March 2021

Market update

*The table below provides details of the movement in average investment returns from various asset classes for the period up to **28 February 2021.***

Asset class (% change)	1 month	3 months	1 year	3 years (% pa)
Australian shares	1.5	3.0	6.5	7.4
Smaller companies	1.5	4.1	17.2	7.2
International shares (unhedged)	1.6	0.7	7.8	11.1
International shares (hedged)	2.7	5.5	26.6	10.9
Emerging markets (unhedged)	-0.1	6.1	13.3	6.6
Property - Australian listed	-2.5	-5.9	-11.3	5.8
Property - global listed	3.9	6.1	-3.4	4.9
Australian fixed interest	-3.6	-4.2	-2.8	4.0
International fixed interest	-1.6	-1.9	-0.2	4.2
Australian cash	0.0	0.0	0.2	1.2

Past performance is not a reliable indicator of future performance.

Overview and outlook

Stimulus and recovery are what 2021 economic conditions are about. With the US President pushing for US$1.9 trillion made of direct payment of up to $1,400 to citizens, additional unemployment benefits of $300 per week; benefits to parents with children under the age of 18. $50bn is being allocated for covid testing and $20bn to develop a national vaccine plan. To aid schools and universities with re-opening $170bn is allocated. As well as additional measure for businesses in a range of sectors worst hit with the pandemic and the shutdown.

The result of this stimulus package has been a significant shift in inflationary expectations. The fiscal stimulus impact on the real economy will be much more significant than past monetary policy stimulus and has market participants worried that the current Central Bank settings may need to adjust faster than was otherwise expected. Until recently the market saw long term bond yields, an indication of longer-term rates, as too low and we saw a significant increase in Bond yields over the month.

Europe remains challenged with forward looking data suggesting sluggish recovery. Lockdowns continue to plague the region driving retail sales down with core CPI inflation in February falling to 1.1% year-on-year.

Australian economic conditions are improving faster than expected with December GDP growing 3.1% for the quarter ahead of the 2.6% some had anticipated. It was the first time in the national accounts' history that GDP has grown by more than 3% in two consecutive quarters.

The economy is seeing strong consumer demand as the savings rate fell from 18.7% in the September quarter to 12% in December as people secured work. In addition, there was significant pent demand as evidenced by car sales which rose 31.8% as compared to a year ago.

The policies around loan repayment deferrals has been very successful given the economic data we have seen. We are now seeing a significant improvement with loan deferrals now just 1% for housing and 1.8% for business

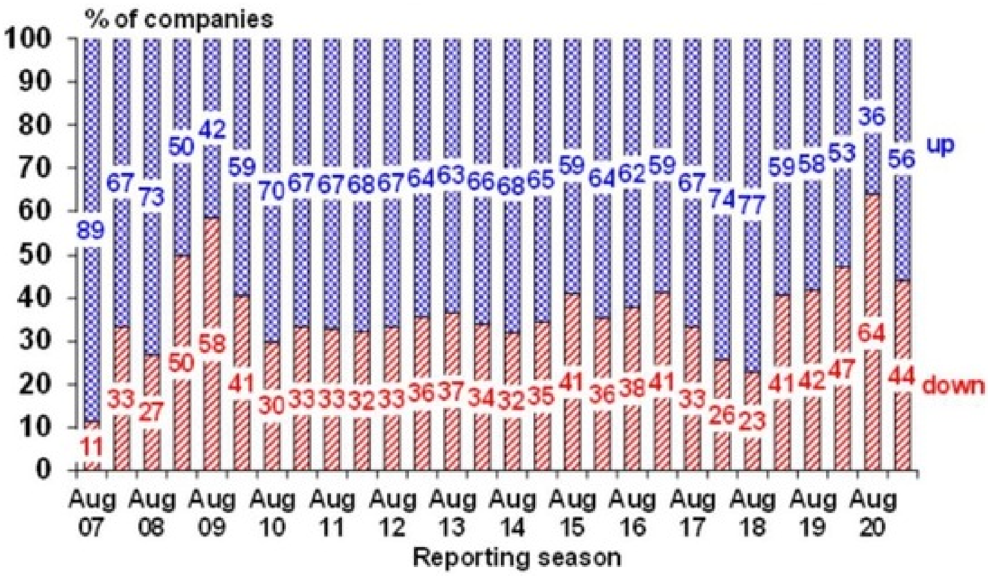
Share of bank loans by value in payment deferrals

Source: APRA, AMP Capital

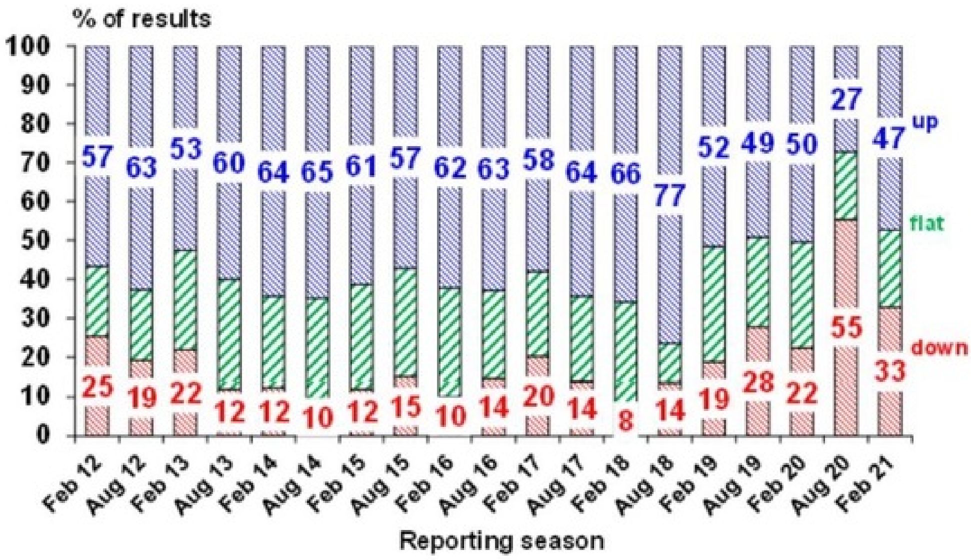
Share markets

The Australian half year reporting season was the focus of investors through February with results generally well ahead of market expectations. The rebound in profits drove a rebound in dividends with 47% of companies increasing their dividend as compared to 55% that were cutting them six months ago.

Australian company profits relative to a year ago



Australian dividends relative to a year ago



Source: AMP Capital

This helped drive Australian shares up by 1.5% over the month despite rising bond yields which saw the market weaker over the last two weeks of the month. Market strength was broad based with Resources (7.5%) the best performing sector, Financials (5.2%) performed well as rising bond yields drove improved expectations around profit growth. Energy (2.4%) also saw solid returns with demand recovery driving oil prices higher.

The weakest sectors were Info Tech (-8.9%) and Utilities (-8.0%) which were impacted by the rising yields in bond markets impacting valuations and Consumer Staples (-4.6%) driven by some rotation into more cyclical value stocks. Gold mining stocks (-9.2%) were particularly weak as Central banks appeared relaxed about rising yields in the bond market.

Looking forward the recovery in earnings is expected to continue. Consensus expectations for earnings growth in 2020/21 have been revised up by 34% with resources expected to see 52% growth in earnings this year. Cyclical stocks in media, banks and retailers have seen the largest earnings upgrades.

International equity markets rose 2.7% on a currency hedged basis despite end of month challenges from rising bond yields. Markets were supported by increasing government stimulus and particularly in the US and continued dovishness from central banks. Strength of the Australian dollar meant the unhedged international shares (1.6%) were not quite as strong. European stocks (3.6%) and US shares (2.7%) drove the international market.

Emerging markets (-0.1%) underperformed developed markets with Brazil (-4.2%) and China (-0.6%) key detractors. India (7.5%) was a standout as retail investors moved from mutual funds and piled into the market.

Interest Rates

Australian fixed interest (-3.6%) continued to be sold off in February as economic recovery and stimulus drive inflation expectations higher. The Australian 10-year bond yield jumped to 1.76%, 106bp up from the low seen last April. International fixed interest (-1.6%) also continue to be sold off as investors move into growth assets. Strong demand in the economy and additional fiscal stimulus in the US in particular is driving inflation expectations higher and saw the US 10-year government bond yield rise to 1.41% at month-end, 109bp higher than the low seen in August 2020.

The outlook for the bond market is for yields to continue to rise as Central banks maintain the current settings. We don’t believe heavily indebted governments can sustain meaningful higher interest on their borrowings. As such rising yield will eventually force central bankers to shift their settings.

Inflation is expected to continue to rise. However, with anaemic wage growth it is difficult to see how this can be sustained beyond the next 12 -18 months when the data rolls past the weakness in prices during the pandemic.

Property

Australian REITs (-2.5%) lagged growth assets generally and was well under the broader Australian share market. This was driven by Industrial REITs (-6.1%) and diversified REITs (-4.7%) which were sold down despite good financial result announcements. International property (3.9%) was the strongest of the asset classes we follow and was in stark contrast to the local market. Hotel and Resorts were up a massive 20.7% as the Covid-19 vaccines continue to raise hopes around normalisation of travel and gatherings at conferences.

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