ATCHISON
CONSULTANTS

Market Review – September 2021

Overview

- Good news is that 63% of Australia's whole population has now had at least one vaccine dose and in NSW its now 70%
- IFM warns that elevated energy prices could begin to chip away at global growth because inflation will persist if energy prices remain high
- US has more than a million job vacancies leading to wage rises and annual inflation running at more than 5%
- Expectation that US Federal Reserve will ease its purchasing of bonds with the expectation that yield will rise
- UK economy growing less than expected, recovery being squeezed by supply shortages and a jump in the cost of goods
- Inflation in the eurozone hits its highest level since 2011, 3%, German inflation rises to 4.1%, its highest level since 2008
- A standard-sized shipping container through the Panama Canal – from China to the US costs $US54,320 (A$73,935), this time last year it was $8.820
- Chinese developer Evergrande missed two bond holder payments in September and carries an extraordinary $400 billion debt, expected to impact China's property sector
- RBA Governor Lowe upbeat – but pushes back against market expectations for the start of rate hikes next year
- Australian unemployment rate fell to 4.5%, the lowest in almost 13 years but effective unemployment rate is higher at 6.3%
- Australian consumer and business confidence are proving resilient compared to last year likely reflecting more confidence that government support will work

Australian Economy

Australian economic data was mostly solid. Retail sales fell another 1.7% in August and are on track for a 5% fall in the September quarter (or slightly more in real terms), which when combined with a bigger fall in services consumption, is consistent with expectation for a 4% lockdown driven fall in September quarter GDP. However, other data was reasonably solid. Job vacancies fell nearly 10% over the three months to August but are up 46% from pre-pandemic levels.

It is predicted that the Budget deficit for 2020-21 will be lower than originally estimated, but higher for 2021-22 than planned. Thanks to a strong jobs market and higher iron ore prices, the final Federal budget deficit for 2020-21 came in at $134bn, which is good news because it is $27bn lower than forecast in the May Budget.

The deficit this financial year could come in at $120bn or more, which would be above the $107bn deficit projected in the May Budget.

Home building approvals rose over the quarter and while they are well down from their HomeBuilder subsidy high point, they remain historically high and point to solid home building for the remainder of this year.

Credit growth was stronger than expected, with annualised growth in housing credit remaining above 7%. While housing finance fell 4.3% in August with owner occupier finance down but investor finance up, this is consistent with the slowdown in sales in lockdown- likely to rebound once lockdowns end. Housing finance remains near record highs, pointing to continued solid credit growth. Meanwhile first home buyers are continuing to lose out again, relative to investors. National average dwelling prices rose another 1.5% in September, leaving them up 20.3% on a year ago, which is their fastest annual pace since 1989.

Houses prices across Australia surged 20.3% in the past year, the fastest growth in more than three decades. Sydney house prices have surged 28.9% in the past 12 months to a median price of $1.31 million. Hobart is leading the charge at 26.8%, followed by Canberra at 24.4% and Darwin at 20.2%. Brisbane, Adelaide, and Perth notched 19.9%, 19.1% and 18.1% respectively. The average owner-occupier loan in NSW rose to a record high in August with the average owner-occupier loan in NSW being $732,000 and $599,000 in Victoria.

Global Economy

US: The third quarter of 2021 is likely to go down as one for investors to largely forget. Not because markets were particularly bad, but because not much changed between the start and the end of the period.

Mostly strong US activity data, put a breather for the US Federal Reserve on inflation. Retail sales rebounded, regional business conditions and small business confidence rose as did industrial production. CPI inflation came in weaker than expected in August as price increases in reopening sectors reversed putting paid to a September taper announcement. However, tapering is still on track for later this year as supply bottlenecks remain, price components in business surveys remain very high and median inflation has been edging up.

US economic data was mostly strong. September’s services ISM surprisingly rose to 61.9. US payrolls only rose by 194,000 in September but the details in the jobs report were solid with private payrolls up by 317,000, previous months revised up by 169,000, household employment up by 526,000, unemployment down to 4.8%, permanent unemployment down and private hours worked up by 0.8%.

What is more the ending of enhanced unemployment benefits and falling new COVID-19 cases point to an increased workforce ahead and business and consumer surveys continue to indicate a strong jobs market. So, on balance the US Fed is likely to regard this as meeting US Federal Reserve Chair Powell’s “reasonably good” employment report test and so the Fed is still likely to proceed with its tapering program commencing in November.

UK and Europe: Latest figures from the UK Office for National Statistics (ONS) showed that the UK economic rebound has stalled. Newly released July data indicated that output grew by 0.1% compared to June and lower than the 0.6% forecasted by economists. Consumers generally spent less, and the construction sector contracted, for the fourth consecutive month, due to a shortage of raw materials. However, rises in IT, financial services, outdoor events and a large expansion in mining and quarrying stopped the economy from shrinking.

UK unemployment fell to 4.6% in the three months to July, whilst the number of job vacancies was above 1m for the first time on record. Inflation in August jumped to 3.2% which is the highest level since 2012. The main drivers of the increase were food, transport, recreation, furniture, and restaurant prices.

Economists expect inflation to remain high this year, with gas and electricity prices rising in the autumn because of wholesale price increases. This coupled with value added tax going back up, has led to some economists predicting inflation will breach 4% over the winter.

Eurozone consumer activity returned to pre-pandemic levels. Shopping, eating out, travel and cinema visits all increased in a sign of returning consumer confidence across the eurozone. Some of the rebound is due to children returning to school and workers back in offices. This is reflected in use of airports and domestic public transport in the eurozone, which both reached their highest level since the start of the pandemic in early 2020.

German inflation hit 4.1% in September, an increase of 0.7% from August and its highest level for 29 years. In Spain, inflation hit a 13-year-high of 4% and French inflation data showed a decade-high of 2.7%. This has led to increasing debates about whether the surge in prices is temporary or structural, with the European Central Bank now slowing down the pace of net asset purchases under its pandemic emergency purchase program.

Emerging Markets & Asia: Emerging Markets have underperformed developed markets equities in 2021. China accounts for the bulk of the underperformance, whose stock market fell over 18% during the quarter. Confidence in the Chinese stock market has been knocked by the news surrounding Evergrande – one of China's largest property developers. It is struggling to pay interest due on its mammoth $300bn debt and many investors are wary of the potential for the company to collapse and the knock-on impact that could have. These worries also spilled over into the broader Asia Pacific and emerging markets, which also declined.

The Evergrande situation is expected to impact China's property sector, with further potential risk in the banking sector. There has been a material negative impact on homebuyer sentiment, with concerns surrounding developers' capacity to complete projects. This resulted in a sell-off of developer bonds. Risks exist for the banking sector should Evergrande liquidate.

In EMEA, Russia and Saudi Arabia were up on rising energy prices. Brent Crude oil rose above US$80 per barrel in September owing to a large supply-demand deficit as global demand continues to recover faster than expected. Additionally, the improvement in Russian fiscal balances should reduce the risks of further tax hikes in 2022-2023. South Africa fell -4.8% despite activity rebounding in recent weeks. In Latin America, Brazil declined -13.0% on the back of a convoluted political scenario, double-digit inflation and risks stemming from China impacting commodities.

In conclusion: The global economic recovery remains in full swing, though its pace is set to moderate in the second half of the year as the major economies move past (sequential) peak growth. Overall, there appears to be a positive economic outlook, despite new uncertainties around the path to normalisation created by the rapid spread of the Delta variant. In addition, the global economy is facing increasing headwinds from supply chain disruptions. However, it is expected that these headwinds are mostly transitory and will eventually abate without derailing the economic recovery in advanced economies.

Currencies

The USD continued to grow stronger against the AUD. This was due to a combination of stronger economic conditions overseas, the continued impact of lockdowns, as well as weaker Chinese data leading to further fall in commodities such as iron ore. The AUD/USD rate closed at 72.27 US cents, a -1.2% depreciation against USD.

Commodities

Brent Oil prices rose $6/bbl to $79/bbl, overcoming considerable headwinds such as COVID-19 Delta strain concerns. Iron ore prices collapsed from $US247/Mt to $US110$/ Mt, off the back of slowing China crude steel demand, down ~3% m/m. Interestingly, Gold prices saw a material drop, falling by $72/oz to $1,742/oz. This could be driven by a strengthening US Dollar, which could make Gold less attractive investment for global buyers and undercut demand.

Table 1: Market Performance – Periods to 30 September 2021

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	-1.9	1.7	30.6	9.7	10.4
Australian Shares Small Cap	-2.1	3.4	30.4	9.4	10.2
International Shares Ex-Aus (Unhedged)	-3.0	3.9	27.8	13.2	15.1
International Shares Ex-Aus (Hedged)	-3.7	0.6	28.3	11.6	13.4
Emerging Markets (Hedged)	-2.8	-6.6	17.2	9.8	10.8
Emerging Markets (Unhedged)	-2.8	-4.4	17.7	9.0	10.9
Australian Listed Property	-2.2	4.2	29.9	8.6	7.1
International Listed Property (Unhedged)	-1.3	2.1	25.2	1.5	2.8
Australian Direct Property	1.5	2.2	6.4	4.2	7.7
Australian Fixed Interest	-1.5	0.3	-1.5	4.1	3.1
International Fixed Interest (Hedged)	-0.6	3.0	-1.7	4.3	3.2
Cash (BAUBIL)	0.0	0.0	0.0	0.8	1.2
		Change over the month			
Australian Govt. 10 yr Bond Yield	1.28	+36 bps			
AUD/USD	$0.72	-$0.01			

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

The S&P/ASX 200 returned -1.9% for the month but still managed to grow +1.7% for the quarter.

On the back of rising inflation, the cyclical Energy (+16.7%), Utilities (+2.5%), and Financials (+1.6%) sectors outperformed in Australia. The sectors which underperformed the most were the Materials sector (-9.3%), Health Care (-4.9%) and Information Technology (-3.9%).

Base and battery metals rose the most emanating from the electrification and decarbonisation metals sector such as Lithium Carbonate, Lithium Spodumene and Cobalt. The demand for these metals on the back of electric vehicle and battery developments may maintain the Australian metals super-cycle going into the future.

The index finished trading at a P/BV of 2.4x and a P/E Ratio of 17.9x and equity yield (dividend) of 3.3%.

The S&P/ASX 200 VIX was at 12.6. 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 dropped -2.1% for the month and up +3.4% for the quarter.

A confluence of factors during the quarter lead to increased volatility and selling pressure in global equity markets. Stocks that lead the index were Predictive Recovery, Atomo Diagnostics, Liontown Resources and Mad Paws. Stocks that underperformed included Global Health and Lumos Diagnostics.

Trailing P/E Ratio was at 15.5x at the end of the month, P/BV is at 2.2x and equity yield (dividend) of 2.1%.

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) -3.0% for September whilst the MSCI World ex Australia Index (Hedged) returned -3.7%. Over the quarter the unhedged index returned +3.9% against the hedged +0.6%.

Global equities retreated in the month of September largely driven by news that large Chinese property developer Evergrande could default on its outstanding debt, as well as concerns on whether US Congress would be passing a bill to raise its current debt ceiling.

The index finished trading at a P/BV of 3.1x and a P/E Ratio of 21.3x and equity yield (dividend) of 1.7%.

US market: For the month of September the US S&P500 Index was down -3.6%, the Nasdaq returned -4.6% and the Russell 1000 -4.7%.

Strong earnings had lifted US stocks in the run up to August, when the US Federal Reserve (Fed) seemed to strike a dovish tone, confirming its hesitance to tighten policy too fast. However, growth and inflation concern late in the quarter meant US equities retraced their steps in September.

The US Fed stated in September that tapering of quantitative easing (i.e., a slowdown in the pace of asset purchases) will be announced at the November meeting, as expected, and will finish by mid-2022. Meanwhile, the fed funds rate projections now show a faster rate hiking schedule than they did in June. The median rate expectation for 2023 moved up to three hikes from two in June, with three additional hikes in 2024. Fed officials were evenly split 9-9 on a rate hike in 2022.

On a sector basis, financials and utilities outperformed. At the other end of the spectrum, industrials and materials struggled, although September's sell-off hit almost all sectors. Energy was an exception, rising as supply constraints drove prices to highs – particularly Brent crude.

UK market: UK equities rose over Q3 with the market driven by a variety of factors. While there were some clear sector winners (such as energy on the back of a recovery in crude oil prices) the difference between the best and worst-performing stocks, or dispersion, was quite marked. Within consumer staples, for instance, some of the more highly valued consumer goods companies performed poorly, while the more-lowly valued grocery retailers performed well.

Merger & Acquisition (M&A) activity remained an important theme. The period began with a recommended counteroffer for Wm Morrison Supermarkets and bid activity was seen across a variety of areas. Gaming remained an area of interest, with a proposal from US sports betting group DraftKings to acquire Entain. Within industrials there was headline-grabbing bid for aerospace and defence equipment supplier Meggitt.

Small and mid-cap (SMID) equities suffered in line with higher growth areas of the market more generally in September but performed very well over the quarter. SMID caps remained a sweet spot for M&A activity and made a useful contribution to overall market returns.

European markets: Eurozone equities were flat in Q3. The energy sector was one of the strongest performers, as was information technology with semiconductor-related stocks seeing a robust advance. Consumer discretionary stocks were among the weakest for the quarter, with luxury goods companies under pressure amid suggestions that China could seek greater wealth redistribution, which could hit demand.

The quarter had started with gains amid a positive Q2 earnings season and ongoing economic recovery from the pandemic. The Delta variant of Covid-19 continued to spread but most large eurozone countries have now fully vaccinated around 75% of their population against the virus, enabling many restrictions on travel and other activities to be lifted.

However, as the period progressed, worries emerged over inflation due to supply chain bottlenecks and rising energy prices. Annual inflation in the eurozone was estimated at 3.4% in September, up from 3.0% in August and 2.2% in July. The European Central Bank said that it would tolerate any moderate and transitory overshoot of its 2.0% inflation target.

Japanese market: The Japanese equity market traded in a range through July and August before rising in September to record a total return of 5.2% for the quarter. The yen showed little trend against the US dollar for most of the period before weakening at the very end of September to reach its lowest level since the start of the pandemic in early 2020.

Throughout the pandemic, Japan has consistently seen a lower infection rate than most developed countries but faced a much more serious test during early summer as infections picked up rapidly. Public opposition towards the government's approach ratcheted up again and the approval rate for the Suga cabinet fell to the lowest levels seen since he took office in September 2020.

Asian (ex-Japan) markets: Asia ex Japan equities recorded a sharply negative return in the third quarter, largely driven by a significant sell off in China. This was partially due to concerns over the ability of property group Evergrande to service its debts. The Evergrande situation sparked global investor concerns over potential spill over risks.

Market concerns over inflation and the outlook for interest rates also dampened investor confidence during the quarter. China was the worst-performing index market, with sentiment towards the country also weakened by the government's regulatory crackdown affecting the education and technology sectors. Power outages in China and the rationing of energy also spooked investors, hurting production of key commodities. The downside risks in China have significantly increased against a backdrop of slowing economic activity and concerns that recent regulatory policies will further weigh on growth.

Pakistan was also sharply weaker as ongoing political upheaval in neighbouring Afghanistan weakened investor sentiment towards the country, with fears that violence and unrest could spill over into Pakistan. Hong Kong and South Korea followed China lower, with both markets sharply lower as market jitters over China spilled out into the wider region.

India was the best-performing index market during the quarter and achieved a strongly positive performance as accommodative monetary policy and the easing of Covid-19 restrictions boosted investor sentiment. Indonesia also achieved a positive return. Singapore was almost unchanged, while declines in Taiwan and the Philippines were modest compared with the falls seen in other index markets.

Emerging markets: Emerging market (EM) equities declined in Q3, which saw a sell-off in Chinese stocks, concern over continued supply chain disruptions, and worries over the implications of higher food and energy prices for some markets. US bond yields rose towards the end of the quarter.

Brazil was the weakest market in the MSCI EM index as above-target inflation continued to rise and the central bank responded with further interest rate hikes. South Korea also posted a double-digit fall amid falling prices of dynamic random access memory chips (DRAM) price and concerns over the impact of power issues in China on production and supply chains. Weaker industrial metals prices also weighed on performance of net exporter markets Peru and Chile.

By contrast, net energy exporters in general outperformed, most notably Colombia, Russia, Kuwait, Saudi Arabia, Qatar, and the UAE. India delivered a strong gain, with sentiment boosted in part by the recent stream of initial public offerings. The economy continued to recover while vaccinations picked up – India is now on track to deliver at least one dose to 70% of its population by November.

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

The gains made by emerging markets (EM) equities in the latter half of August were undone in September. Emerging market (EM) equities (unhedged) was up +0.1% in September but down -0.9% on a hedged basis. ,

Areas of concern across many emerging economies remained largely focused on supply chain disruptions and the second order effects of higher food and energy prices through these economies. The China A equities saw a sharp decline of 7.9% (or 10.9% in local currency terms) over the quarter. Indian equities increased their bull run further (albeit at a slower pace), currently up by more than 25% year-to-date. Latin American equities were weak, with Brazil and Argentina the largest underperformers and Colombia the standout outperformer as the only country to post positive returns despite their year-on-year inflation figure, the CPI (Core Price Index), coming in higher than market expectations.

The index ended trading at a forward P/E Ratio of 9.3x and P/BV of 2.1x and equity yield (dividend) 2.2%.

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

The S&P/ASX 200 Property Accumulation index returned -2.2% in September underperforming the S&P/ASX 200 which returned -1.9%. The index was up +4.2% quarter. For the past 12 months rolling, A-REITs returned +29.9%, underperforming the market, which returned +30.6%.

S&P/ASX Retail AREITs returned +1.8% in September, S&P/ASX Office AREITs returned -0.1%, S&P/ASX Diversified AREITs returned -2.0% and S&P/ASX Industrial AREITs returned -6.2%. Key outperformers were CQR (+5.0%), SCG (+4.9%) and GPT (+4.5%). Key underperformers were URW (-12.3%), CMW (-11.3%) and GMG (-6.3%).

At the end of the month the index was trading on a dividend yield of 3.8% with a P/BV 1.2x and a P/E Ratio 11.6x.

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

Globally, REITs returned -1.3% over the month of September and +2.1% for the quarter. The top performing region was once again Singapore (+0.1%) followed by Australia (-0.8%). The worst-performing region over the month was Continental Europe (-10.1%).

At the end of the month the index was trading on a dividend yield of 3.1% with a P/BV 1.7x and a P/E Ratio 23.5x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted +2.2% return over 3-month period to 30 September 2021. Capitalisation rates across property sectors continued to trend upwards. Cap rates across CBD office, industrial and regional retail properties range are 5.1%, 4.2% and 5.3% respectively.

Australian Fixed Interest (Bloomberg AusBond Composite Bond Index)

Australian fixed interest returned -1.51% over the month but marginally up +0.3% for the quarter. The Australian government 10-year bond yield jumped 38bps to 1.52% (December futures contract) (June: 1.54%, September futures). At this point, the Australian 10-year Treasury bond yield was 3bps above the US 10-year Treasury yield.

3-year "single A" corporate credit spreads widened from 0.55% to 0.65%. (End of June: 0.47%).

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

Euro-zone 10-year bond yields rose moderately (Germany, France up 19bps each to -0.20% and +0.16% respectively. June: -0.21%, +0.13%) while the US 10-year Treasury bond yield increased by 18bps to 1.49% (June: 1.47%). The Aussie dollar moved from 75.97 US cents to 72.27 US cents.

International fixed interest returned -0.6% over the month (in AUD, as per Bloomberg Barclays' benchmark). (July: 1.31%, August: -0.24%) and +3.0% for the quarter.

The US corporate investment-grade (BBB) credit spread tightened by 4bps to 1.10%. (June: 1.07%).

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