Quality Listed Portfolios

Market Update – July 2021

Total Return to 31/07/2021	1M (%)	3M (%)	6M (%)	1YR (%)	3 YR (% p.a.)	5 YR (% p.a.)	Current Yield
Cash	0.0	0.0	0.1	0.1	1.0	1.3	0.1%
Fixed Term Bank Deposit (12M)	0.0	0.1	0.2	0.4	1.2	1.6	0.4%
Australian Bonds (composite)	1.8	2.7	0.4	0.5	4.8	3.4	1.0%
Australian Bank Hybrids (gross yield to call)	0.7	1.4	2.6	4.2	4.4	4.5	3.4%
Australian Property	0.5	7.9	15.3	33.7	8.0	5.2	3.9%
Australian Shares	1.1	5.8	13.8	28.6	9.5	10.0	3.8%
Global Shares (unhedged)	4.0	10.2	21.5	31.9	15.1	15.2	1.8%
Global Infrastructure (hedged)	2.2	1.3	11.9	15.7	6.2	6.7	3.7%

Movement to	31/07/2021	1M	3M	6M	1YR
AUD/USD (cents)	0.73	-0.02	-0.04	-0.03	0.02
Aust. 10-year bond yield (%)	1.19	-0.32	-0.51	0.09	0.36
Gold US$/ounce	1,814	2.5%	2.5%	-1.8%	-8.2%
Brent oil US$/bbl	76.3	1.6%	13.5%	36.6%	76.3%
Iron ore US$/t	213	-0.7%	18.3%	26.7%	95.6%
Copper US$/pound	4.48	4.3%	0.0%	25.4%	56.7%

Source: Refinitiv, relevant ETF/Benchmark data

Global

The new financial year started with a couple of negative issues, not that you could tell from the continued strong performance of equities. The first issue is a new wave of COVID-19 spreading across the globe in the form the delta variant, which seems to be more infectious but just as serious as the original strain. The second issue is the apparent crackdown by Chinese regulators on Chinese technology stocks. Major Chinese stocks, Tencent and Alibaba, were down over 15% in July. The Chinese government seems to be exercising greater control over its technology and education companies. This is actually a serious issue because the US regulator (the SEC) wants to be able to audit Chinese companies listed in the US but China is baulking at this request, over data security issues. Ultimately, this could lead to foreign investment withdrawing from China and is a key issue to watch.

Regardless, growth assets managed to rally in July in response to the continual fall in bond yields, over the past three months. The delta virus outbreak is likely to slow growth and inflation concerns over the September quarter and equity markets are relieved that central banks are likely to step back from tightening and that interest rates remain low.

Of course, we now have growth issues to worry about but the market is taking a ‘glass-half-full’ approach at this stage. Bad news is good news, or it so it seems. For now, the US is printing strong growth and payroll numbers but the next few months will be interesting as the US is also battling a new COVID wave that is largely impacting the 40% of the population that are not vaccinated, as yet.

The US Federal Reserve (the Fed) has been talking about reducing its US$120bn per month in bond and mortgage debt purchases but that is about all, at this stage, and we suspect COVID will delay tapering until 2022 and even then, it is likely to begin at a glacial pace.

The US government is still trying to pass a US$3.5 trillion ‘budget reconciliation’ bill and a US$1 trillion infrastructure package but has hit its self-imposed US$28.5 trillion public debt limit. The Democrats must wrestle with Congress to get the public debt limit extended (once again) but they should have the numbers. To give some context, the US government is already running a circa US$2.5 trillion budget deficit and has accumulated US$28.5 trillion in public debt, which is equivalent to a public debt/GDP ratio of 135% (Australia is around 50%).

In recent years, the Fed has been the largest buyer of US government bonds and is currently buying US$80bn in bonds per month and has accumulated around 22% of all public debt on its balance sheet (it does so with money it creates out of thin air). This extra demand from the Fed ensures bond yields stay low. This is the manipulation of the USD monetary system that began with a previous head of the Fed, Ben Bernanke, back in the global financial crisis of 2008/2009.

But don't worry, all the central banks of the developed world are in on this caper. The Bank of Japan, the European Central Bank, the Bank of England and even our own Reserve Bank has recently joined the party. If they are all doing it, then relatively speaking, things should be all okay…. However, with central banks using their "licence to print money" it is likely that governments will continue to take advantage of this and run budget deficits forever, further indebting each country. One wonders, where does it all end?

Australia

Australia's recovery has been abruptly interrupted by a new wave of COVID, with most States, particularly NSW and VIC, experiencing lockdown in the September quarter. Australia's low vaccination rate has been exposed as a weakness and the national vaccination program is now ramping up with hopes of getting to 70-80% immunity by Christmas.

The RBA is keeping the cash rate low at 0.10% but has implemented a little tightening by maintaining (and not extending) its 0.10% yield curve control from cash out to the April 2024 bond and reducing its bond purchasing program from $5bn a week to $4bn a week. The RBA acknowledges the growth outlook is now uncertain for 2021 but expects a bounce back to 4.0% in 2022, based on a significant share of the population being vaccinated. The unemployment rate is expected to fall to 4.25% by the end of 2022 and underlying inflation is expected to gradually increase to 2.25% by 2023.

The RBA's dovish stance and the Fed's recent talk of tightening has seen the USD rally and the AUD fall to $0.74. Recent weakness in the iron ore price may also keep the AUD depressed. The Federal and State governments have had to offer new rounds of support for business and employees, and this is likely to see budget deficits widen further over FY22.

Australian companies are expected to post solid results and strong balance sheets in the August reporting season. However, the outlook will now be uncertain. The usual experience is for the economy to bounce back quickly, post virus outbreaks, and the vaccination program gives a strong reason to believe this will be the case in 2022.

Outlook

The outlook generally remains positive on very accommodative fiscal and monetary policy and the hope of mitigating the economic and social impact of COVID, with the rollout of vaccination programs.

However, recent COVID outbreaks have probably tilted the risks towards slowing growth rather than inflation and this is reflected in lower bond yields. Much depends on the pace of economic recovery, post COVID vaccines, and whether inflation is transitory or sustained. Other known risks include: East/West relations and regulatory intervention in various sectors, which seems to be on the rise in recent years.

With equity markets at record levels, there is a risk that slowing growth and/or persistent inflation sparks a market correction or indeed some unknown risk factor. We have been generally recommending a dollar cost averaging strategy of investing gradually with perhaps 1/3 of funds invested every 3 months.

The next key events on the calendar include:

- Australian FY21 reporting season – August 2021
- Jackson Hole Central Bank conference - 26-28 August 2021
- G20 meeting in Italy - 30-31 October 2021
- US $28.5 trillion public debt limit - must be resolved by 31 October 2021

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Warnings, Disclosure and Disclaimer

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