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MONTHLY UPDATE ON THE INVESTMENT ENVIRONMENT

July 2021

primesuper
surprisingly straightforward

MARKET UPDATE

Continuing progress in the containment of the COVID-19 virus was reflected in positive economic developments over the past month, with concerns around the impact of the more virulent delta strain mitigated by the initial success of vaccines in reducing case severity. By early August there had been over 200 million confirmed cases of COVID-19 globally, with over 4.25 million confirmed deaths.

Rising optimism about the economic recovery is uneven across countries, with a notable divergence between developed versus emerging economies relating to access to vaccines. The IMF's July 2021 outlook noted this 'fault line', upgrading developed economy growth forecasts and downgrading those for emerging economies, particularly south-east Asia and India, which have recently struggled with serious COVID-19 outbreaks.

After being relatively insulated from the worst effects of the pandemic, delta strain outbreaks worsened in Australia during the month, plunging Sydney into an extended lockdown and leading to restrictions in other parts of the country. Nonetheless, there appears to be optimism that any economic impacts will be temporary. The RBA went against consensus expectations of a dovish tilt in its early August meeting, deciding not to delay a tapering of its weekly bond purchases. The RBA anticipates a prompt recovery once lockdowns ease and vaccination rollouts advance, also noting that unemployment is not expected to materially rise.

The latest Australian jobs data proved favourable, with the unemployment rate declining 0.2% over June to a decade-low of just 4.9%. Inflation was also above forecasts, with prices rising 0.8% over the quarter, and base effects from mid-2020 leading to a spike in the year-on-year headline print from 1.1% to a 12-year high of 3.8%. Australian dwelling prices surged despite lockdowns, rising 1.6% in July and 16.1% annually; the fastest rate in 17 years.

US economic data was positive overall, albeit somewhat mixed. Second quarter GDP growth was strong but below consensus, taking the annual rate to 6.5%. An unexpected weakening in government and residential investment expenditure detracted from the print. By contrast, inflation beat expectations, with the annual headline rate rising to a 13-year high of 5.4% on June. High energy costs and increased demand for cars were to blame, the latter due to a global semiconductor shortage. Core inflation similarly soared to 4.5%, a 30-year high.

While the Federal Reserve's late July meeting saw no changes to policy settings, members suggested that 'progress' was being made to reaching its employment and inflation goals. The language was interpreted as a sign tapering is approaching, although with no discrete timeline yet.

Chinese June quarterly GDP growth improved to 1.3%, being 0.9% higher than that for the March quarter, with growth in construction and industrial output the key drivers. However, the Chinese central bank announced a 0.5% cut in required bank reserve ratios, representing a more accommodative stance aimed at encouraging lending activity to businesses. Meanwhile, regulatory risks came to the fore, with a sudden ban on for-profit activity in China's enormous private education sector rattling local equities. Sino-US tensions remain elevated, with discussions between officials during the month ending in stalemate.

In Europe, easing lockdown restrictions led to an above-expected GDP growth figure of 2% quarter-on-quarter, supported by strong household consumption growth in Italy, Spain and Portugal. The ECB revised its policy framework, changing its inflation target from 'below, but close to 2%' to just 2%, a move that will allow it more leeway to hold back on tightening policy when inflation rises. In the UK, 'Freedom Day' on 19 July saw a relaxation in most social distancing restrictions, with a sharp rise in cases fortunately not yet matched with an increase in deaths; the vaccination rollout appears to have helped reduce serious cases.

Risk assets continued to rally over the month as accommodative monetary and fiscal policy settings and an easing in the pandemic's economic impact benefitted equities. A number of local and overseas equity indices reached record highs, with major technology firms posting exceptionally robust second quarter profits. A fall in bond yields amid expected longer-term accommodative policy saw fixed interest also record strong returns over July.

Table: Index Returns to 31 July 2021

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	1.1	5.8	1.1	29.1
S&P/ASX Small Ordinaries Accumulation Index	0.7	4.1	0.7	32.3
International Equities				
MSCI World (ex Australia) Index (hedged A$)	1.8	5.2	1.8	33.7
MSCI World (ex Australia) Index (unhedged A$)	4.0	10.2	4.0	31.8
MSCI Emerging Markets Index (unhedged A$)	-4.7	0.5	-4.7	17.7
Property				
S&P/ASX 200 A-REIT Accumulation Index	0.3	7.6	0.3	32.8
Australian Fixed Interest				
Bloomberg AusBond Composite Index	1.8	2.7	1.8	0.5
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	1.5	2.2	1.5	-1.0
Barclay's Global Capital Aggregate Bond Index (hedged A$)	1.3	2.0	1.3	0.1
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.0	0.0	0.1
Commodities				
Gold (US$ per ounce)	3.6	3.3	3.6	-7.1
Copper (US$ per metric tonne)	3.8	-1.0	3.8	51.7
WTI Crude Oil (US$ per barrel)	0.7	16.3	0.7	83.6
RBA Index of Commodity Prices (A$)	7.7	21.1	7.7	55.0

Table 1: Australian Dollar versus Foreign Currencies to 31 July 2021

AUSTRALIAN DOLLAR VERSUS	AS AT 31 JULY 2021	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.74	-2.1	-4.8	-2.1	2.5
British Pound Sterling	0.53	-2.7	-5.2	-2.7	-3.2
Euro	0.62	-2.1	-3.4	-2.1	2.2
Japanese Yen	80.67	-3.2	-4.5	-3.2	6.4