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Summary of Key Views

Markets buoyed by Covid reflation trade

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 continued to be positive. 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 with the most recent inflation data indicating a significant jump in CPI. 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. We expect to see inflation pressures grow, however as we see global supply/demand dynamics normalise as economies open up from their Covid lockdowns inflationary pressures are expected to ease.

Market developments during May 2021 included:

Australian Equities

May saw a continuation of the broad cyclical value rotation we have experienced over the last few months, with the Financials and Consumer Discretionary sectors among the strongest over the month. Index heavyweight CBA released its 3Q21 trading update in May, highlighting unaudited Cash NPAT of ~2.4 billion in the quarter, an increase of 24% on the 1H21 quarterly average. Loan impairment expenses were significantly lower in the quarter, with the company citing an improved economic outlook resulting in a reduction in collective provisioning levels.

In a reversal of Aprils' gains, Information Technology fell -9.9% led by Afterpay, down 21% over the month and off 38% from recent highs despite little stock-specific news. Growth names generally have come under pressure in recent months as upbeat indications of normalizing economic activity lead investors into the cyclical value pockets of the market.

Global Equities

First quarter earnings in the United States came in generally stronger than expected. The strongest results were seen in the cyclical areas of the market. Similar to the sentiment we have seen domestically, more expensive sectors have come under pressure amid continued inflation concerns, highlighted again by the divergence between the 'old economy' Dow Jones Industrial Average and the 'new economy' Nasdaq 100, returning 2.2% and -1.7% respectively in May.

Despite seeing a brief elevated period during May, the CBOE VIX ended the month reaching a low of 16.7, the lowest level we have seen post-Covid, reflecting the ongoing downward trend in implied market volatility. Valuations however remain at elevated levels in a historical context, particularly in the United States. Emerging Markets gained in May and outperformed Developed market peers, benefitting from weakness in the US Dollar. Despite elevated Covid-19 infections, among the worst hit by the pandemic, India one of the best performing markets in May.

Fixed Interest

Since the large movements in bond yields, we experienced late in 2020 and into early 2021, yields globally have generally traded sideways as a result of ongoing inflationary uncertainty and central bankers monetary response. Underlying the relatively stagnant bond yield movements, rises in inflation expectations continue to push real yields downwards. Credit spreads widened over the month but remain near their narrowest points.

At the June meeting, the RBA elected to maintain the official cash rate and 3-year Australian Government bond yield at current rates. RBA Governor Phillip Lowe noted the recent stability of sovereign bond yields after increasing earlier in the year, citing positive news on vaccines and additional fiscal stimulus in the United States. Governor Lowe also reflected on the pick-up in medium-term inflation expectations from near record lows, now sitting closer to central bank target levels. The outlook for strong growth in the global economy continues amid the recovery from the Covid-19 pandemic, supported by fiscal measures and accommodative financial conditions.

REITs (listed property securities)

Australian Listed Property added another month of positive performance, although underperformed the broader Australian equity market. Diversified REITS Charter Hall Long WALE (-1.97%), Abacus Property Group (-0.66%), and GPT Group (-0.04%) dragged on the index. Index standout over the month was Unibail-Rodamco-Westfield, gaining 7.17% over the month and announcing a new 1.25 billion Euro bond placement.

Residential property developer Ingenia Communities was among the best performers within the A-REIT index. In May, Ingenia announced the purchase of a portfolio of five coastal holiday parks at a combined value of $40 million, bringing total acquisitions announced year to date to $220 million. In the May Reserve Bank meeting, members noted the continued strength of the Australian residential housing market, with prices continuing to increase across all major markets. Housing credit growth had also strengthened, with strong demand from owner-occupiers, especially first-home buyers.

Alternatives

Preliminary estimates for May indicate that the index increased by 5.9 per cent (on a monthly average basis) in SDR terms, after increasing by 2.2 per cent in April (revised). The rural, non-rural and base metals sub-indices all increased in the month. In Australian dollar terms, the index increased by 5.8 per cent in May.

Over the past year, the index has increased by 39.7 per cent in SDR terms, led by higher iron ore prices. The index has increased by 23.8 per cent in Australian dollar terms.