MONTHLY UPDATE ON THE INVESTMENT ENVIRONMENT

October 2021

WHITEHELM ADVISERS

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MARKET UPDATE

The global economy continued to show signs of ongoing economic recovery over the month, with strong inflation and jobs growth in a number of countries prompting policy tightening from a number of central banks, including the US Federal Reserve and the RBA.

Confirmed global deaths from COVID-19 eclipsed 5 million in late October, although some estimates suggest the true number could be potentially much higher. Daily cases and deaths are elevated across eastern Europe, where vaccination rates are lower than in western Europe, while also remaining high in south-eastern US states. The story is more optimistic in Australia, however, with the lifting of lockdown restrictions in the states of Victoria and New South Wales following highly successful vaccine rollout programs, with international borders reopening.

The IMF issued its twice-yearly economic outlook in mid-October, making a slight downward revision to its global growth forecast for 2021, cutting expected GDP growth by 0.1% to 5.9%. Citing ongoing supply chain bottlenecks as a driver behind the downward revision, the IMF also voiced caution about the risks around elevated inflation and the persistence of the pandemic, warning central banks to be 'very, very vigilant' in balancing inflation pressures with stimulating growth.

The major economic development in Australia over the month was the third quarter inflation print, with the RBA's preferred measure – the trimmed mean – beating consensus forecasts to rise to 0.7% for the quarter, taking the annual rate to 2.1% - the first time inflation has entered the RBA's target range in six years. The data prompted bond markets to bet that the RBA would have to tighten rates well ahead of its prior guidance of 2024, and ultimately prompted the RBA to abandon its 0.1% yield curve control target out to the April 2024 government bond. The RBA revised its outlook to suggest a potential rate hike in 2023, while markets are far more hawkish, currently pricing in four hikes in 2022 alone.

In a widely anticipated development, the US Federal Reserve decided at its early November meeting to proceed with tapering of asset purchases, noting that employment and inflation criteria had been achieved. Expected to start in late November, the US$120 billion in monthly purchases will be cut by US$15 billion initially and further scaled back in coming months, suggesting an end to quantitative easing by mid-2022; this will likely be followed by the commencement of a hiking cycle in its target rate.

US inflation data suggested an easing in price pressures relative to recent months, although price growth remains highly elevated. The Federal Reserve's preferred measure, the Core PCE Index, remains at a thirty-year high of 3.6% year-on-year, while US CPI came in at a year-on-year 5.4%. A combination of ongoing supply chain issues, rising housing costs and food prices all contributed to the high figure, suggesting price pressures are broadening across the economy.

China's third quarter GDP data reflected a weakening rate of growth, falling to an annual 4.9%. An ongoing energy crisis within the manufacturing sector, property sector concerns, and a zero-tolerance approach to COVID-19 containment all curbed consumer spending.

The European economy continued to be impacted by soaring energy costs triggered by a shortage of Russian gas imports, potentially as a political move designed to expedite German certification of the recently completed Nord Stream 2 pipeline, which will supply gas from Russia to Germany. Both energy costs and supply bottlenecks pushed Euro area inflation to a 13-year high of 4.1% in October. On the policy front, the ECB made no changes to policy settings in October, suggesting a greater need for substantial ongoing stimulus. The Bank of England proved similarly dovish at its early November meeting, surprising markets by not hiking rates.

The savage sell-off in Australian bond yields – especially for shorter tenors – led to Australian fixed interest assets posting a sizeable -3.6% loss for the month. By contrast, overseas fixed interest yields were less volatile given limited policy surprises during October, returning -0.3% as yields edged upwards. Equities markets generally proved unswayed by fears of high inflation and tighter central bank stimulus, with developed overseas equities returning a robust 5.4% for the month on a hedged basis. The impact of Australia's sharper spike in bond yields did, however, impact the performance of Australian equities, which returned a modest 0.1% on a total return basis over October.

Table 1: Index Returns to 31 October 2021

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	0.1	0.8	1.9	28.6
S&P/ASX Small Ordinaries Accumulation Index	0.9	3.7	4.4	31.0
International Equities				
MSCI World (ex Australia) Index (hedged A$)	5.4	4.2	6.0	39.7
MSCI World (ex Australia) Index (unhedged A$)	1.7	1.6	5.7	31.4
MSCI Emerging Markets Index (unhedged A$)	-2.9	-2.6	-7.2	9.4
Property				
S&P/ASX 200 A-REIT Accumulation Index	0.4	4.4	4.7	30.9
Australian Fixed Interest				
Bloomberg AusBond Composite Index	-3.6	-4.9	-3.3	-5.3
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	-0.1	-1.7	-0.2	-2.4
Barclay's Global Capital Aggregate Bond Index (hedged A$)	-0.3	-1.4	-0.2	-1.0
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.0	0.0	0.0
Commodities				
Gold (US$ per ounce)	1.5	-3.1	0.3	-6.0
Copper (US$ per metric tonne)	6.3	-2.4	1.3	41.3
WTI Crude Oil (US$ per barrel)	11.4	13.0	13.7	133.5
RBA Index of Commodity Prices (A$)	2.5	-9.1	-3.3	35.5

Table 2: Australian Dollar versus Foreign Currencies to 31 October 2021

AUSTRALIAN DOLLAR VERSUS	AS AT 31 OCTOBER 2021	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.75	4.0	2.2	0.0	7.0
British Pound Sterling	0.55	2.3	3.6	0.8	0.9
Euro	0.65	4.1	4.7	2.5	7.7
Japanese Yen	85.64	6.3	6.2	2.8	16.7