Client Newsletter

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Summary of Key Views

Markets continued their upward trajectory in May with strong returns across most equity markets. The so called Covid reflation trade continued as global economic growth bounced back ahead of market expectations. The risk of inflation remains a focal point as both monetary and fiscal policy around the globe remains supportive of growth. Inflation expectations particularly within the US have risen reflected in rising bond yields. Modest inflation is generally positive for equities, however a sharp rise in inflation would be negative particularly for growth equities and interest rate sensitive assets as such as government bonds. Our expectation is that we will likely see the reflation trade continue for the coming months, however that broader structural deflationary pressures remain including the continue impact technology is having on industries and the aging population in many developed economies.

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Market developments during April 2021 included:

Australian Equities

The rotation out of growth and into value sectors has been the key theme through 2021 as the economic recovery materialises, underpinned by a lower unemployment rate. Unless some unforeseen tail risk event occurs, it is expected that business and consumer confidence will rise, providing a clear indication of 'normal' conditions returning in the not-too-distant future. In recent stock related news, JB Hi-Fi reported 3Q21 total sales growth of 10.4% in Australia, 16.0% in New Zealand, and 5.8% in The Good Guys. Sales growth slowed in February and March, but the company noted that it started to cycle elevated sales growth from mid-March.

Afterpay reported 3Q21 underlying sales growth of 104% on the prior corresponding period, reflecting strong operating performance across all regions. The US was the highlight, becoming the first region to record more than $1 billion in underlying sales in a single month. Given the US market is now its largest contributor, Afterpay is currently engaging external advisors to explore options for a dual listing in the US. Woolworths provided its 3Q21 sales results, with group sales up 0.4% on the prior corresponding period.

Global Equities

The broadening of the recovery in equities globally would suggest that the market anticipates a successful global inoculation drive and a potential reopening of borders. Valuations have moderated through the start of 2021 but remain at elevated levels, while sources of yield across both equities and fixed income remain constrained. The US S&P 500 rose 3.5% over April as optimism about corporate earnings offset concerns regarding rising Covid-19 infections. Facebook reported better than expected 1Q21 results, with revenue jumping 48% on the prior corresponding period to US$26.17 billion, driven by a 30% year-on-year increase in the average price per ad and a 12% increase in the number of ads delivered. Alphabet (Google) also beat the market's expectations, reporting a rise in revenue of 34% to US$55.31 billion, boosted by a surge in advertising revenues.

The rise in European equities and optimistic economic data came despite a sluggish vaccine rollout and fears of a third wave of the virus across much of the eurozone, sparking tighter restrictions. Developed market shares rose 3.2% in April while emerging markets were softer, rising 1.1% in Australian dollar terms, but are still outperforming developed markets over 12 months.

Fixed Interest

Sovereign bond yields steadied in April after pushing higher earlier in the year due to the positive news on vaccines and the additional fiscal stimulus announced in the US. The Australian sovereign yield curve has steepened since the end of 2020, reflected in the spread between the 10-year and 2-year government bond yields, which has risen from 90 basis points at the end of December to 158 basis points at the end of April. While a rise in yields is potentially a welcome sign for economic conditions ahead, the inverse is that they also represent higher borrowing costs for market participants such as corporations and governments. While the RBA has noted the rise in the 'long end' of the yield curve, their announcements have indicated a firm stance in relation to the official cash rate remaining at its current level until a sustained rise in inflation. The RBA has briefly acknowledged a temporary rise in inflation "due to reversals in some Covid-19 related price reductions", however they note that "underlying inflation is expected to remain below 2 percent over the next few years". Other markets—including the US, UK, and Europe—have seen similar yield curve steepening over 2021. The US Federal Reserve has also acknowledged a potential temporary rise in US inflation and a continued willingness to tolerate overshoots of their target.

REITs (listed property securities)

Australian listed property had a positive month but struggled compared to other sectors as major retail REITs Vicinity Centres (-4.2%) and Scentre Group (-3.6%) dragged on the index. Charter Hall (+8.7%) led the pack in April, advising that it expects post-tax operating earnings per security to increase more than 57 cents, or 6% compared to FY20, noting that there is no material change to current trading conditions. Charter Hall's $1.5 billion office development on Collins Street in Melbourne's CBD will be Amazon's new Victorian home as the company expands its Australian presence.

Unibail-Rodamco-Westfield provided a 1Q21 update, with Covid-19 restrictions continuing to impact centres. Proportionate Gross Rental Income (GRI) fell 33.4% in the quarter with 42 days of closures versus 13 days in the prior period. Australia’s residential housing market was in focus again given the pace of house price rises, especially in Sydney and Melbourne. March house prices rose 2.8% month-over-month across Australia’s eight capital cities, and February building approvals were up a dramatic 21.6% month-on-month, supported by the HomeBuilder scheme. In the US, February’s S&P/Case-Shiller Home Price Index posted a 1.2% rise, with year-on-year growth in the index coming in ahead of expectations at 11.9%.

Alternatives

Preliminary estimates for April indicate that the index increased by 3.1 per cent (on a monthly average basis) in SDR terms, after increasing by 2.8 per cent in March (revised). The rural, non-rural and base metals sub-indices all increased in the month. In Australian dollar terms, the index increased by 3.4 per cent in April.

Over the past year, the index has increased by 34.7 per cent in SDR terms, led by higher iron ore prices. The index has increased by 15.4 per cent in Australian dollar terms.