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MONTHLY UPDATE ON THE INVESTMENT ENVIRONMENT

June 2021

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MARKET UPDATE

The 2020-21 financial year ended on a high note for both growth and defensive assets, with the easing of COVID-19 restrictions providing a formidable tailwind. Despite an unexpectedly hawkish revision to policy outlook from the US Federal Reserve, market consensus suggests inflationary pressures remain contained, and central banks are not expected to tighten policy until persistent robust growth materialises.

Nonetheless, the health impact of the pandemic remains severe; by early July, a grim milestone was reached, with the number of total confirmed deaths reaching four million. While cases and deaths are easing across most developed nations, new and more contagious strains are emerging, presenting new challenges for health authorities worldwide.

Both equities and fixed interest assets rallied over the quarter. Despite revisions to the Federal Reserve's 'dot plot' suggesting a faster than expected rate of policy normalisation, markets were sufficiently assuaged by the more dovish guidance from Fed Chair Powell that policy would not be tightened pre-emptively.

Powell's comments helped push the S&P 500 Index and Nasdaq Composite indices to record highs in June, with developed overseas equities returning 7.6% on a currency-hedged basis for the quarter, lifting the annual return to a remarkable 35.8%. Australian equities were also lifted by the global equities rally, as well as benefitting from strong commodities export demand. The S&P/ASX 200 Index briefly eclipsed a record 7,400 points in mid-June, while Australian equities returned 8.5% for the quarter, and 28.5% over the past twelve months.

Fixed interest assets benefitted from the Federal Reserve's policy recalibration and changes to the outlook for longer term rates. The US government bond yield curve flattened, with short-end rates rising amid expectations rates would hike sooner than previously expected, while longer-dated yields narrowed significantly given lower expectations of a surge in inflation. Falling yields benefitted fixed interest returns, leading to a positive quarter following the sharp decline over the March quarter.

Meanwhile, credit spreads narrowed in line with ongoing optimism; indeed, US high yield spreads neared 300 basis points in early July; their tightest level since July 2007.

AUSTRALIA

Despite an outbreak of the highly contagious delta variant of the COVID-19 virus in Sydney at quarter-end which plunged the city into lockdown, the domestic outlook remains sanguine as the Australian economy continues to record strong economic data, helped by firm commodity prices. Indeed, the RBA's index of commodities prices showed an annual growth rate in commodities prices of 40% at 30 June 2021.

At its early July meeting, the RBA decided not to extend its 0.1% yield curve control target beyond early 2024, suggesting a moderately hawkish shift in its official cash rate outlook. It also extended its bond purchase program, albeit on a tapered rate of A$4 billion per week, specified as a weekly rate rather than a total dollar sum as per previous rounds. The revised weekly amount was below expectations, also suggesting a hawkish tilt from the central bank. Markets have brought forward expectations of a rate hike to late 2022 in response.

The nation's housing sector continued to run hot over the quarter, taking year-on-year growth to 12.4%. Both owner and investor finance approvals continued to soar, growing at an annual 88% and 116%, respectively. Australian jobs data also improved significantly, with more than 115,000 new jobs added in the most recent month, and the unemployment rate plummeting to 5.1%.

The Australian Government's 2021-22 budget announced on 11 May unveiled a projected $107 billion budget deficit this year, as well as deficits for each of the next 10 years. The level of projected spending is higher than anticipated and is focused on infrastructure and aged care. The budget also incorporates tax write-offs for businesses and tax cuts for low- and middle-income earners.

Following the announcement, ratings agency S&P reaffirmed its negative outlook on Australia, noting the sizeable deficits leave the government little room to respond to the ongoing geopolitical risks.

UNITED STATES

The US economy continued to improve as pandemic-era restrictions eased, with a successful vaccine rollout driving down daily cases to their lowest levels since March last year. The Federal Reserve's preferred inflation measure, the core PCE index, increased at an annual rate of 3.4%; its highest in nearly three decades, albeit cycling pandemic related price falls in 2020. Non-farm payrolls also soared by 850,000 in June, although other jobs data suggests there are still pockets of weakness, with hours worked falling and the unemployment rate actually rising.

GDP also supported the notion that conditions were improving, growing by an annualised 6.4% GDP growth in the first quarter, the third consecutive quarter of strong growth. The robust recovery continues to be supported by extraordinary levels of fiscal stimulus. US Congress has so far approved US$5.3 trillion across a variety of fiscal spending measures over the course of the pandemic, with both Biden's US$2 trillion infrastructure bill and his US$2 trillion 'American Families Plan' still going through the negotiation and approval process.

The Federal Reserve released its revised 'dot plot' of member cash rate forecasts, unexpectedly revealing a median expectation that rates would lift 0.5% in 2023; earlier and by more than previously anticipated. Chair Jay Powell noted that the Federal Reserve was now 'talking about talking about' tapering, although he then clarified that there would be no policy tightening until clear signs of persistent, above-target inflation were evident.

EUROPE

Despite the eurozone officially recording a 'double dip' recession with a first quarter GDP print of -0.6%, economic sentiment has improved significantly over the past few months. This is reflective of the view that the worst of the pandemic is over, attributed to the acceleration of the vaccine rollout after a sluggish start, and the easing of containment measures in many countries.

The easing of lockdown restrictions in Europe continued to benefit the regional economy as it enters summer. The Eurozone unemployment rate fell to 7.9%, while the June IHS Markit Eurozone Composite PMI hit a fifteen-year high, suggesting firms hold a highly optimistic outlook.

CHINA

China's economic recovery continues to benefit Australia, despite the ongoing trade tensions. Customs data has shown that the value of trade between the two nations is 33% higher so far this year, compared to over the same period in 2020. China's imports of Australian products are up 6% when measured by trade volume compared to last year, but up 86% when measured by value, due to the surge in commodity prices, especially iron ore.

That said, China's strong economic growth continues to be overshadowed by the ongoing tensions between China and several other nations, including Australia. After the Australian Government cancelled the Victorian state government's planned involvement in China's Belt and Road global infrastructure initiative in late April, the Chinese Government announced the indefinite suspension of all activities under the China-Australia Strategic Economic Dialogue. During June, the US imposed sanctions on Chinese solar manufacturers over alleged slave labour usage, while Chinese leader Xi Jinping publicly reiterated his objective of unifying Taiwan with the mainland, and Chinese authorities placed curbs on Chinese companies seeking to list on overseas exchanges.

Finally, small COVID-19 outbreaks continue to occur, including one in the port city of Shenzhen in June that required a lockdown, hindering export supply chains.

Table: Index Returns to 30 June 2021

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	2.3	8.5	28.5	28.5
S&P/ASX Small Ordinaries Accumulation Index	3.1	8.5	33.2	33.2
International Equities				
MSCI World (ex Australia) Index (hedged A$)	2.4	7.6	35.8	35.8
MSCI World (ex Australia) Index (unhedged A$)	4.7	9.3	27.5	27.5
MSCI Emerging Markets Index (unhedged A$)	3.3	6.6	29.2	29.2
Property				
S&P/ASX 200 A-REIT Accumulation Index	5.5	10.5	33.2	33.2
Australian Fixed Interest				
Bloomberg AusBond Composite Index	0.7	1.5	-0.8	-0.8
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	0.5	0.7	-1.6	-1.6
Barclay's Global Capital Aggregate Bond Index (hedged A$)	0.5	0.9	-0.2	-0.2
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.0	0.1	0.1
Commodities				
Gold (US$ per ounce)	-7.2	4.3	-0.3	-0.3
Copper (US$ per metric tonne)	-8.6	6.7	55.9	55.9
WTI Crude Oil (US$ per barrel)	10.8	24.2	87.1	87.1
RBA Index of Commodity Prices (A$)	6.8	16.4	40.0	40.0

Table 1: Australian Dollar versus Foreign Currencies to 30 June 2021

AUSTRALIAN DOLLAR VERSUS	AS AT 30 JUNE 2021	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.75	-3.0	-1.4	9.0	9.0
British Pound Sterling	0.54	-0.2	-1.6	-2.5	-2.5
Euro	0.63	0.0	-2.3	3.3	3.3
Japanese Yen	83.33	-1.6	-1.0	12.2	12.2