Quality Listed Portfolios

Monthly Market Update – September 2021

Total Return to 30/09/2021	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	1.1	1.5	0.4%
Australian Bonds (composite)	-1.5	0.3	1.8	-1.5	4.1	3.1	1.6%
Australian Bank Hybrids (gross yield to call)	0.3	0.3	1.8	4.4	4.0	4.1	3.4%
Australian Property	-1.9	4.8	16.1	30.7	9.2	7.7	4.0%
Australian Shares	-1.9	1.7	10.1	30.6	9.6	10.4	4.0%
Global Shares (unhedged)	-3.1	4.0	13.7	27.8	13.3	15.2	1.8%
Global Infrastructure (hedged)	-2.6	1.6	4.1	14.6	6.6	6.8	3.8%

Movement to	30/09/2021	1M	3M	6M	1YR
AUD/USD (cents)	0.72	-0.02	-0.03	-0.04	0.01
Aust. 10-year bond yield (%)	1.41	0.24	-0.11	-0.40	0.56
Gold US$/ounce	1,757	-2.9%	-0.7%	2.9%	-6.8%
Brent oil US$/bbl	78.5	7.9%	4.5%	23.6%	91.7%
Iron ore US$/t	120	-24.9%	-44.2%	-27.8%	-3.5%
Copper US$/pound	4.17	-3.5%	-3.1%	4.1%	37.5%

Source: Refinitiv, relevant benchmark data. Note: Past performance is not a reliable indicator of future performance.

Global

A long-awaited market correction started to come through in September sparked by a number of issues, including:

- Pending default of China's largest property developer - Evergrande
- Congress wrangling over lifting the US$28.5 trillion debt ceiling
- Inflation issues related to rising energy costs and supply bottlenecks
- US Federal Reserve proposing to reduce or taper its bond purchasing program from November 2021
- Ongoing COVID issues

The Evergrande news seems like the most worrisome, but we find it hard to see it becoming a big issue outside of China. Chinese property is mostly financed via Chinese debt and equity and any losses will be borne by these investors. Further, the Chinese government itself has precipitated the situation with a crackdown on property developers via its 'three red line' policy which aimed to reduce leverage in the sector. It should have known Evergrande issues would come and now it must decide how to deflate its property bubble in an 'orderly' manner. Given the Chinese government has absolute control over the economy and Banks, we expect a restructure that minimises damage to the broader economy and population but does lead to losses for equity and debt holders. Property construction represents around 30% of the Chinese economy and the most likely outcome is slower Chinese growth moving forward. This has direct implications for Australian exports, like iron ore, but the market has already adjusted for this. We believe Evergrande issues will be contained to China and developed markets will move on. However, investors will need to think carefully about investing in China.

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 have been wrestling with Republicans to get the public debt limit extended (once again) but both sides have agreed to a short-term funding deal and to delay debate until December 2021. 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%).

The Fed has signaled it is ready to start tapering its $120bn/month in bond purchases in November. It is becoming more worried about inflation. However, the tricky part is that US payroll numbers have been soft in recent months, casting some doubt over economic growth and employment. This is why market commentators are beginning to talk about stagflation - meaning stagnation with inflation.

We think US payrolls are being depressed by ongoing COVID issues, storms in the Southern States and government welfare payments (which will soon expire). Payrolls should gradually improve, and this will lower concerns over stagflation and the Fed beginning to reduce its asset purchases. In addition, the US 3Q21 reporting season begins shortly and it is likely the market will change its focus from macro issues to bottom-up company earnings.

The remaining issues of inflation and Delta are inextricably linked and ongoing vaccination rollouts and new antiviral drugs to treat COVID continue to suggest that the worst of COVID will be behind us in 2022. Inflation issues should subside as supply chains recover.

Australia

The Australian share market's run of 11 straight gains ended in September, with equity markets down and bond yields rising. The economy is headed for a weak start to FY22, with the iron ore price falling significantly and Australia's largest states (by GDP), NSW and Victoria, in lockdown for most of the first half of FY22.

However, markets are about the future and here the news is good with double-vaccination rates headed for 80% by early November 2021, which is expected to lead to a return of 'normal' social and economic activity. In addition, the Federal and State governments and RBA continue to provide very accommodative financial conditions.

The Australian dollar remains depressed by Australia's lockdowns and worries over China. China will most likely remain the main influence in the short term but the expected economic recovery in 2022, should provide support.

Outlook

China and inflation seem to be the two main risks. We expect Chinese property issues to be largely contained within China and we expect inflation issues to subside as economic activity recovers in 2022. The rollout of vaccination programs and the development on new anti-viral drugs, gives us confidence that the worst of COVID should be behind us in 2022.

With financial conditions very accommodative and economic activity likely to recover in 2022, it seems unlikely that the bull market is over. We remain cautiously optimistic and expect equity markets to recover into Christmas.

The key known risks ahead seem to be:

1. COVID pandemic (expected to fade in 2022);
2. Inflation (supply bottlenecks and ESG transition issues);
3. China (Xi pivoting back to Mao policies and property bubble);
4. Regulatory interventions (ongoing in various sectors); and
5. Geopolitical tensions around trade, security and sovereignty.

The next key events on the calendar include:

- US 3Q21 reporting season
- G20 meeting in Italy - 30-31 October 2021
- UN Climate Change conference, Scotland - 31 October - 12 November 2021
- US Federal Reserve meeting – 3 November 2021
- Australian AGM season - November 2021
- Australian Bank reporting season - November 2021
- US $28.5 trillion public debt limit - must be resolved by December 2021

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Warnings, Disclosure and Disclaimer

Date issued: Tuesday, October 12, 2021

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