic, including around $20 billion on health care and around $290 billion on stimulus spending. Unfortunately, this has plunged the country back into a sizeable budget deficit.
- The expiration of the JobKeeper program saw employment numbers fall by more than 30,000 in April. This was a set-back, but employment trends have been quite encouraging recently.

### US

- Inflation data remained closely watched, to see whether current policy settings remain appropriate. CPI was up 0.8% month-on-month in April; the highest reading since 2009 and double the consensus forecast. The annual rate rose to 4.2%.
- Investors are trying to understand whether the recent spike is temporary, or a signal that inflationary forces are becoming more entrenched. For now, officials are insisting that the recent rise in inflation will not persist.
- Employment data for April were well below expectations. Just 266,000 new jobs were created over the month, compared to consensus expectations of 1 million. In fact, this was the biggest ‘miss’ in history. The unemployment rate increased, to 6.1%.
- For some, this was a sign that the recent economic recovery is stalling. For others, it was indicative of temporary labour supply constraints. Several commentators – including Federal Reserve officials – suggested a strong rebound in hiring remains likely.
- Either way, the surprise was a reminder that the economic recovery could remain uneven; investors should be prepared for bouts of volatility in financial markets in the months and years ahead as the latest economic data releases are digested.

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## US CONTINUED

- In other news, a survey suggested conditions in the US manufacturing sector have deteriorated. There have been reports of bottlenecks in supply chains including long lead-times, shortages of critical basic materials, rising commodity prices and transportation difficulties.

## New Zealand

In its latest Budget, the Government announced the biggest increase in welfare payments in 'more than a generation' to help support a post-virus rebound in the economy.

- The new spending packages are also designed to tackle ongoing social inequality in the country.
- The country's labour force survey showed stronger than expected employment growth in the March quarter. At 4.7%, unemployment is lower than that in Australia. In fact, employment in New Zealand has now surpassed its pre-pandemic peak.

## Europe

There was some speculation that the European Central Bank could start reducing the size of its bond buying program, as economic conditions in the region appear to have stabilised.

- Services sectors are seeing higher demand, which augurs well for stronger spending during the northern hemisphere summer.
- That said, whilst the outlook has improved thanks to the rollout of vaccines, current conditions remain challenging. German GDP contracted by -1.8% in first quarter of 2021, for example; an even worse outcome than had been forecast.
- More encouragingly, the Bank of England raised its growth forecasts for the UK economy for 2021 and 2022 and said it is scaling back its own quantitative easing program. Activity levels have surged since lockdown restrictions were eased further in mid-May, with credit card spending picking up sharply.
- Also in the UK, the Scottish National Party's failure to win an outright majority in the Scottish Parliament in the latest elections suggests the risk of another disruptive and divisive Scottish independence referendum has receded, at least for now.

## Asia

Chinese authorities have taken action to try and moderate recent strength in the yuan. The currency has risen by more than 10% against the US dollar over the past year, which is acting as a headwind for exporters. From mid-June, Chinese banks will be required to hold more foreign currency in reserve, which will reduce the supply of US dollars and other foreign currencies onshore and potentially weaken the yuan.

- Interestingly, China also announced that couples will be permitted to have a third child. Until 2016, the country had adopted a 'one child policy', but is now looking to lift the birth rate. Like we have seen in Japan in recent years, ageing populations can act as a drag on a country's economic prospects.
- In Japan, there was ongoing debate on whether the summer Olympics should proceed given the ongoing pandemic.
- Elsewhere, Q1 2021 GDP data was below expectations in both Malaysia and the Philippines – another reminder that the effects of Covid-19 are far from over.

## Australian Dollar

- At around 77 US cents, the Australian dollar was little changed against the US dollar in May.
- The Australian dollar weakened slightly against a trade-weighted basket of international currencies, reversing April's move.

## Australian Equities

- May was a somewhat volatile month for Australian equities. Gains made early in the month – largely driven by record high iron ore prices and positive trading updates from the major banks – reversed following higher-than-expected US inflation data. The market recovered later in the month, thanks to strength in the Consumer Discretionary sector and in the major banks. The S&P/ASX 100 Accumulation Index rose 2.6% in the month as a whole.
- All of the major banks rallied as trading updates highlighted higher net interest margins, housing credit growth and provision releases given the improved domestic economic outlook. Commonwealth Bank of Australia (+12.0%) was the best performer (+4.4%), closely followed by QBE Insurance (+11.1%).
- The Materials sector rose 1.6%, with constituents benefiting from higher iron ore (+14%) and gold (+8%) prices. Strong steel demand and high margins in the Chinese steel industry sent the price of iron ore briefly above US$200/tonne.
- April's recovery in the Information Technology sector unwound in May, with the sector falling -9.9%. Broad-based weakness in the Buy-Now-Pay-Later sector saw Afterpay drop -21.1%, as the market factored in the impact of rising bond yields on discount rates. Appen fell -14.4% after releasing a business update that discussed the sales impact from changing consumer needs.
- The S&P/ASX Small Ordinaries Accumulation Index returned just 0.3%, missing out on the strength in the large cap banking sector.

## Listed Property

- Global property securities posted small gains in May. The FTSE EPRA/NAREIT Developed Index rose 1.6% in Australian dollar terms, slightly underperforming broader equity markets. Global real estate markets continue to be underpinned by the evolving pandemic and the relaxation of social distancing restrictions.
- Analysts continued to debate whether inflation will be transitory or persistent, which contributed to volatility in the sector in May.
- The best performing regions included Sweden (+7.1%), Spain (+7.0%) and France (+6.8%), while the laggards included Singapore (-2.7%) and the US (+0.8%).
- The residential sector performed well throughout Europe, particularly in Germany where there was a proposed takeover of a German residential apartment company.
- The performance of US REITs was hampered by inflationary concerns, but the sector could perform better later in the year if the economy fully reopens as expected.
- Asian economies have not yet reopened at the same rate, as Covid-19 cases have plateaued at high levels. High numbers of infections in Japan and greater restrictions in Singapore, for example, were reflected in the performance of those markets.
- Locally, the A-REIT market increased 1.7%. The best performers included Unibail-Rodamco-Westfield (+7.2%) and Arena REIT (+5.9%).

## Global Equities

- The ongoing rollout of Covid vaccines in most countries and the relaxation of social distancing restrictions continued to support investor sentiment towards risk assets, including shares.
- In general, the reopening of economies and fiscal support programs rolled out by major governments are expected to benefit corporate earnings. This has been underlined by recent quarterly earnings announcements in the US and Europe.
- Against this backdrop, most global share markets registered further gains in May. The MSCI World Index added 1.8% in Australian dollar terms, extending gains in the calendar year to date to more than 11%.
- European markets were among the best performers. The Swiss, Italian and Spanish share markets all rose by more than 3% over the month, for example. The French CAC Index added 2.8%, while the German DAX closed the month 1.9% higher.
- Performance was mixed in Asia. Chinese shares climbed 4.1%, while Hong Kong's Hang Seng Index rose 1.5%. Japanese shares were little changed and those in Singapore actually lost ground – the Straits Times Index closed May 0.8% lower.
- The S&P 500 Index in the US rose 0.6%, although the underperformance of technology stocks meant the NASDAQ closed the month 1.5% lower. Some investors appeared to take profits after the index had risen to

## Global & Australian Fixed Income

- Returns from global bond markets were modestly positive, although May was a relatively quiet month in major bond markets. Yields were little changed in most regions.
- In the US, 10-year Treasury yields closed the month 3 bps lower, at 1.59%. Yields on shorter and longer-dated securities in the US were similarly flat.
- It was a similar story elsewhere – yields on UK gilts, Japanese Government Bonds and Australian Commonwealth Government Securities declined between 1 and 5 bps, while German Bund yields rose 1 bp over the month.
- The major focus remained on the outlook for inflation – specifically whether gathering inflationary forces might prompt central bank officials to review monetary policy settings.
- Cash rates are not expected to move meaningfully, if at all, in most regions for the foreseeable future. Bond yields will likely move, however, if and when these expectations begin to shift.

## Global Credit

- Like shares, corporate bonds have been supported by generally favourable earnings releases from listed companies.
- Additionally, early indications suggest discretionary expenditure is increasing rapidly as social distancing restrictions are being lifted and as economies are reopening. In general, consumers are flush with cash after more than a year of saving and, in some cases, following the receipt of income support payments. This augurs well for revenues and company profitability in the remainder of 2021 and beyond.
- Investment grade spreads continued to grind tighter, closing May 2 bps lower, at 0.89%.
- The average maturity of new bonds issued has been steadily increasing recently, as companies look to lock in favourable interest rates for long periods. Most new bonds fared well in secondary markets in May after the issuance process was complete. This underlined the strong demand for yielding securities worldwide.
- There has also been an increasing trend towards sustainable bonds. 'Green' issues accounted for around 5% of total corporate bond issuance in May, an increase from historic levels.



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