ATCHISON
CONSULTANTS

Market Review – March 2021

Overview

- Government relief spending from the developed economies around the world helped fuel inflation expectations
- Optimism was boosted by some strong economic data in the US and Europe
- More than 900,000 US jobs added in March as vaccinations spur return to normal
- US$1.9 trillion relief package bill signed into law by President Biden
- European equity markets post strong returns in March
- Economic data emanating from Europe confirms recovery well underway
- 'Third wave' forces more lockdowns in France and Germany
- Better-than-expected economic growth meant the UK looks set to avoid double dip recession
- China's equity market underperformed as new economy plays suffered amidst tightened regulatory measures
- Japan's equity market ended higher helped by improved global growth outlook
- Government bond yields continued to rise during March. The main drivers were optimism over the vaccine roll-out programmes in the US and UK, as well as concerns about the inflationary impact of the economic stimulus being provided by central banks and governments
- Corporate bonds held up reasonably well. The more interest rate sensitive investment grade market saw the weakest returns. However, high yield credit spreads continued to tighten
- The Australian economy has performed better than expected since the onset of the pandemic and much better than some other advanced economies. In its February 2021 Statement on Monetary Policy the Reserve Bank of Australia indicated that the Australian economy had begun to recover in the second half of 2020, much earlier than expected
- A ship blocking the Suez Canal since 22 February was set free on 31 March. The blocking of the Suez Canal reduced global trade by almost $9 billion a day (12% of daily global trade).

Australian Economy

CoreLogic dwelling prices boomed +2.6% m/m in March 2021, the strongest in 33 years since 1988 (after +1.7%), to be up +6.1% y/y (after +3.9%). Prices are a record high level, and up +7% since the COVID trough in September2020. By city, Sydney is now strongest (+3.5% m/m, +5.3% y/y), but regional areas also rose further (+2.4%, +11.4% y/y). Houses remain stronger (+2.9%, +7.3% y/y), but units are also now picking up (+1.8%, +2.2% y/y). Supply is very-low, with new listings in March 25.5% below the five-year average, but demand is strong, seeing sales jump ~43% y/y, which is obviously pushing up prices.

Job vacancies increased strongly again in the February 2021 quarter by +13.7% q/q (after +23.3%), to another record high level, and rose +26.8% y/y (the fastest since 2010, after +12.0%). The RBA's preferred metric of job vacancies as a ratio of the labour force also leaped to a record high of +2.1%, which is >40% above the average since 2009. Hence, at face value this implies an exceptionally tight labour market, which is historically consistent with an unemployment rate of ~4%. Given JobKeeper just ended in March, looking ahead it is expected employment to decline by ~100k in Q2, seeing unemployment temporarily increase by ~¼%pt, or up to ½%.

Private deposits growth eased in February 2021, down by -0.3% m/m and moderating to +12.0% y/y, albeit after 12.3% y/y was the fastest since 2009. Before COVID, deposits were growing ~2½% y/y. Hence, given that since February 2020 deposits surged $242bn, this implies an extra ~$200bn was 'saved', worth ~10% of GDP, suggesting massive 'left over' stimulus to offset the 'fiscal cliff'. Looking ahead, it is assumed deposit growth to slow, seeing the household savings ratio retrace to its pre-COVID trend of 5%.

Private credit growth remains weak, up only +0.2% m/m again (UBS: +0.3%, mkt: +0.2%), and ticked down further to -1.6% y/y (after -1.7%), the slowest since 2010. Housing remains strongest (+0.4%, +3.8% y/y), driven by owner-occupiers (+0.6%, +5.9% y/y), but investors remain ~flat (+0.1%,+ 0.2% y/y). The record flow of home loans still suggests significant upside to housing credit growth, to ~6% y/y. Meanwhile, personal credit continues to contract sharply (0.5%, -12.3% y/y). Business remains ~flat (0.0% m/m, -0.2% y/y).

February retail sales fell -0.8%, slightly above the preliminary January retail sales (1.1% m/m). Employment in February rose 88.7k, ahead of UBS expectations (UBS: +30.0k, previous: +29.1k), and the unemployment rate fell to 5.8% (consensus: 6.3%, previous: 6.3%).

Consumer confidence rebounds, NAB business conditions rebounded to +15.4 in February (previous: +9.1), but business confidence rose to +16.4 (previous: +12.0). March Westpac Melbourne Institute consumer sentiment increased again, up +2.6%, after rising strongly +1.9% in February.

Global Economy

US: With more people being vaccinated and lockdown measures being eased in certain areas, the unemployment rate fell to 6% as employers took on more workers.

More than 900,000 jobs were added in March, a sharp improvement from the previous two months. While the leisure and hospitality sectors led the hiring, manufacturers also took on new staff to deal with a strong rise in orders.

Further evidence that the services sector is returning to health was reflected by the Institute for Supply Management's services index, which rose to an all-time high of 63.7 in March from 55.3 in February. Any reading above 50 indicates an expansion.

In other developments, the US$1.9 trillion relief package bill was finally signed into law by President Joe Biden. The spending bill, one of the largest in US history, includes one-off direct payments worth US$1,400 to be sent off to most Americans and an extension of jobless benefits. Laying out "the next phase" of the US Covid response, Biden unveiled a US$2 trillion plan targeted at overhauling and upgrading the nation's infrastructure as well as hastening a shift to new, cleaner energy sources.

In terms of market performance, all sectors in the S&P500 index registered gains with utilities, industrials and consumer staples leading the way. Information technology and energy were the laggards.

UK and Europe: Increasing optimism about the outlook for economic activity helped the UK equity market to end March in positive territory. Optimism was supported by the easing of Covid-19 restrictions, the continued progress on vaccine rollouts, which underpins the UK's plans to re-open the economy over the next three months, and further economic stimulus measures announced in the first half of the month. News of better-than-expected economic growth meant that the UK looks set to avoid a double dip recession. Official data showed that UK gross domestic product rose 1.3% in the final quarter of 2020, versus the previous three months, exceeding an early estimate of 1%, according to the Office for National Statistics (ONS). Further positive news came from the retail sector, which rebounded in February, according to figures released by the ONS in March, after experiencing a sharp fall in sales at the beginning of the year. Sales rose by 2.1% in February, having fallen by 8.2% in January, when the UK went into its third lockdown.

Economic data across the Eurozone region showed positive signs as the Eurozone composite PMIs (Purchasing Managers' Index) readings came in well above consensus. The surveys are typically considered a key leading economic indicator due to their strong correlation with subsequent GDP growth – a level above 50 indicates that the economy is likely to expand whilst a reading below that suggests growth will slow down. The composite index climbed back into expansionary territory after rising from 48.8 in February to 52.5 in March.

The Manufacturing component continued to impress most and reached an all-time high of 62.4 – with Germany also at a record 66.6 and France at a very strong 58.8. Strong export demand remains one of the key factors behind current manufacturing strength, as European corporates benefit from the strong rebounds in China and the US.

Inflation data released at the end of the month showed that eurozone inflation jumped to its highest level since the beginning of the pandemic. Headline inflation came in at 1.3%, driven largely by a rise in energy prices. Core inflation (excludes energy) decelerated after falling to 0.9% (1.1% in February). Some of the weakness could be lockdown-related, as for example shown in the weak pick-up in clothing prices in Italy.

Emerging Markets & Asia:

Weakness in Asia pushed emerging equity markets lower although performance elsewhere was more positive with Latin America and EMEA (Europe, Middle East and Africa) registering gains.

The performance of the Asian equity markets was mixed as investor sentiment was dampened by expectations surrounding economic policy normalisation.

Rising optimism about the outlook for global growth triggered an increase in inflation forecasts and US bond yields, and, at the same time, raised concerns that central banks would hike policy rates sooner than expected.

Within equity markets, the rise in bond yields over recent weeks continues to be closely correlated with the financial stocks' outperformance and a global rotation away from growth into value.

In Asia, major dual-listed Chinese technology stocks traded in Hong Kong came under pressure on fears that some of them could be de-listed from US stock exchanges. This followed the US Securities and Exchange Commission adopting a law called the Holding Foreign Companies Accountable Act, which was passed by the administration of former President Donald Trump.

In conclusion: The current economic growth path is expected to run through the balance of 2021 and 2022, and possibly beyond, and is expected to be accompanied by solid years of earnings growth. Markets are still, on average, tentative around the impact of firming bond yields and the potential for unanticipated inflation.

At this stage in the recovery, the view remains that while there might be some unanticipated higher reads on inflation, it is not expected that inflation will become a problem in the short to medium term such that it warrants central banks to move.

Currencies

The USD (DXY) rose by 2.58% in February. Against the USD, the Norwegian Krone (+0.63) and the Canadian Dollar (+0.37%) were the best performing currencies, while the Swedish Krona (-4.07%), New Zealand Dollar (-3.99%) and Swiss Franc (-3.97%) were relative underperformers.

Commodities

Brent Oil prices fell $2.59/bbl to $63.54/bbl, as the market awaits news about possible production cuts from the recent OPEC meeting. Iron ore prices pulled back to US$165.0/Mt, falling by US$9.0/Mt. Gold prices fell again by $51.80/oz to $1,691.05/oz.

Table 1: Market Performance – Periods to 31 March 2021

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	2.4	4.3	37.5	9.7	10.3
Australian Shares Small Cap	0.8	2.1	52.2	8.3	10.7
International Shares Ex-Aus (Unhedged)	5.2	6.5	24.1	13.8	14.3
International Shares Ex-Aus (Hedged)	4.3	6.3	51.8	13.9	14.1
Emerging Markets (Hedged)	-0.9	4.0	53.5	9.7	13.3
Emerging Markets (Unhedged)	0.1	3.7	27.7	7.1	12.7
Australian Listed Property	6.6	-0.5	44.7	7.6	5.6
International Listed Property (Unhedged)	3.9	6.1	5.6	6.9	5.4
Australian Direct Property	0.5	1.0	0.8	5.2	8.4
Australian Fixed Interest	0.8	-3.2	-1.8	4.0	3.5
International Fixed Interest (Hedged)	-0.4	-2.5	1.1	3.8	3.3
Cash (BAUBIL)	0.0	0.0	0.1	1.1	1.4
		Change over the month			
Australian Govt. 10 yr Bond Yield	1.69	+37 bps			
AUD/USD	$0.76	-$0.01			

Australian Shares (S&P/ASX 200 Accumulation Index)

The S&P/ASX 200 returned +2.4% for the month and solid +37.5% for the past 12 months.

At the sector level, performance was mixed, reflecting the rotation from the more speculative and momentum driven end of the market into good quality companies trading on attractive valuations. Consumer Discretionary (+7.0%), Utilities (+6.8%), and REITs (+6.6%) sectors outperformed. The IT sector fell -3.0% over the month and -11.3% over the quarter, with the likes of Afterpay, Xero, Appen, Altium, Megaport and Wisetech falling considerably as many investors reduced their holdings in-light of rising bond yields which significantly affect valuations.

The index finished trading at a P/BV of 2.3x and a P/E Ratio of 22.2x and equity yield (dividend) of 2.5%.

The S&P/ASX 200 VIX was at 12.06. A volatility index at relatively high levels generally implies a market expectation of very large changes in the S&P/ASX 200 over the next 30 days, while a relatively low volatility index value generally implies a market expectation of very little change.

Australian Shares Small Cap (S&P/ASX Small Ordinaries Index)

The Small Ords Accumulation Index edged +0.8% higher in March, reached an all-time high in mid-March before easing back.

Top performing stocks over the month were: Lynas Rare Earths, Codan, Sealink Travel Group, Uniti Group and Think Childcare Group. Stocks that underperformed included NRW Holdings and 4DMedical.

Trailing P/E Ratio was at 18.1x at the end of the month, P/BV is at 2.0x and equity yield (dividend) of 2.3%.

International Shares (MSCI World ex Australia Index, Net AUD and the MSCI World ex Australia Index, Net LCL)

The MSCI World ex Australia Index (Unhedged) +5.2% for March whilst the MSCI World ex Australia Index (Hedged) returned +4.3%.

Global equities advanced, supported by the roll-out of Covid-19 vaccines and news of further US fiscal stimulus. Lowly-valued parts of the market fared well, as did smaller companies.

The index finished trading at a P/BV of 3.0x and a P/E Ratio of 15.9x and equity yield (dividend) of 1.7%.

US market: The US S&P500 Index was up +4.2%, the Nasdaq up +0.4% and the Russell 1000 +3.7%.

US equities gained in Q1, despite starting uncertainly. Unusual, highly targeted trading activity saw markets rattled in January, before recovering as optimism over significant government stimulus took root.

President Biden first confirmed a fiscal stimulus package of $1.9 trillion, which was followed up with an additional promise of $2 trillion in infrastructure spending. Energy, Financials and Industrials made strong gains. Technology and Consumer Staples lagged.

For the month, all 11 sectors gained, compared with the prior month's 7 gainers and the previous month's 4. Utilities did the best for the month, adding +10.1%, making up for its prior two months of declines, as it was up 1.94% YTD. Industrials posted a strong +8.8% gain, as the economy (and production) was seen as starting to pick up; year-to-date, the sector was up +11.00. Consumer sectors continued to vary, as Consumer Staples gained +7.7% and turned positive YTD, up +0.45%—the worst sector in the index—while Consumer Discretionary gained +3.6% and was up +2.9% YTD. Financials continued up, adding +5.6% for the month, as the US Fed said big banks could start to increase dividends and buybacks in the second half of the year; year-to-date, the sector was up +15.4%. Energy, which had jumped up +21.5% last month, held its ground in March, adding +2.7% though it remained down -19.0% from the end of 2019. Information Technology posted a +1.6% gain and was the worst-performing sector for the month, though it was up +1.7% YTD and up +44.7% from the end of 2019 (the best-performing sector for that period).

UK market: UK equity market to end March in positive territory, supported by the easing of Covid-19 restrictions, the continued progress on vaccine rollouts, which underpins the UK's plans to re-open the economy over the next three months, and further economic stimulus measures announced in the first half of the month.

Further positive news came from the retail sector, which rebounded in February, according to figures released by the ONS in March, after experiencing a sharp fall in sales at the beginning of the year. Sales rose by +2.1% in February, having fallen by -8.2% in January, when the UK went into its third lockdown.

Strong gains over the month came from more defensive areas of the market (those which are less exposed to the economic cycle), such as Consumer Staples and Utilities stocks. Financials were also in positive territory after banks reported an increase in capital.

In contrast, Energy and Materials stocks underperformed the market. Energy stocks were impacted by oil prices, which experienced their steepest weekly drop since October after concerns over weaker demand put an end to the recent rally. Concerns about demand were driven by several European countries reimposing lockdowns and halting vaccination programmes, while weakness in the materials sector was driven by mining stocks.

European markets: European bourses rallied strongly driven by positive earnings announcements and a continued pick-up in economic and survey data across the region. From a sector perspective, consumer staples, communication services, consumer discretionary and materials were the best performing. No sectors returned negative although energy, health care and real estate lagged the broad market most.

Services also improved as the German index climbed back above the all-important 50 mark after rising to 50.8 (45.7 in February). However, the euro area aggregate remains in contraction territory at 48.8 (45.7 in February). Services is one of the most sensitive areas to Covid restrictions and is likely to take longest to recover.

Asian markets: The MSCI Asia ex Japan Index has performed well, despite ongoing uncertainty. Over this time the wider Asian and emerging stock markets have outperformed some other major markets like the US

However Asian emerging economies have not fared as well in handling the COVID-19. There Is still a clear difference in performance between markets. Korea and Taiwan are two of the best performing, with China not far behind. During a time when at-home tech and delivery services have been in demand, large tech businesses have done well. This includes companies SMC (Taiwan Semiconductor Manufacturing Company), Korea's Samsung Electronics, and Chinese internet platforms Alibaba and Tencent.

Areas including health care and consumer goods have also held up well. These sectors usually do well in uncertain times because they produce goods that tend to stay in demand even when the outlook for the economy is uncertain.

Emerging markets: Emerging market (EM) equities on the back of massive stimulus efforts by the US led to continued interest in cyclicals and value stocks causing the MSCI EM Value Net Total Return Index to outperform the MSCI EM Growth Net Total Return Index. The quarter was also marked by extreme volatility resulting from China ADR volatility due to US delisting concerns, the Archegos hedge fund blow up signalling hidden leverage in the system, and a deteriorating Brazilian macro and political environment to name a few.

From a sector standpoint, top performers were Materials +10.5%, Real Estate +7.3%, and Communication Services +7.0%, while the bottom performers were Healthcare -3.3%, Consumer Discretionary -1.9%, and Consumer Staples -1.5%. Strong prior year outperformers and defensive sectors were sold to rotate more into cyclicals with exception of Information Technology which has continued to perform well, up +6.1% in the quarter.

Emerging Markets Shares (MSCI Emerging Markets Index, Net AUD)

Emerging market (EM) equities (unhedged) was up +0.1% in March but down -0.9% on a hedged basis, underperforming other global indices as signs of strong US growth led to a surge in treasury yields.

The first quarter saw strong performance from commodity centric economies with oil (Brent) in particular, up +33.6% in spite of a stronger USD. Top performing countries were Chile +18.4%, Saudi Arabia +18.0), UAE +16.6%, South Africa +13.6%, and Taiwan +12.4%.

The index ended trading at a forward P/E Ratio of 19.2x and P/BV of 2.2x and equity yield (dividend) 1.8%.

Australian Listed Property (S&P/ASX 200 A-REIT Accumulation Index)

The S&P/ASX 200 Property Accumulation index returned +6.6% in March, outperforming the S&P/ASX 200, which returned +2.4%. For the past 12 months, AREITs returned +44.7%, outperforming the market, which returned +37.5%.

S&P/ASX Industrial AREITs returned +9.5% in March, S&P/ASX Office AREITs returned +8.4%, S&P/ASX Diversified AREITs returned +7.8% and S&P/ASX Retail AREITs returned +1.0%. Key outperformers were URW (+14.8%), CIP (+14.0%) and MGR (+12.1%). Key underperformers were SCG (-2.1%), VCX (+0.9%) and CQR (+3.5%).

At the end of the month the index was trading on a dividend yield of 3.6% with a P/BV 1.1x and a P/E Ratio 19.0x.

International Listed Property (FTSE EPRA/NAREIT Developed ex-Australia Index, AUD)

Globally, REITs returned +2.8% over the month of March in USD terms. The top performing region was Singapore (+4.7%) followed by US (+4.4%). The worst-performing region over the month was Hong Kong (-1.7%).

At the end of the month the index was trading on a dividend yield of 3.5% with a P/BV 1.6x and a P/E Ratio 24.7x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted +1.0% return over 3-month period to 31 March 2021. Investors should continue to see downward revaluation of the direct property sector. Capitalisation rates across property sectors continued to trend upwards. Cap rates across office, industrial and retail properties range are 5.1%, 5.3% and 5.3% respectively.

Australian Fixed Interest (Bloomberg AusBond Composite Bond Index)

Australian fixed interest returned +0.80% over the month. The Australian government 10-year bond yield declined by 9bps to 1.82% (June futures contract). At this point, the Australian 10-year Treasury bond yield was 8bps above the US 10-year Treasury yield.

3-year “single A” corporate credit spreads tightened from 0.80% to 0.76%.

International Fixed Interest (Barclays Global Aggregate TR Bond Index, Hedged to AUD)

Euro-zone 10-year bond yields fell modestly in March, but they rose significantly in the US, with the US 10-year Treasury bond yield up 30 basis points to 1.74%. The Aussie dollar moved from 77.05 US cents to 75.97 US cents.

International fixed interest returned -0.56% over the month (in AUD, as per Bloomberg Barclays' benchmark). The US corporate investment-grade (BBB) credit spread returned to its starting point at 1.19%.

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