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Summary of Key Views

Inflation and its implication for asset allocation

As part of our dynamic asset allocation process, we look at a couple of key factors that we think determine the direction of where different asset prices will go into the future. And those are valuation – so are assets cheap or expensive. Where are we in the business cycle, and then policy and liquidity.

If we take those three metrics in isolation, from a valuation perspective, it's probably fair to say that most assets from an absolute perspective look pretty expensive. However, we are in the game of allocating capital. And so we have to look at things from a relative perspective. If we look at asset classes, from a relative perspective, we've continued to think that risk assets such as equities are favourable compared to things like bonds and cash, where know there's you're getting little reward for that risk. From an equity perspective, we probably have a bias towards emerging markets and Australian equities over some developed markets, particularly the US, from a pure valuation perspective. So overall picture is that from a relative perspective, risk assets are still looking attractive, you're still being rewarded for risk from a valuation perspective. If you look at other indicators, and one of those is cyclical indicators – so where are we in the cycle? Cyclical indicators continue to look positive. A lot of economic data that's been coming out, whether it's looking at PMIs, whether it's looking at job growth, all of them pointing in the right direction.

Market developments during June 2021 included:

Australian Equities

The Australian share market finished the fiscal year with its best performance since inception, with the market gaining 23.9% over the past 12 months. For June, Australia's S&P/ASX 200 Index rose 2.3%. The recent value rotation showed some signs of weakening, with the S&P/ASX 200 Value Index returning 1.6% for the month, versus a return of 3% for the S&P/ASX 200 Growth Index. The best performing sectors for the month were information technology (+13.4%), followed by communications services (+5.6%) and property (+5.3%). Financials was the only sector to finish in the red for the month (-0.2%).

In stock specific news, Nuix's share price fell 20.2% for the month and was the worst performing stock on the ASX 200. The disappointing result follows a series of negative developments, including the departure of several executives and allegations of insider trading within the firm. Altium was the best performing stock in the index, with a gain of 29.8% following the announcement of a takeover offer made by Autodesk.

Afterpay also had a strong month with a 27.4% gain in June, with the company announcing the expansion of its US offering to 12 of the country's largest merchants, including Nike and Amazon.

Two of Australia's longest standing investment companies are set to merge, following the news that Washington H. Soul Pattinson has entered a binding scheme of arrangement with Milton. If approved, Soul Pattinson will pay an equivalent of $6 per Milton Share and asset under management at Soul Patts will increase to over $10bn.

Sydney Airport, which has been devastated by the pandemic, has received an opportunistic takeover bid from a consortium of investors which includes IFM, QSuper and Global Infrastructure Management. The offer of $8.25 a share represents a huge premium to the company's average share price throughout COVID; however, it is still well below where the company traded prior to the pandemic (c. $9 in December 2019). The company is currently reviewing the offer.

Global Equities

Global equities continued to rally for their fifth consecutive quarter in June buoyed by the global vaccination rollout supporting strong corporate earnings results posted in the US and Europe.

Developed markets rose 4.7% during June while performance in emerging market equities were softer, rising 3.3% in Australian dollar terms despite continuing to lead developed markets over 12 months. June performance remains dispersed across developed markets with the US S&P 500 returning 2.3% and 40.8% for the fiscal year. More cyclical economies like Europe (1.6%) and Japan (1.2%) lagged the US as investors in these regions remain within defensive assets. The disparity in economic recovery continues within emerging markets with China posting an 8.8% YOY growth in industrial production for June whilst India and Brazil remain hamstrung by consecutive second and fourth wave Covid outbreaks.

Given the varied economic backdrop across developed and emerging markets, June factor performance for global equities was dispersed by region. Notably, there was a broad reversal to the much-publicised rotation to value in the June month as investors increased their risk appetites, seeking out high beta stocks. Momentum, and to a lesser extent growth, had strong outperformance within emerging markets, whilst US, Europe and Japan saw similar outperformance in measures of quality. Across all regions value and yield were underperformers with the US posting the strongest underperformance in the value factor.

While global equity markets remain buoyed in the short term by continued vaccination efforts, inflation concerns and a tapering of the global monetary stimulus by central banks pose significant uncertainties for global equities into the medium term.

Fixed Interest

Throughout June, yields at the higher end of the Australian Sovereign curve fell substantially, with the 10-year yield having fallen by 17 basis points over the course of the month. This movement has helped to drive strong returns for the Bloomberg AusBond Composite 0+ Yr Index, which increased by 0.7% throughout June. Similar movements have been observed globally, resulting in the Bloomberg Barclays Global Aggregate Index (AUD Hedged) returning 0.5% over the month. However, this fall in yields is not universal, as the shorter end of the curve has seen yields rise recently, most notably at the 3-year level, which increased by 35 basis points in Australia over the course of June. This has resulted in a flattening of the yield curve, signalling headwinds for strategies that rely substantially on roll-down as a source of return.

Maintaining its focus on the real economy, the Reserve Bank of Australia (RBA) remains committed to seeing realised inflation within its target range of 2-3% before raising the Cash Rate from its current record low level of 0.1%. However, a recent announcement wherein the Central Bank declined to switch its target bond for yield curve control from the April 2024 to the November 2024 issue has been widely interpreted as a prelude to a tapering of stimulus. In this respect the RBA is moving in tandem with Central Banks around the world, who are beginning similar discussions as the global economy surpasses projections in its recovery from COVID.

REITs (listed property securities)

Australian listed property achieved strong results in June, posting a 5.6% gain and finishing the month with 33.9% YTD. June's move higher was largely fuelled by Goodman Group (ASX: GMG) (the largest constituent in the S&P/ASX 300 A-REIT index) advancing 8.96%, with some of this gain being attributable to the dividend distribution announcement on 15 June.

The A-REIT segment has continued to witness acquisition activity. Abacus Property Group (ASX: ABP) announced that it had exchanged contracts to acquire a one-third interest in 314-336 Bourke Street, Melbourne (known as "Myer Melbourne"). Charter Hall Long WALE REIT (ASX: CLW) will also acquire a one-third interest while Vicinity (ASX: VCX) with retain the remaining third. Total consideration for the acquisition, which will be funded by debt, is $135.2m, with settlement expected by the end of July 2021.
SCA Property Group (ASX: SCP) agreed to acquire Marketown in Newcastle from AMP Capital Investors Ltd for $150.5m.

Charter Hall announced late June that its FUM has risen to $52b, with the industrial sector being a key contributor, achieving 10.8% growth over six months and 15.5% growth over 12 months, the largest of the five sectors across both time periods. The Group's FUM has increased by $12b over the course of FY21, equating to 28% growth.

Residential property markets advanced further in June, with CoreLogic Daily Home Value Index reporting the five-city aggregate increasing by 1.9%, Sydney led the charge, achieving 2.6% and Melbourne lagged the aggregate with 1.5%. CoreLogic's data also indicates that the rise in residential property prices has outstripped that of rent values for all cities but Perth and Darwin. This is despite National rent values having risen 5.6% in the year to May, being the fastest annual increase since February 2009.

Alternatives

Preliminary estimates for June indicate that the index increased by 5.6% (on a monthly average basis) in SDR terms, after increasing by 4.7% in May (revised). The rural and non-rural sub-indices increased in the month, while the base metals sub-index fell. In Australian dollar terms, the index increased by 6.8% in June.

Over the past year, the index has increased by 49.1% in SDR terms, led by higher iron ore prices. The index has increased by 40.0% Australian dollar terms.