

Shares down as energy prices start to bite

End-September 2021

Economic and market overview

- A near 10% increase in oil prices and talk of a global energy supply crisis in the upcoming northern hemisphere winter dampened sentiment towards equities, and saw most major share markets lose ground. Australian shares lost nearly 2%, for example, having previously risen for 11 consecutive months.
- There was increasing discussion about the possibility of interest rate increases in key regions, to counteract gathering inflationary pressures. This saw bond yields rise, and adversely affected the performance of fixed income markets.
- **US:** The Chair of the Federal Reserve suggested the US central bank could start scaling back the pace of asset purchases as early as November. A phased withdrawal of the quantitative easing program would likely last for several months, but could be complete by mid-2022.
- Increases to official interest rates are not anticipated until after the 'tapering' process is complete, but the latest release of forward-looking projections indicated central bank policymakers are now starting to contemplate tightening monetary policy settings. Officials are currently evenly split on whether higher interest rates will be necessary in 2022. Consensus forecasts suggest US interest rates will have been raised to around 1.0% by the end of 2023, and to around 1.8% by the end of 2024.
- Separately, President Biden sought support to raise the current debt ceiling – the maximum amount the US is able to borrow under federal law. Opposition to the plan caused some consternation among investors.
- **Australia:** Australia's Covid vaccination rate is now around 55%, close to the same level as the US. On the current trajectory, enough vaccines should have been administered to enable restrictions in Sydney and Melbourne to be lifted by the end of the year. With the next Federal Election little over six months away, a relaxation of the restrictions and a full reopening of the economy is becoming increasingly important politically.
- The Prime Minister has indicated that international travel bans will be lifted in November, a month earlier than previously suggested. This move should be supportive of the local economy over time, benefiting tourism-related sectors in particular. It could also enable foreign students to return, brightening the prospects for universities and related industries.
- Economic statistics are currently being distorted by ongoing lockdowns, although consensus expectations suggest conditions will improve markedly later this year and in early 2022. Indeed, money markets are expecting official interest rates to be increased to 0.25% by the end of next year.
- **New Zealand:** Home prices in New Zealand rose 27.8% in the year to 30 September. The market has remained buoyant recently as buyers have sought to transact ahead of a well-signalled increase in interest rates.
- The economy grew 2.8% in the June quarter, and by 17.4% on a rolling 12-month view. This raised the prospect of an interest rate hike this month. Consensus forecasts suggest the Reserve Bank of New Zealand will increase official borrowing costs by 0.25%, to 0.50% at its meeting in early October.
- Two separate surveys showed consumer confidence slipping a little, likely the result of recent lockdowns and the prospect of higher borrowing costs in the months ahead.
- **Europe:** The outlook for European economies is being adversely affected by a sharp increase in natural gas prices. Prices rose to record highs as utilities rushed to restock lower-than-average inventories.
- In fact, gas prices in the region nearly doubled in September and have risen more than 180% over the past three months. This is bad news for industrial companies and other energy-intensive industries, whose input costs are rising rapidly. Some factories have had to cut back on production, or close temporarily.
- It seems European businesses and consumers could be forced to accept higher gas and electricity prices during the coming winter, as governments in the region compete with China for energy supplies.
- In the UK, officials raised the prospect of interest rates being raised sooner than previously anticipated. Minutes from the Bank of England's latest meeting suggested policymakers are becoming uncomfortable with rising inflation. Consumer prices rose at an annual pace of 3.2% in August; a sharp increase on the previous month's reading and above the Bank's target.
- **Asia/EM:** There were some political changes in Japan, as incumbent Prime Minister Suga did not seek re-election for leadership of the ruling Liberal Democratic Party. Former foreign minister Kishida won the leadership contest, and will become the new Prime Minister ahead of the general election next month. Time will tell whether the change will affect economic policies, or the Bank of Japan's ultra-loose policy settings.
- In China, news reports suggested government officials have instructed the country's top state-owned energy companies to secure energy supplies "at all costs". Like elsewhere, China is facing potential energy shortages at a time when demand for power from factories is rising sharply. With energy supplies under pressure, some regions had to restrict power to the industrial sector as residential areas faced blackouts. These kinds of disruptions are unpalatable for government officials, who are keen to maintain rapid and world-leading economic growth rates.

Australian dollar

- The dollar continued to depreciate in September – by 1.2% against the US dollar and by 0.7% against a trade-weighted basket of international currencies.
- The weakness appeared partly due to subdued economic data in China, as well as lower iron ore prices.

Australian equities

- The S&P/ASX 200 Accumulation Index moved 1.9% lower through September, as inflation fears and rising bond yields dampened investor sentiment. The growing prospect of reduced central bank stimulus compounded concerns, as did the risk of prolonged lockdowns given elevated numbers of Covid cases in New South Wales and Victoria.
- The decline in equities was broad-based, with seven of the 11 GICS sectors falling.
- After treading water for most of the calendar year, the Energy sector surged 16.4% as natural gas, coal and oil prices neared multi-year highs. Concerns about declining inventories given growing demand from reopening economies, combined with supply shortages due to the damage caused by hurricane Ida saw the price of Brent oil rally more than 10% to just under US\$80/barrel.
- The Financials sector also outperformed, rising 1.5% thanks to positive performances from Macquarie Group and the major banks. Macquarie Group announced better-than-expected earnings guidance for the first half of the financial year, while the major banks benefited from rising bond yields.
- Conversely, the Materials sector fell 12.1% as iron ore and gold miners followed their respective commodity prices lower. Iron ore continued to suffer from demand concerns in China as policymakers look to contain steel output growth as a way of reducing carbon emissions. Gold prices were dragged lower by the rise in bond yields, as central banks announced plans to reduce the scale of stimulus packages.
- The moderation in optimism affected small caps too, with the S&P/ASX Small Ordinaries Accumulation Index falling 2.1%. Nearly two-thirds of constituents lost ground, with meal delivery company Marley Spoon and financial services company Iress among the worst performers.

Listed property

- Like other equities, global property securities struggled in September. The FTSE EPRA/NAREIT Developed Index declined 4.6% in Australian dollar terms.
- The best performing regions included Singapore (+1.0%), Japan (+0.1%) and Australia (-2.2%), while the laggards included Sweden (-12.1%), Spain (-9.2%) and France (-8.6%).
- Global vaccination rates have continued to increase, giving more nations the confidence to relax social distancing restrictions. Eased restrictions are helping restore mobility, boosting sentiment towards some stocks that have struggled recently. The retail and lodging sub-sectors outperformed, for example.
- In Asia, concerning news about the financial stability of a large Chinese property developer hampered other property stocks in the region. Whilst this eroded confidence in markets, property fundamentals continue to strengthen, fuelled by a low cost of capital and the return of tenancy demand in many areas.
- Locally, A-REITs declined 2.2%. Charter Hall Retail REIT (+5.0%) and Scentre Group (+4.9%) were among the best performing stocks in the Index.

Global equities

- September saw a pickup in volatility in share markets globally. Rising bond yields amid inflationary fears did not help. Sentiment was also adversely affected by concerns over the US debt ceiling

and a debt crisis affecting large Chinese property developer Evergrande.

- With valuations quite high, these concerns resulted in some profit taking in key regions. As a result, major global indices snapped a run of seven consecutive monthly gains.
- The S&P 500 Index in the US closed September 4.7% lower. Early in the month technology giants Apple and Netflix had both risen to new all-time highs, but they subsequently fell back alongside most peers. In fact the tech-heavy NASDAQ performed even less well than the broader S&P 500 Index, retreating 5.3%.
- In Europe the STOXX 600 fell 3.3%, with weakness extending across major markets like Germany and Switzerland. Most areas of the market struggled, although financial stocks fared well, benefiting from higher bond yields.
- UK stocks fared better, with the FTSE 100 Index falling 'only' 0.5%. This partly reflecting sterling weakness, which boosted the overseas earnings of some of the large multinational companies in the Index. The large energy-related stocks in the Index also typically fared well, thanks to rising oil prices.
- In Japan the resignation of former Prime Minister Suga saw market strength early in the month. Investors suggested a change in leadership could increase the prospects of fiscal and other policy reforms. The Nikkei 225 Index surged to its highest level since the early 1990s, before drifting lower into month end.

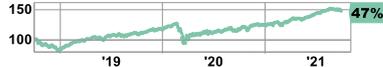
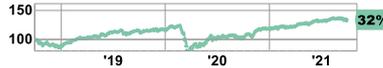
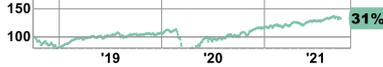
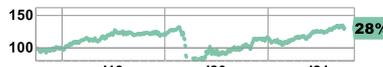
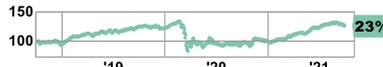
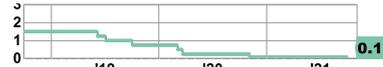
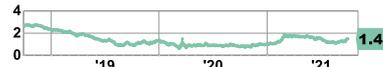
Global and Australian Fixed Income

- The release of some better-than-expected economic data globally and ongoing inflationary pressure in key regions meant investors continued to focus on the probability of interest rate hikes. In turn, this exerted upward pressure on bond yields. Returns from fixed income markets were negative as a result.
- The Australian market was one of the most adversely affected. Yields on 10-year Commonwealth Government Bonds rose 0.34% over the month, to 1.49%. Against this background, the Bloomberg AusBond Composite 0+ Year Index declined 1.5%; an unwelcome surprise for any investors who thought investments in fixed income were stable, and provided capital security.
- Ten-year Treasury yields in the US also closed September at 1.49%, an increase of 0.18% over the month. Again this primarily reflected evolving expectations for official interest rates, with inflation running well above target. Money markets suggest borrowing costs in the US will be raised in the next 12-18 months.
- Similarly in the UK, officials started talking more openly about the possibility of rate hikes – this saw 10-year gilt yields rise 0.31% over the month, to 1.02%.

Global credit

- Despite the weakness in equity markets, credit spreads narrowed slightly over the month, which supported returns from corporate bonds.
- That said, there was some divergence in performance regionally. While US credit fared relatively well, European markets were little changed. At the same time, Asian issuers were hampered by the debt crisis facing large Chinese property developer, Evergrande. This episode highlighted the indebtedness of some issuers in the region, and resulted in a negative return from the Asian credit market as a whole.

MARKET WATCH DATA SHEET

		1 Month Return/Change	3 Month Return/Change	12 Month Return/Change	3 Year Annualised Return/Change	3 Year Chart
EQUITIES						
MSCI World (Gross of withholding tax, in AUD)	4,661.50	-2.98%	4.03%	28.39%	13.79%	
MSCI Emerging Markets (AUD)	1,252.49	-2.81%	-4.35%	17.66%	9.02%	
ASX 200	7,332.20	-1.85%	1.71%	30.56%	9.65%	
ASX Small Ordinaries	3,472.90	-2.14%	3.44%	30.41%	9.43%	
S&P 500 (USD)	4,307.54	-4.65%	0.58%	30.00%	15.99%	
REITs						
ASX 200 A-REIT	1,610.70	-2.18%	4.24%	29.85%	8.57%	
FTSE EPRA/NAREIT Developed (AUD)	3,664.65	-4.60%	3.18%	29.79%	7.24%	
CASH and FIXED INCOME						
Official Cash Rate Australia	0.10%	0.00%	0.00%	-0.15%	-	
10-year yield Australia	1.49%	+0.34%	-0.04%	+0.70%	-	
10-year yield US	1.49%	+0.18%	+0.02%	+0.80%	-	
Foreign Exchange						
AUD/USD	0.7224	-1.16%	-3.78%	0.78%	-0.06%	

Source: Factset and Bloomberg, at 30 September 2021

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