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Lonsec

Summary of Key Views

Insights from our CIO: Inflation: Structural or not?

Inflation continues to be on everyone's lips. The debate as to whether inflation is transitory or structural in nature is gaining momentum as the US recorded an annual rate of inflation of 6.2%, the highest rate in three decades. What is interesting is that we are observing a growing divergence between what is driving inflation in different countries, which is making the debate between structural and transitory inflation more nuanced.

There is no doubt that supply shortages related to COVID-19 have been putting upward pressure in input costs for many companies around the world. In recent company meetings conducted by Lonsec, rising input costs were a common theme for many companies across a broad range of industries. These pressures should ease as supply chains reopen and as we emerge out of the pandemic, which is consistent with the transitory narrative.

From an Australian perspective, wage growth continues to be sanguine. Apart from certain industries such as hospitality, where staff shortages are pushing wages up, with some restaurants indicating that dishwashers are asking for $90 per hour due to staff shortages. Wage growth, or the lack of, has been a key focus for the RBA and while wage growth remains low, the prospect of a rise in structural inflation is lower than other countries.

Market developments during November 2021 included:

Australian Equities

The Australian share market declined for a third consecutive month with the S&P/ASX 200 falling 0.5% despite seven out of the eleven sectors in the Index finishing higher. Materials was the standout sector producing a return of 6.3%, whilst Communication Services (+5.2%) and Consumer Staples (4.5%) also contributed positively. Heavy declines in the Financials (-7%) and Energy (-8.3%) sectors weighed on the Index.

Local miners were bolstered by a slight recovery in the price of iron ore which was driven by China's move to ease the recent liquidity crunch on the debt-laden property sector. The Financials sector was impacted by fears of contracting margins for the major banks as cash rates remain at record lows and competition in the home loan market continues to intensify. Weaker oil prices weighed on the Energy sector as concerns grow that the Omicron variant will further disrupt travel and lead to additional lockdowns globally.

Momentum and quality were the strongest performing factors for the month with gains of 4.3% and 3.5% respectively. Value was the only factor to finish the month in the red, with a decline of 3.5%. Year to date, value remains as the leading factor (+17%), although its dominance is beginning to wane.

Global Equities

After a strong recovery in global markets over the prior month and stable performance for most of November, the month ended in volatility with the worst one-day decline of the year for the DJIA as news of the spread of the new Omicron Covid-19 variant drove a sharp sell-off in global equities. Developed markets detracted by -1.5% over the month, faring better than Asian and emerging markets, which fell -3.4% and -3.9%, respectively in local currency terms. Global small caps detracted the more than their broad cap counterparts during November, receding by -4.8%.

Given the relative decline in the AUD over the month, the returns presented above in AUD are positive and somewhat misleading. As such, we quote USD returns in the following commentary. Over the month, all sectors in the developed market index excluding IT delivered negative returns in USD terms, with IT performing returning 2.6%, whilst finance and energy detracted by -6.2% and -7.3%.

Within emerging markets, IT was again the only sector with positive returns over the month, returning 1.3%, with energy and consumer discretionary detracting by -7.5% and -10.1% for the period in USD terms. Whilst global markets have stabilised since the end of month sell off, further volatility may occur until scientists can confirm if the new variant has improved resistance to the available vaccines. If this were the case, a return to social restrictions and lockdowns would see further de-risking in global equities.

Fixed Interest

Australian Fixed Income markets rebounded in November, following the large selloff at the short end in late October. Yields fell substantially across the Australian Government Bonds curve over the month, with the 10-year and 3-year yields falling by 22 and 14 basis points respectively. Australian credit spreads continued to widen over the course of the month, but as this increase was smaller in magnitude than the fall in government bond yields the Bloomberg AusBond Composite 0+ Yr Index ended the month with a strong result of 2.1%.

In global markets, yields for government bonds in developed economies trended downwards, but by less than in Australia. As the October selloff was a uniquely Australian phenomenon, so too was the correction after the fact. The Bloomberg Barclays Global Aggregate Index (AUD Hedged) Index returned 0.74% over the month, with the unhedged variant's return of 5.6% being primarily driven by a weakening Australian Dollar.

REITs (listed property securities)

The S&P/ASX 200 A-REIT Accumulation index advanced strongly during November, finishing the month 4.5% higher. Global real estate equities (represented by the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)) finished down 1.45% for the month, after its very strong October performance. Nareit has cited the Omicron Variant as the potential cause for the pullback in G-REITs.

November was relatively quiet across the A-REITs sector. Some activity includes SCA Property Group (ASX: SCP) acquiring Delacombe Town Centre for a price of $112m (with an implied fully let yield of 5.3%), Ingenia Communities Group (ASX: INA) announced an intention to raise $475m in equity to fund $552m of identified acquisitions, and Centuria Industrial REIT (ASX: CIP) announced it acquired four high-quality freehold industrial assets for $129.4m.

The Australian domestic housing market again experienced positive growth last month, with the CoreLogic 5 capital city aggregate advancing 1.1%. Darwin is the only major city to have experienced negative growth for November, recording -0.37%. At the end of October, the combined value of residential real estate in Australia is estimated to be $9.3 trillion (CoreLogic, November 2021).

Alternatives

Preliminary estimates for November indicate that the index decreased by 1.1% (on a monthly average basis) in SDR terms, after increasing by 6.4% in October (revised). The rural sub-index increased in the month, while the non-rural and base metals sub-indices decreased in the month. In Australian dollar terms, the index decreased by 0.6% in November.

Over the past year, the index has increased by 36.2% in SDR terms, led by higher LNG, coking coal and thermal coal prices. The index has increased by 33.7% in Australian dollar terms.