View from the hill

OCTOBER 2021

Market update

The table below provides details of the movement in average investment returns from various asset classes for the period up to **30 September 2021.**

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	-1.9	1.7	30.6	9.7
Smaller companies	-2.1	3.4	30.4	9.4
International shares (unhedged)	-3.0	4.0	27.8	13.3
International shares (hedged)	-3.7	0.6	29.0	13.0
Emerging markets (unhedged)	-2.8	-4.5	17.3	8.6
Property – Australian listed	-1.9	4.8	30.7	9.2
Property – global listed	-5.2	0.0	30.3	5.8
Infrastructure - global listed	-4.4	-0.6	13.2	8.1
Australian fixed interest	-1.5	0.3	-1.5	4.1
International fixed interest	-1.0	0.1	-0.8	4.1
Australian cash	0.0	0.0	0.0	0.8

Past performance is not a reliable indicator of future performance.

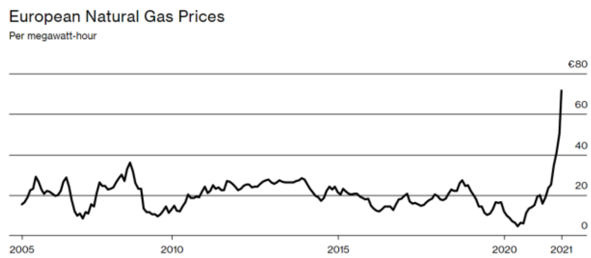
Overview & Outlook

Markets don't go up in straight lines and we have been reminded of this in September as a confluence of factors drove markets down. Supply constraints as a result of COVID-19 shutdowns and other lockdown measures have combined with a surge in demand for goods to keep inflationary concerns alive and raise concerns about economic growth.

In the UK, Brexit has resulted in insufficient trucks drivers to transport fuel to the pumps resulting in shortages. At the same time Europe has experienced significantly lower wind and solar generation due to weather conditions. In China, government policy constraints on energy use has resulted in blackouts and factory shutdowns as they move to ensure they are within their allowed power usage. Additionally, the rise in coal prices hasn't been able to be passed on through higher electricity prices due to caps on the electricity price

The prices of natural gas, oil, coal and other energy sources have hit multi-year highs driven by supply and demand issue. The price of natural gas in Europe, has risen by over 400% since the beginning of the year while the price of electricity has risen by over 250%.

The supply of gas which was impacted by Covid-19 from both demand and supply side due to lockdowns is yet to recover. On the other hand, the demand has bounced back as factories ramped up production to satisfy the pent-up demand for goods. This has resulted in demand for energy soaring with supply still challenged.



Source: Bloomberg

The combination of these factors is keeping upward pressure on inflation which is again a concern for markets. Economic growth is being constrained by these issues and with other economic indicators softening in recent months are contributing to a slowing of the global economy and China particularly.

In addition to these issues, Chinese construction companies China Evergrande and Fantasia Holdings both based in Shenzhen have been grappling with excessive debt amid a credit crunch. First to collapse, China Evergrande remains unresolved however we do not consider it "too big to fail" as it only represents 0.1% of Chinese bank debt. In our view a restructure is most likely with shareholders and management not being bailed out but suppliers & home buyers likely to be protected to limit economic damage.

Despite these issues the outlook remains positive on the basis that activity normalises as vaccination rates climb. The US has approved 500 million doses of Covid-19 vaccination to be sent to developing countries with President Biden saying, "America will become the arsenal of vaccines…" to fight the problem globally recognising if the pandemic remains a problem internationally it poses a problem domestically.

Share markets

The Australian share market (-1.9%) fell as the range of issues combined with overstretched markets to unsettle investors.

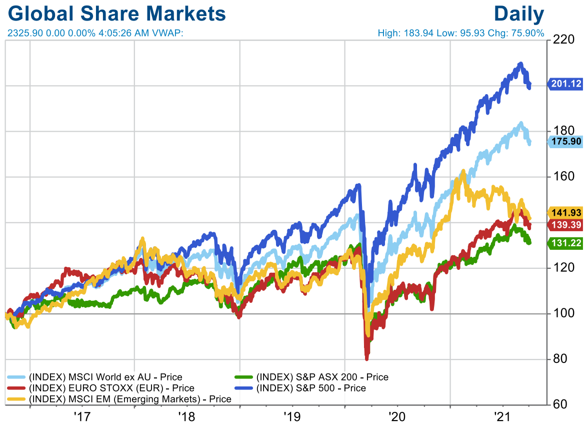
The Materials sector (-9.3%) was hardest hit as slowing economic data combined with China's environmental policies to slow the demand for iron ore. FMG (-28.8%) was the worst in the sector while BHP (-17.5%) and Rio Tinto (-11.6%) were also sold heavily. Health Care (-4.9%) and Info Tech (-3.9%) also saw significant weakness through the month as investors seek short duration (near term profits rather than long term profits) assets.

With the northern hemisphere's energy crisis evolving through September, it is not surprising that Energy (+16.7%) was the strongest sector. Utilities (+2.5%) and Telecom Services (+1.9%) also performed solidly in a difficult month.

International shares (-3.7%) on a currency hedged basis underperformed the local market as Australian shares made up a little of the ground lost in recent years. Currency exposures provided some cushion as unhedged International Shares (-3.0%) performed slightly better.

The S&P 500 (-4.7%) in local currency terms ended its longest monthly winning streak since December 2017. US tech stocks were down significantly with the NASDAQ Composite (-5.3%) underperforming the S&P 500 as result of rising concerns around longer duration assets. European stocks (-3.4%) were sold down also with German stocks (-3.6%) underperforming. The UK (-0.2%) fared better losing little ground.

Emerging markets (-2.8%) saw weakness in Brazil (-6.8%) and China (-4.7%) while India (+3.2%) bucked the global trend as investors continued to shift into this market in response to China's interference with its listed companies. Despite the recent weakness the move thus far is not overly noteworthy as demonstrated in the chart below. The returns for many share markets in the last 12 months is around 30%, with Emerging markets lagging having delivered just over 17% in the 12 months to September '21. We therefore see no cause for concern and welcome a correction as a means of taking the heat out of the market and making some areas of the market more attractively priced.



Source: AMP, as of 5th October 2021

Interest Rates

Losses were not constrained to growth assets with fixed interest markets also losing ground in September The Australian fixed interest market (-1.5%) underperformed the international market (-1.0%). This was impacted by raised concerns around inflation levels with cost pressures, supply issues and high levels of demand a continuing concern. During the month we saw Australian Government Bonds (-1.7%) down more than Australian Credit (-0.8%) similarly Global Treasuries (-1.1%) underperformed.

The US 10-year bond yield rose 18.5bps to 1.49% which is still lower than recent highs seen in March. The Australian 10-year bond yield ended the month at 1.48% after rising 33bps for the month. The rise in bond yields reflects the concerns that the inflation we are seeing is likely to sustained for longer than previously anticipated due to the ongoing supply issues, rise in energy prices and continued strong demand. Markets are therefore again considering if Central bank policy changes may need to be brought forward and reflects that we are closer to seeing tapering of the bond buying programs in both the US and Australia. Credit markets were also impacted by fears about contagion from Evergrande.

Property & Infrastructure

Australian REITs (-1.9%) were in line with the broader Australian share market and significantly ahead of International listed property (-5.2%) which was the weakest of the asset classes that we follow.

We have added Global Listed Infrastructure (-4.4%) to the asset classes we monitor to be consistent with the Strategic Asset Allocations and note that this area of the market was no exception to the negative returns seen across financial markets.