ATCHISON
CONSULTANTS

July 2021

Market Commentary Financial Year Ended 30 June 2021

Remarkable Returns from Equity Markets Drive Superannuation Fund Returns in FY21

2020-21 (FY21) Financial Year COVD-19, lockdowns and vaccinations could not deter the Australian financial market from posting another solid year and providing members of superannuation funds with stellar returns. As we reflect on the financial year, the month of June 2021 is the twelfth month in a row we have seen positive results for the median balanced fund and double-digit returns for the year ending 30 June 2021.

As in past years, markets had to contend with a range of geopolitical issues, some new while others like Brexit were all too familiar. The US Presidential election in November 2020 was a major focus for markets. The strong performance of the US economy at the beginning of the year was expected to favour the incumbent President Trump. However, the economic damage caused by COVID-19 and the indifferent and inadequate response by the Trump administration to the worsening health crisis enabled the Democratic nominee Joe Biden to win the Presidency with most Electoral College votes.

The Brexit saga continued to unfold through the year. After securing parliamentary agreement early in 2020 for the withdrawal, the terms of Britain's exit from the EU were finally agreed between Brussels and London and ratified just days before the 31 December deadline. While the agreement means there will be no tariffs or quotas imposed on trade between Britain and the EU from 1 January 2021, the terms of the 1,200+ page agreement which cover living, working, trade and a multitude of issues between them are complex and may present unexpected challenges ahead.

A concerning development over FY21 was the deteriorating diplomatic and trade relationship with China, Australia's largest trading partner and destination for approximately a third of Australia's total exports. Several issues over an extended period have contributed to the growing tension, including banning Huawei from tendering for the 5G mobile network, introducing "foreign interference laws" on national security grounds, Australia speaking out on the South China Sea and human rights issues in China and the call for an inquiry into the origins of the coronavirus pandemic. China imposed high tariffs or import restrictions on a range of Australian agricultural and food exports such as barley, beef, and wine and, more recently coal. Exports of iron ore to China have not been affected so far as it is a commodity that is crucial to China's ongoing infrastructure development and supply of iron ore from Brazil remains limited. Should this change, the impact on Australia's economy, government revenue, share market and currency would be significant.

Looking back, following the economic downturn in the June 2020 quarter global economic conditions started to improve on the back of moderating COVID infection rates that allowed many economies to gradually re-open and relax social mobility restrictions. In the US, roughly half of the 22 million jobs that were lost in March and April 2020 were regained by year end. After peaking at 14.7%, the US unemployment ended the calendar year 2020 much lower at 6.7%. China's economy rebounded strongly following massive fiscal and monetary stimulus that enabled China's industrial production to grow 6.9% in the year, which was a remarkable recovery from the -13.5% fall in January and February 2020. Compared to other countries, Australia was fortunate. Despite the economic impact caused by Victoria's infection outbreaks, consumer confidence was above pre-COVID-19 levels and unemployment fell to around 6.8%.

Level 3, 155 Queen Street, Melbourne VIC 3000 ABN: 58 097 703 047 AFSL Number: 230846
enquiries@atchison.com.au www.atchison.com.au P: +61 3 9642 3835 F: +61 3 9642 8886

Market confidence at the beginning of the second half of the financial year received further boost when encouraging vaccine trial results were announced by Pfizer, Modena, and AstraZeneca. These encouraging tests helped global sharemarkets to continue-on their upward trajectory, outweighing the concerns caused by the acceleration in new virus infections across the world, especially Europe, the UK, India, and Japan.

Australian shares returned +12.9% for the six months to 30 June 2021 and +27.8% in FY21, relatively modest when compared to US equities +42.5%, Japan +28.9% and Europe +27.3%. For Australian investors seeking income, dividends only made up a sliver of returns in FY21 due to COVID-19 induced uncertainty, providing the lowest level of income returns since 1987 for Australian shares.

FY21 witnessed a residential market on fire. House values in Sydney are up around +15% for the year, Only the Canadian Pacific coast city of Vancouver has experienced a sharper rise. Sydney's median value is around $1.2 million while Melbourne is at $908,000. Smaller capital markets such as Hobart, Darwin and Canberra have seen increases in value over FY21 rise +11%. It is not only Australian homebuyers facing a tough market. Property prices around the world have surged on the back of ultra-cheap interest rates and stimulus put in place to deal with the COVID pandemic. US was up +13%, and Canada +23%, which leaves Central Banks around the world having to consider tentatively lifting interest rates in the future, which means cash and bank deposits are likely to continue to provide low returns.

Superannuation funds finished FY21 on a high, a typical diversified balanced portfolio with an allocation between 61% to 80% growth assets is expected to deliver on average a return of around +18% for the financial year, the second highest figure since 1992.

Australian Markets

The Australian sharemarket capped its best financial year in more than 30 years, with shares rebounding after a poor start to the year. The S&P/ASX 200 Accumulation Index (including the benefit of dividends) returned +27.8% in FY21, its best financial year performance since 1987.

The rally of the last year was dominated by the swift recovery from COVID-19 induced sell-off the market had suffered during early months of calendar 2020, activated by record levels of central bank and government spending.

While growth stocks (such as the Technology sector) led the recovery at the start of the year, the market pivoted sharply to value stocks (such as Financials/Banks) in November, which allowed the market to surpass its pre-COVID-19 levels and hit a record high in May. Over FY21 Australian value-returned +39.2% compared to growth's +15.7%.

Australia's Consumer Discretionary sector outperformed over FY21 rising +42.6% over the year, ahead of Information Technology +38.9% and the Financials sector +35.7%.

The four major banks and the three major iron ore miners were responsible for more than 50% of the gains on the local sharemarket in the last 12 months, boosted by a rapid recovery in both the Australian and Chinese economies.

Commonwealth Bank led the gains, rising +49% in FY21, rallying alongside an improving economic outlook. Westpac advanced +49.9%, ANZ firmed +60.2% and NAB added +49.6%.

China's demand for steel pushed iron ore prices to their highest level on record, boosting the major miners, which are set to pay record dividends in the August earnings season.

BHP Group climbed +42.4%, Rio Tinto +37.9%, Fortesque Metals Group +90.2% and South32 closed the year +46% higher.

Other blue-chip stocks that performed well FY21 were Wesfarmers+37.2%, Macquarie Group +36.4%, Woolworths +23.9% and Telstra +26.5%.

Afterpay had another extraordinarily strong financial year, breaking into the S&P/ASX 20, driven by strong growth, particularly in the US, up +93.8% in FY21.

The new financial year is expected to be a bumpy ride dominated by lockdowns across the states, disrupting the recovery, particularly for small businesses. However, providing the lockdowns are relatively short, the experience of the eight or so snap lockdowns seen since last November, is that economic activity is largely pent up or delayed through the lockdown and then bounces back relatively quickly on reopening.

Global Markets

The best description for the financial year of FY21 is 'a tale of two halves.' The year began with justified despair and fear over the outcomes from COVID-19 and has ended with near-euphoria in equity markets. Global shares as represented by the MSCI World ex Australia (with net dividends reinvested) Index for FY21 returned +28.1% on an unhedged basis while the hedged return of +37.7% was due to the strength of the Australian dollar against the world's major currencies.

In the second half of the financial year, we experienced significant asset price appreciation and liquidity stemming from record low interest rates, record government welfare payments, vast asset buying, record residential house prices, robust bounce-back in construction activity and high confidence levels from consumers as well as businesses. The rally in global equities was fuelled by a stellar year from the Technology sector, which was the largest contributor to gains, returning +45.5%, closely followed by Financials +45.3%. The Financial sector was supported by a lift in bond yields and a rotation out of growth stocks into the battered value sectors.

Global value stocks marginally outperformed growth, with the MSCI Value Index returning +41.5% compared to the MSCI Growth's +37.8%.

Wall Street hosted some of the best performing stocks in FY21. The S&P 500, which tracks 500 of the largest companies listed in the US returned +40.8% outperforming the Australian sharemarket by +13%.

Other equity markets were not far behind the US in FY21, Japan's Nikkei 225 Index returned +31.3%, Europe 350 Index returned +29.5% and the MSCI Emerging Markets Index provided investors with a stellar return of +38.7% for the year.

Economists and business owners alike have been astounded by how quick the global recovery from COVID-19 has been, with only a few exceptions. The scale of the fiscal (government spending and tax policies) response from governments around the world has been unparalleled, including Australia's splurge with the Federal budget in May. For the last few decades policy makers primarily relied on monetary policy (control of money supply and interest rates) to stimulate economies during a downturn. But this time, with interest rates rapidly hitting or nearing their "zero lower bound", governments have played the primary role by

making fiscal transfers to those most impacted. This has led to household income, savings and spending moving to a better position than pre-COVID-19. The danger is that markets start pricing in some companies as if their super profits will be permanent.

Australian and International Property

Returns from Australian listed property trusts (A-REITs) market surpassed Australian sharemarket returns, up+33.2% for FY21 outperforming the Australian share market by +5.4%.

Globally Real Estate Investment Trusts (G-REITs) also had a strong rebound from FY20 returning +31.6% (US$ terms) for 12 months to June 2021.

Cash, Fixed Interest and Corporate Bonds

The RBA lowered the cash rate only once during FY21 from 0.25% to 0.10% (in November 2020), which is at a historic low to support lending and employment. It is likely that the RBA will stop at 0.1% and patiently gradually move interest rates up as the Australian economy continues to improve.

The market-determined 90-day bank bill rate fell from highs near 0.1056% in July 2020 to record lows of 0.0097% in February and yields ended FY21 at 0.0303%.

Yields on Australian long bonds – 10-year government bond – held in a range of 0.75% to 1.85% over FY21 and ended the year at 1.48%. The lowest yield was set on November 5, 2020.

Global bond yields over FY21 retraced from previously elevated levels, with the 10-year government bond yield finishing at 1.44%. The retracement appears to be a normalisation after significant rises in previous months on the back of a high inflation environment and strong business conditions.

The US Federal Reserve maintained the asset purchasing program during FY21 to keep yields down and corporate bond spreads tight to continue to promote accommodative financial conditions.

Australian Dollar (AUD) Exchange Rate

The Australian Dollar traded sideways for much of FY21 reaching US80 cents at the end of February before falling back and trading in a two-cent range for most of the year. The lacklustre performance of the AUD comes in contrast to stocks and commodities. The AUD finished FY21 near US$75 cents, supported by solid economic data, rising commodity prices (especially iron ore) and improved risk sentiment on the global economy.

Outlook

The economic outlook will clearly be dictated by the virus and its variants, and how quickly the vaccine can stem the case numbers and allow economies to start repairing.

Over the last several months, public health data have indicated that the global pandemic measured by number of cases, has likely peaked in the second quarter of 2021. With the pandemic receding, governments in the developed market have started to indicate that policy support is also likely to have peaked and tighter financial conditions are to be expected leading to the slowing in the growth of credit. Tighter financial conditions will impact growth to varying degrees across industries and across regions and may result in a somewhat desynchronised developed market growth rebound in FY22.

The resilience of the Australian economy continues to surprise, reinforced by the strength of the job market. The latest data shows that a stunning 115,200 jobs were created in just the month of May. Employment is back at record highs – recovering from the pandemic losses – in-fact it is one of only a few economies to have achieved that feat. Reduction in the jobless rate is regarded as a "national priority". There seems to be scope for unemployment to fall further. This is important in terms of the spending power of the newly employed, but also the boost to confidence of those people on jobs.

While the annual rate of headline inflation (CPI) is expected to spike from 3% to 3.5% in the June quarter, underlying inflation (excluding items that have particularly unrelated large price changes) is expected to remain below the Reserve Bank of Australia (RBA) 2% to 3% target band. Still, underlying inflation is expected to gradually lift to 1.8% by the end of 2021 and possibly 2.2% by the end of 2022.

Shares are expected to remain vulnerable to short-term correction with possible triggers being an inflation scare and US Federal Reserve adjusting the pace of asset purchase i.e., reducing the US$120 billion or so of bond buys it makes each month. However, a combination of improving global growth and earnings (as the world moves out of the COVID pandemic) assisted by tax stimulants and real interest rates remaining low bodes well for shares.

Commercial property and infrastructure assets should benefit from investors chasing yield however yields may remain somewhat subdued due to low demand, especially office space.

However, a movement up from the current ultra-low yields has the potential to result in capital losses from rising bond yields, likely to result in negative returns from bonds over the next 12 months.

Cash and bank deposits over FY22 will continue to provide very-low returns, starting from the ultra-low cash rate of 0.1%. It is unlikely that the RBA will commence increasing the cash rate until actual inflation is sustainably within 2% to 3% target range, which is not expected to be before 2023.

The AUD is deemed to be prone to rises and falls with the price and demand for commodities such as iron ore, coupled with a suggestion on the direction of Australian interest rates. The currency is therefore expected to remain supported by the strength of the global economy.

A theme that is garnering traction and is expected to be a principal topic in the future revolves around climate and social equity calls to action, which may add a new dimension to government policy making, regulatory disclosures, capital creation, sustainable investment, and potential market adjustments. Global policy makers and business leaders are looking at formulating tangible and lasting progress by incorporating Environmental, Social and (Corporate) Governance (ESG) objectives for the betterment of society that will also overtime be reflected in the performance of certain regions, asset classes, sectors, and industries.

Contact Details

To obtain further information, please contact Atchison Consultants.

Jake Jodlowski
Principal
Atchison Consultants
Phone: +61 3 9642 3835
Email: jake.jodlowski@atchison.com.au

Alex Wong
Senior Investment Analyst
Atchison Consultants
Phone: +61 3 9642 3835
Email: alex.wong@atchison.com.au