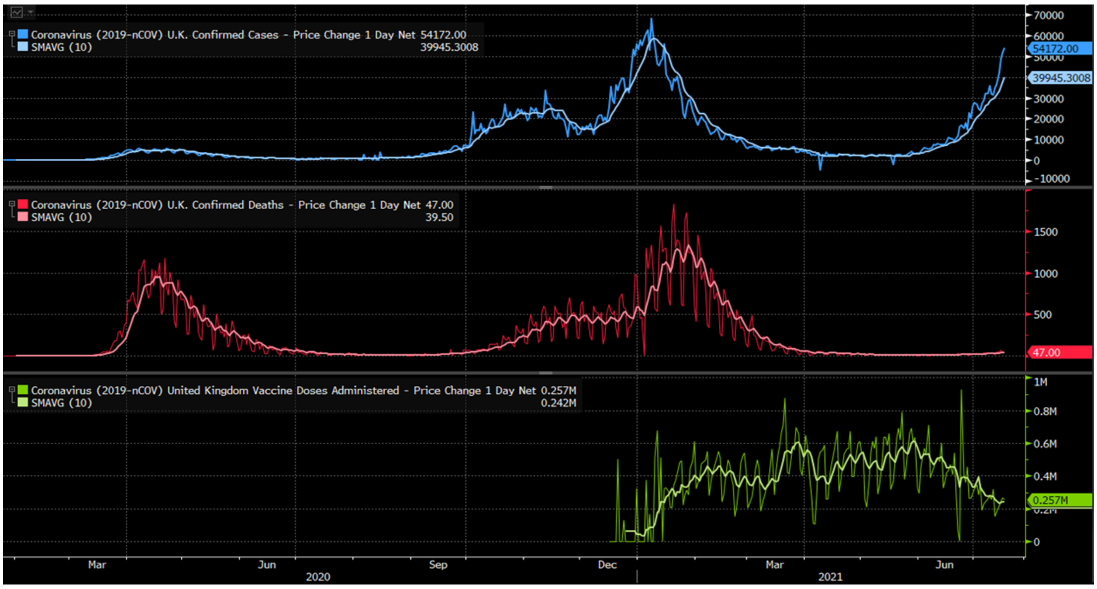
Monthly Economic & Investment Market Commentary

June 2021

"The world needs a reality check," according to an epidemiologist working in Geneva for the World Health Organisation. The article quoting her goes on to say: "Around the world, scientists and public health officials fear that the world's protracted battle against the coronavirus is at a delicate and dangerous moment. Reality checks abound. Coronavirus infections are surging in places with low vaccination rates. SARS-CoV-2 is continuing to mutate. Researchers have confirmed the delta variant is far more transmissible than earlier strains. Although the vaccines remain remarkably effective, the virus has bountiful opportunities to find new ways to evade immunity. Most of the world remains unvaccinated." [1]

As most of us endure some form of lockdown over these last few weeks, many of us will have watched the crowds at sporting events in the northern hemisphere, with a degree of envy, but also perhaps with some trepidation. Packed crowds in the United Kingdom in recent weeks are already coinciding with an alarming trend in cases, and they come ahead of the full re-opening scheduled for July 19th.

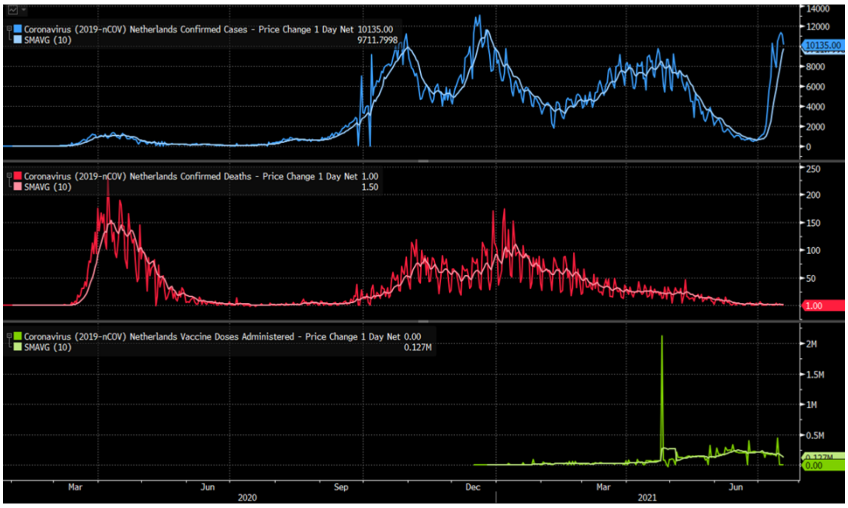


As this chart shows, it is not just in places with low vaccination rates that the number of cases is surging. The UK has achieved among the world's highest vaccinations rate, but as the blue line shows, cases are now approaching the previous peak.

The red line shows the confirmed deaths, and by extension the remarkable vaccine efficacy, whilst the number of daily vaccine doses administered is shown in green, confirming that this is now tapering. Only time will tell if the current level of vaccination in the UK is sufficient to sustain the reopening of their economy, and whether the ebullient spirit we've seen in the sporting crowds can sustain investors.

As our Victorian compatriots in their 5th lockdown perhaps know best, a false start on that re-opening and a cycle of new restrictions can be draining on the hardiest of spirits. It is at least sobering then to look to the example in the Netherlands, where a month ago politicians made a promise to their citizens, "You can expect a beautiful summer."

As the country relaxed all social distancing and restrictions, the cases grew 500% in a week. The Dutch PM was then forced to acknowledge that "what we thought would be possible, turned out not to be possible in practice," and that "we had poor judgement, which we regret and for which we apologise." Note that whilst deaths for now also remain low, the sharp rises in cases risked an increase in the rate of hospitalisation, and as such the government "had no option but to reintroduce restrictions."[2]



We can also observe moves to reintroduce or persist with restrictions in some form or another in countries as diverse as Singapore and the United States, and the honest answer is that we cannot predict the impact on financial markets from one month to the next. Fortuitously, a requirement to reliably make accurate short-term predictions is not part of our forecasting or our approach to managing your portfolio.

As we seek to interpret these trends, and those that are taking shape in other key portfolio exposures, we do so as always through the lens of our long-term forecasting. This approach served your portfolio well during the depths of the crisis and the sharp recovery in markets last year, when there was clearly much higher levels of uncertainty and angst than exist today. We remain confident that this approach will continue to deliver you good long-term portfolio outcomes.

In fact, in thinking back to the onset of the crisis last year, there are several good reasons to be much more optimistic, and for any short-term dips in sentiment and markets to be viewed as an opportunity. A year ago, one effective vaccine against this virus was but an aspirational goal, today we have several vaccines that far exceeded early expectations on how effective they would be. Evidence to date also shows that these vaccines remain effective against the many mutations, including delta.

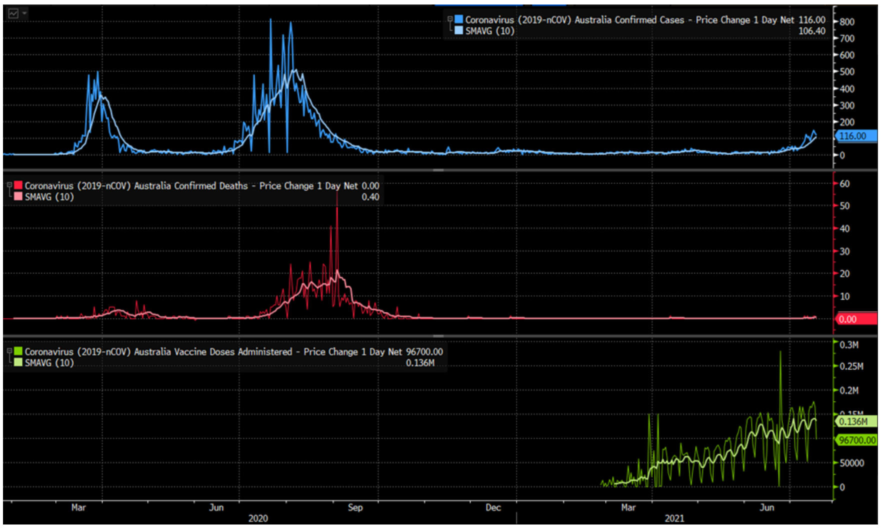
A year ago, it was much less clear what level of policy support would be forthcoming, from both central banks and governments, and for how long it would be continued. Today, we have all been witness to a truly unprecedented level of coordinated fiscal and monetary policy support over the last year or so, and just as importantly we can also credibly believe that it will not be withdrawn until the recovery is able to sustain itself, and very likely would be bolstered if circumstances demand that.

From a portfolio perspective, we most importantly saw the resilience of markets and the truly remarkable recovery in global equity markets particularly. Though 2020 was amongst the most challenging times most of us will face, we can take confidence that the right portfolio management approach was to stay the course, indeed, to do a modest amount of buying, but most importantly to maintain a focus on long-term outcomes. That stood your portfolio in good stead last year, and we all have every reason to believe it will continue to do so.

For the sake of balance, it is worth reiterating here that we are very aware of the array of risks that lie ahead, including but not limited to increased rates of inflation, a premature withdrawal of current policy support, and prolonged health, economic and market impacts from the coronavirus.

As a general comment, the range of portfolios we manage on your behalf are reasonably defensively positioned at the moment, and that defensive stance will grow as we continue to incrementally reduce the Australian Equities asset class from the long-held Overweight back to Neutral. This process has been underway for several months now, and our current expectation remains that portfolios will be back to Neutral within another couple of months. In practical terms, that will mean that a portfolio invested in our No.3 program will have moved 8% of their exposure from risky assets to defensive assets.

At the same time, the flexibility of the Individually Managed Account structure means that newer portfolios will be implemented up to that Neutral target, an exposure still supported by the current long-term forecast for Australian Equities. The inputs to this forecast, as shown in the following Asset Class Tipping Points tables, are as always, the answers to these questions: how much income you will receive, how quickly will that income grow, and what valuation is likely to apply to your investments in the future. The summation of the answer to each of those questions for the broad asset class is about 6%. That is the expected per annum return, averaged out over the next decade.



For reference, we include here the same chart as above but with the Australian data, showing an uptick in cases, but with more upside in vaccine distribution to come.

The original article we referenced above includes the line, "and so the end of the pandemic remains somewhere over the horizon." That seems like a good focus to maintain to deliver on long-term portfolio management objectives.

Thank you for your patience with the delayed publication of this commentary, and we look forward to writing to you again in the next couple of weeks, back on our regular schedule.

Kind regards,
Asset Allocation & Investment Committee

Asset Class Tipping Points

Given the delayed publication of this June commentary, we share below a version of the tables updated through mid-July. There has in fact not been that many significant changes in the tables since the end of June, with many markets continuing to trade in a sideways range for the last couple of months.

Asset Class Tipping Points - July 2021

Australian Equities

All Ords	10 Year Forecast	Valuation	12-Jul
10,900	1.3%	Overpriced	
10,600	1.7%	Fully Priced	
10,300	2.0%	Fully Priced	
10,000	2.4%	Fully Priced	
9,700	2.8%	Fully Priced	
9,400	3.2%	Fully Priced	
9,100	3.6%	Fully Priced	
8,800	4.1%	Fair Value	
8,500	4.6%	Fair Value	
8,200	5.0%	Fair Value	
7,900	5.6%	Fair Value	
7,600	6.1%	Fair Value	Aust 6.1%
7,300	6.7%	Cheap	Fin'l 6.6%
7,000	7.3%	Cheap	
6,700	7.9%	Cheap	
6,400	8.6%	Cheap	
6,100	9.3%	Cheap	

Income	4.3%	p.a.
Earnings	3.7%	p.a.
Valuation	-1.9%	p.a.
Forecast	**6.1%**	**p.a.**

International Equities - Developed

World ExAust	10 Year Forecast	Valuation	12-Jul
3,600	1.2%	Overpriced	
3,500	1.5%	Fully Priced	
3,400	1.8%	Fully Priced	
3,300	2.2%	Fully Priced	
3,200	2.5%	Fully Priced	Dev 2.7%
3,100	2.9%	Fully Priced	
3,000	3.3%	Fully Priced	
2,900	3.6%	Fully Priced	
2,800	4.1%	Fair Value	
2,700	4.5%	Fair Value	
2,600	4.9%	Fair Value	
2,500	5.4%	Fair Value	
2,400	5.9%	Fair Value	EU 6.1%
2,300	6.4%	Fair Value	UK 6.4%
2,200	7.0%	Cheap	Japan 6.8%
2,100	7.5%	Cheap	
2,000	8.2%	Cheap	

Income*	2.1%	p.a.
Earnings	3.1%	p.a.
Valuation	-2.5%	p.a.
Forecast	**2.7%**	**p.a.**

International Equities - Emerging

Emerging Markets	10 Year Forecast	Valuation	12-Jul
1,850	1.3%	Overpriced	
1,800	1.6%	Fully Priced	
1,750	1.9%	Fully Priced	
1,700	2.2%	Fully Priced	
1,650	2.6%	Fully Priced	
1,600	2.9%	Fully Priced	
1,550	3.3%	Fully Priced	
1,500	3.7%	Fully Priced	
1,450	4.1%	Fair Value	
1,400	4.5%	Fair Value	
1,350	4.9%	Fair Value	EM 5.1%
1,300	5.4%	Fair Value	
1,250	5.9%	Fair Value	Asia-P 5.8%
1,200	6.4%	Fair Value	
1,150	6.9%	Cheap	
1,100	7.5%	Cheap	
1,050	8.1%	Cheap	

Income*	-0.8%	p.a.
Earnings	4.8%	p.a.
Valuation	1.1%	p.a.
Forecast	**5.1%**	**p.a.**

Listed Property

ASX200 Property	10 Year Forecast	Valuation	12-Jul
2,150	1.4%	Overpriced	
2,100	1.7%	Fully Priced	
2,050	2.0%	Fully Priced	
2,000	2.4%	Fully Priced	
1,950	2.7%	Fully Priced	
1,900	3.0%	Fully Priced	
1,850	3.4%	Fully Priced	
1,800	3.7%	Fully Priced	
1,750	4.1%	Fair Value	
1,700	4.5%	Fair Value	
1,650	4.9%	Fair Value	
1,600	5.4%	Fair Value	
1,550	5.8%	Fair Value	A-REITs 5.7%
1,500	6.3%	Fair Value	
1,450	6.7%	Cheap	
1,400	7.3%	Cheap	
1,350	7.8%	Cheap	

Income	4.0%	p.a.
Dist Grwth	1.4%	p.a.
Valuation	0.3%	p.a.
Forecast	**5.7%**	**p.a.**

** Income for International Equities includes dividends and forecast currency impact.*

Sources

1. *J Achenbach, "In this summer of covid freedom, disease experts warn: 'The world needs a reality check' – Washington Post. 17-Jul-21.*
2. *J Hawke, "England will soon abandon coronavirus restrictions. The Netherlands shows what could happen next" – abc.net.au. 18-Jul-21.*

NOTE: *It is important to note that each portfolio is managed to its own mandate, which can mean that activity mentioned above is not reflected in your own portfolio. This may be because it is more beneficial to your portfolios after tax performance to complete the trading at a different time, or may be due to individual customisation that you have requested. This flexibility is an integral part of the investment process. If you would like to discuss the tailoring of your portfolio, please contact your Adviser.*