Economic Wrap

September Quarter 2021

Summary

- The September quarter was a positive one overall for risk assets marred by growing macro uncertainty towards quarter-end.
- Chinese growth and soaring energy prices were one concern, hawkish central banks, another.
- The Global Composite PMI (a useful leading indicator of economic growth) remained positive but weaker over the quarter pointing towards slower economic growth for the global economy.

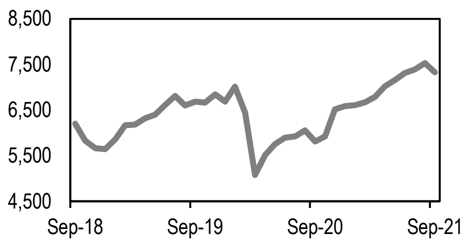
Markets

- The September quarter saw a continuation of strong performance for equity markets with growth stocks back in vogue domestically and internationally. Australian equities slightly outperformed against global peers (see Chart 2) while a steep decline in iron ore mining stocks saw value underperform (see chart 3).
- Emerging market underperformance relative to developed markets persisted. This was driven by a regulatory crackdown in China on technology and online education businesses as well as concerns of possible spill over from the potential collapse of property developer Evergrande (see Chart 4).

Key economic news

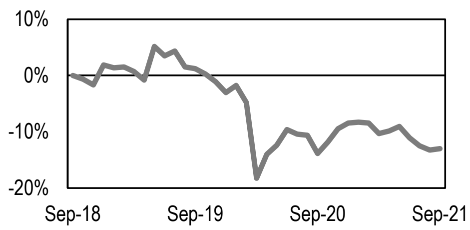
- Rising energy prices and supply chain pressures have seen concerns over inflation increase. When coupled with slower growth we have seen some alarmist calls of "stagflation" emerge.
- It is important to note that growth is slower than the immediate bounce back from pandemic lows but is still strongly positive with the US anticipated to growth at 7.54% annualised in the December quarter accordingly to the NY Fed Weekly Economic Index.
- While the September quarter is likely to be a negative growth quarter (given lockdowns) the bounce back as restrictions ease bolsters confidence for the December quarter in Australia.

1. S&P/ASX 200 Price Index



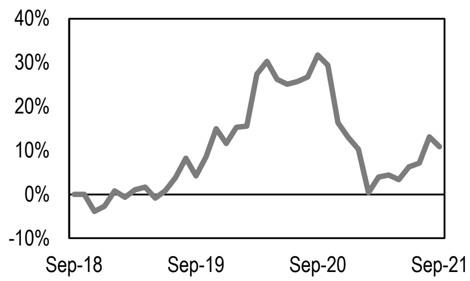
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



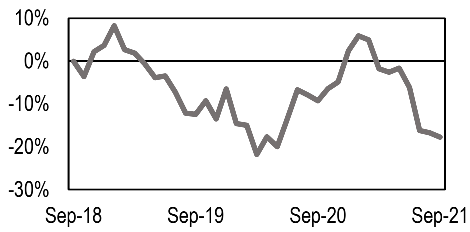
Source: Bloomberg, IOOF

3. Australia – Growth vs Value stocks



Source: Bloomberg, IOOF

4. Emerging markets vs Developed Markets, (In USD)



Sources: Bloomberg, MSCI, S&P, IOOF

Sector and stock returns

ASX/S&P 200 Sectors (GICS)				
	Monthly	**% ∆**	**Quarterly**	**% ∆**
▼	Consumer Discretionary	-0.90	Consumer Discretionary	1.63
▼	Consumer Staples	-4.43	Consumer Staples	3.23
▲	Energy	16.38	Energy	7.63
▲	Financials ex Property	1.46	Financials ex Property	3.96
▲	Financials	1.46	Financials	3.96
▼	Health Care	-5.50	Health Care	2.09
▼	Industrials	-0.83	Industrials	5.91
▼	IT	-4.00	IT	4.42
▼	Materials	-12.09	Materials	-13.29
▼	Property Trusts	-2.26	Property Trusts	3.66
▲	Telecommunications	0.88	Communication Services	3.47
▲	Utilities	2.07	Utilities	3.66

Source: Bloomberg, IOOF

Best and Worst S&P/ASX 200 Performers			
Top five stocks		**Bottom five stocks**	
Monthly			
Beach Energy Ltd	+42.4%	Fortescue Metals Group Ltd	-28.8%
Flight Centre Travel Group Ltd	+30.8%	Iress Ltd	-22.1%
Ausnet Services	+30.2%	Bluescope Steel Ltd	-18.7%
Whitehaven Coal Ltd	+27.7%	Regis Resources Ltd	-18.6%
Woodside Petroleum Ltd	+22.5%	Mineral Resources Ltd	-18.4%
Quarterly			
WiseTech Global Ltd	+68.0%	Fortescue Metals Group Ltd	-35.9%
Whitehaven Coal Ltd	+66.5%	Magellan Financial Group Ltd	-34.3%
Flight Centre Travel Group Ltd	+44.5%	Appen Ltd	-34.1%
Ausnet Services	+44.0%	Polynovo Ltd	-31.7%
Sydney Airport	+42.3%	AGL Energy Ltd	-29.5%

Source: Bloomberg, IOOF

Share Markets, September 2021

	Australian Indices	Sep-21 Price	1M return (%)	Jun-21 Price	3M return (%)
▼	S&P/ASX 200	7332	-2.69	7313	0.26
▼	All Ordinaries	7630	-2.47	7585	0.59
▼	Small Ordinaries	3473	-2.69	3384	2.64
US Indices					
▼	S&P 500	4308	-4.76	4298	0.23
▼	Dow Jones	33844	-4.29	34503	-1.91
▼	Nasdaq	14449	-5.31	14504	-0.38
Asia Pacific Indices					
▼	Hang Seng	24576	-5.04	28828	-14.75
▲	Nikkei 225	29453	4.85	28792	2.30
UK & Europe Indices					
▼	FTSE 100	7086	-0.47	7037	0.70
▼	CAC40	6520	-2.40	6508	0.19
▼	DAX Index	15261	-3.63	15531	-1.74

Sources: Bloomberg, MSCI, FTSE, S&P, IOOF
Note: return is reported on a price basis and in local currency terms e.g. S&P500 performance is in US dollars and excluding dividends

Global equity markets

International markets were broadly positive for the September quarter. Emerging market equities were a notable exception (down 4.5%). A regulatory crackdown in China continued to weigh on the index with some more recent examples including denunciation of video games as a "spiritual opium" and restrictions on player game time punishing large cap tech names. Another concern was the variable interest entity (VIE) structure which Chinese large caps have relied upon to raise capital from Western markets. The crackdown on the online tutorial sector also involved banning this as an option, raising concerns for other companies that employed it.

	1-mth	3-mth	6-mth	1-yr
MSCI World	-3.0%	3.9%	13.6%	27.8%
Value	-1.7%	3.1%	9.6%	30.9%
Value-Weighted	-0.9%	4.0%	11.6%	39.6%
Momentum	-2.4%	5.0%	14.0%	19.1%
Growth	-3.9%	4.8%	18.0%	25.4%
Quality	-5.1%	4.0%	17.0%	25.1%
Low volatility	-3.4%	3.1%	10.4%	14.4%
Equal weight	-0.4%	3.4%	10.8%	29.1%
Small caps	-1.8%	2.5%	9.3%	39.4%

Source: Bloomberg, IOOF, MSCI

Slowing global growth cooled optimism on the "reflation trade" which benefitted cyclical stocks and the value style during the September quarter. In September, China and energy concerns were a heavier focus triggering a slight correction following positive performance in July and August. Energy concerns relate to production issues for coal and natural gas with lower supply helping to drive prices higher. Another factor was market distortion given Chinese bans on Australian thermal coal while weaker renewable production in Europe from North Sea wind generation was another driver. The combination drove concerns over an "energy crunch" on these economies and triggered equity market weakness.

Australian equity markets

The Australian market rose by 1.7% in the September quarter. The leading sectors were Energy (up 9.3%) and Industrials (up 6.6%). Materials (down 9.9%) was the worst and only negative performer. We saw a rare event with all sectors except for Materials outperforming the ASX 200 benchmark index. Returns were defined by a gradual rise over both July and August with September seeing a sharp selloff in the Materials sector, triggered by a decline in iron ore prices and weaker sentiment on Chinese growth. Concerns over energy shortages in China and Europe amidst rising LNG prices saw a sharp Energy sector rally (up 16.7% in September) to end the quarter as the best performer.

	1-mth	3-mth	6-mth	1-yr
MSCI Australia	-2.0%	0.8%	9.3%	30.9%
Value	-0.9%	-0.7%	6.8%	43.4%
Value-Weighted	-1.0%	0.9%	8.3%	40.9%
Momentum	-2.2%	-1.0%	8.4%	13.2%
Growth	-3.9%	4.9%	18.3%	25.8%
Quality	-5.2%	4.4%	17.3%	25.9%
Low volatility	-2.1%	2.0%	10.3%	24.2%
Equal weight	-0.4%	3.4%	10.8%	29.1%
Small caps	-2.1%	3.4%	12.2%	30.4%

Source: Bloomberg, IOOF, MSCI

At a style level, the September quarter saw a breakdown of certain trends domestically. Small caps were the clear leaders with the small ordinaries up almost 3% vs a 1.7% rise for large caps. The quarterly returns were impacted by the rotation during the month of September with quality stocks (dominated by healthcare and large miners) the worst performers albeit the strongest overall with investors avoiding cyclicals due to domestic lockdowns.

Fixed Income

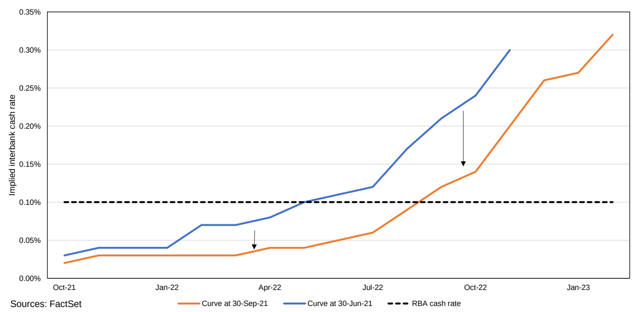
	Fixed Income	Sep-21 yield	1M mvt (bps)	Jun-21 yield	3M mvt (bps)
	Australian Cash rate	0.10	--	0.10	--
▲	10-year Bond Yield	1.49	0.34	1.53	-0.04
▲	3-year Bond Yield	0.31	0.08	0.41	-0.10
▲	90 Day Bank Bill Yield	0.02	0.01	0.03	-0.01
▲	US 10-year Bond Yield	1.49	0.18	1.47	0.02
▲	US 3-year Bond Yield	0.51	0.10	0.46	0.05
▼	US Investment Grade spread	1.07	-0.02	1.04	0.03
▲	US High Yield spread	2.56	0.02	2.28	0.28

Source: Bloomberg, IOOF

Australian bond market

The Australian yield curve steepened with the 3Y yield declining less than the 10Y yield. This was consistent with a drop in market expectations (Chart 5 below) with an initial rate hike not anticipated until late 2022.

5. Australian rate expectations (Jun-21 vs Sep-21)

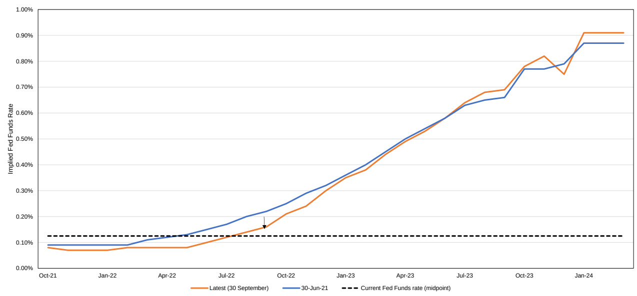


During the quarter the RBA deferred its review of the bond purchasing program (initiated last year) until February 2022. It also lowered the pace of weekly purchases to $4bn/week, down from $5bn/week. The RBA remained positive, given the pace of vaccinations, that the economic recovery will resume during the December quarter. In addition, it anticipated that the economy would return to its pre-Delta path in the second half of 2022. This reflects the economic damage done to date by this coronavirus variant but also highlights confidence in the recovery resuming.

US bond market

Chart 6 illustrates the state of rate expectations at the end of **June** vs the end of **September** for the Fed Funds rate. Broadly speaking these were unchanged for 2023-24 but there was some pushback on rate hikes in 2022. This arguably reflects softening growth momentum in the US with the energy challenges faced by Europe and China also casting doubt on global demand and increasing macro uncertainty.

6. US rate expectations (Jun-21 vs Sep-21)



There were two notable developments from the Federal Reserve's Jackson Hole event.

1. Tapering of the Fed's quantitative easing (bond purchase) program is set to begin this year, and
2. Tapering will not go hand in hand with rate hikes instead it will precede them and there will be some time until rate hikes are appropriate notwithstanding current elevated inflation levels.

Uncertainty about Federal Reserve leadership is also a growing issue. Personal trading, arguably benefitting from insider information, is accelerating turnover in the Federal Reserve Board and may even see Chairman Powell replaced when his term ends. This could have implications for the future of US monetary policy. At present those departing are more hawkish (in favour of rate hikes and quantitative tightening) suggesting a more dovish bias from the Fed may result, further entrenching the "lower rates for longer" dynamic.

Another factor in US markets is the legislated debt ceiling which is due for renegotiation with a potential default nearing. This may lead to further volatility in US markets if an expected agreement is not reached and has arguably contributed to driving yields higher on fears of a potential US default.

Currencies

	Currencies	Sep-21 Price	1M return (%)	Jun-21 Price	3M return (%)
▼	$A vs $US	72.27	-1.22	74.98	-3.61
▲	$A vs GBP	53.64	0.85	54.22	-1.07
▼	$A vs YEN	80.42	-0.06	83.32	-3.47
▲	$A vs EUR	62.41	0.74	63.24	-1.31
▲	$A vs $NZ	104.75	0.90	107.38	-2.45
▼	$A TWI	60.80	-0.65	62.70	-3.03
▲	$US vs EUR	86.38	2.01	84.34	2.42
▼	$US vs CNY	6.44	-0.25	6.46	-0.19
▲	$US vs GBP	74.21	2.08	72.29	2.66
▲	$US vs JPY	111.29	1.15	111.11	0.16
▲	$US vs CHF	93.17	1.81	92.50	0.72
▲	US Dollar Index	94.23	1.73	92.44	1.94
▼	JPM EM Currency Index	55.24	-2.92	57.25	-3.52

Source: Bloomberg, IOOF

The Australian dollar (AUD) fell 3.6% against the US Dollar (USD), down to USD 0.7227 in September over the quarter. We also saw a 3% decline in value against major trading partners ($A TWI) driven by:

- Reduced risk appetite with a more uncertain global environment.
- Concerns over Chinese growth amid the Evergrande saga and energy price pressures soured sentiment on assets/countries exposed to China such as Australia.
- Weaker relative economic momentum with economic data surprises for Australia poorer compared to results for other countries.

USD was broadly up vs other currencies with the trade-weighted dollar (DXY) up 1.9%. Arguably this was driven by a flight to safety as investors juggled increasing macro uncertainty towards quarter-end with the bulk of USD returns occurring in September. EM currencies depreciated due to China concerns with the bulk of the 3.5% decline occurring in September as fears of weaker commodity demand escalated.

Commodities

	Commodities	Sep-21 Price	1M return (%)	Jun-21 Price	3M return (%)
▲	Aluminium	2850	4.92	2521	13.06
▼	Copper	409	-6.54	428	-4.54
▼	Nickel	17946	-8.25	18219	-1.50
▼	Zinc	2979	-0.77	2976	0.11
▲	Crude Oil - Brent	78.52	7.58	75.13	4.51
▲	Natural Gas	5.87	34.04	3.65	60.74
	Metallurgical Coal	117	--	123	-5.03
▲	Thermal Coal	196	13.22	136	43.53
▼	Iron Ore	119.65	-24.87	214.55	-44.23
▼	Gold	1757	-3.36	1776	-1.06
▼	Silver	22	-8.16	26	-15.98

Source: Bloomberg, IOOF

Commodities saw substantial dispersion during the September quarter with a clear contrast between energy and base/precious metals.

Iron ore prices plunged amidst headwinds including:

- Continued disappointing economic data out of China with the Citi Economic Surprise index drifting into negative territory (this means economic data such as trade or retail sales was disappointing market expectations). This suggested a weaker demand outlook for iron ore, and
- The looming collapse of major property developer Evergrande saw sentiment towards assets exposed to Chinese property weaken such as iron ore.
- Ongoing efforts by Chinese authorities to curb steel production to meet environmental targets.

The second major development was a burgeoning energy crisis affecting China and Europe most notably. This saw the prices of energy commodities saw as producers looked to secure available supply.

Natural gas prices surged amidst demand substitution given issues with coal production (floods in China limiting mining activity) and renewables (weak wind season on the North Sea). Limited production increases by oil in response to soaring prices also stoked the rally in energy commodities.

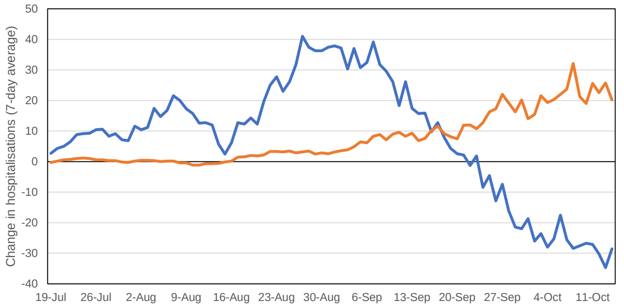
Australia

The Australian economy weathered lockdowns across the East Coast states across the September quarter. Our mass vaccination program and government financial support helped prevent a deterioration in sentiment setting the stage for a bounce back in the December quarter.

Coronavirus pandemic

Lockdown restrictions cast a pall over the East Coast States for the September quarter. However, the vaccination programs in NSW and Victoria limited the worst consequences of the pandemic, namely longer-term health problems and death. Hospitalisations in NSW were in decline since an early September peak while Victorian hospitalisations stabilised (Chart 7).

7. Daily change in hospitalisations (7-day average)



Source: covid19data.com.au

Nationally 83.6% of eligible Australians have received at least one vaccination with 65.4% fully vaccinated as of mid-October. NSW will likely hit the 80% threshold for fully vaccinated persons while Victoria appears likely to reach this juncture in late October.

Sentiment

The Westpac-MI Consumer Confidence Index held steady over the quarter only falling slightly to 106.2 in September, down from 107.2 in June and well above the pandemic lows in early 2020 and even the 5-year average prior to the pandemic. It appears that people are willing to look past the current situation and anticipate a sustained improvement as lockdowns are relaxed with both next year and next 5-year economic expectations tracking well above long-term averages.

The Composite Markit PMI survey contracted for a third month with a reading of 46.5 in September as months of East Coast lockdowns dragged on activity. This was driven by weakness in the services sector with manufacturing marking a sixteenth successive month of expansion. Notably however business confidence (as measured by the NAB Monthly Business Survey) improved in September to levels well-above long-term averages as vaccination efforts spurred sentiment higher.
Taken together sentiment has held up reasonably well. This continues to offer some cause for optimism in activity bouncing back once the current outbreaks are sufficiently contained.

Labour market

Headline data for the labour market held up surprisingly well over the quarter with the unemployment rate declining from 4.9% in June to 4.6% in September. However, that improvement belies several issues. These include a surge in staff working 0 or fewer hours with almost 185k (1.4% of workers) doing so due to a lack of work or being stood down. A 1.7% decline in the participation rate to from 66.2% to 64.5% (as hidden unemployment increased) also contributed substantially. In NSW, the worst-affected state, we saw monthly hours worked decline 10.7% during the quarter highlighting the weakness a 4.6% unemployment rate obscures.

Wage growth remained modest with a 1.8% increase in the year to June (consensus: 1.8%). This result was led by the private sector, up 1.9% with the public sector paling in comparison with 1.3% growth. These numbers came before the worst of the lockdown restrictions and given the impact on employment and the general economy we would not expect a substantial surge in wage growth in the near-term.

Growth

Australian economic growth surprised, rising 0.7% during the June quarter (consensus; 0.35%). Key drivers were both public and private sector spending, contributing 0.7% and 1% respectively. Meanwhile net exports were a notable drag of -1% as high commodity prices and disruption in production saw export volumes decline. We focus on a measure called real GDP which looks to strip out price effects in measuring overall economic activity. This result suggests Australia will avoid a recession provided the anticipated bounce back in Q4 occurs. We are beginning to see this take shape with shut down services including the hospitality sector resuming in NSW on 11 October with signs of strong consumer demand in restaurant bookings & hospitality spending for example.

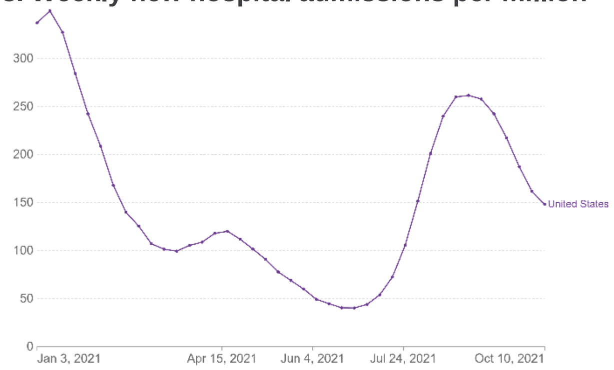
United States

Leading indicators remained supportive of continued US economic growth, but momentum has peaked suggesting the level of economic growth is normalising to pre-pandemic levels. Inflation concerns are higher for the near term with cyclical drivers elevated while structural drivers (wage growth) are still contained.

Coronavirus pandemic

The US moved to release booster doses to support efficacy of existing vaccines from next month with vulnerable groups the first to be targeted. This follows evidence to suggest the waning effectiveness of vaccines after six or more months although we should emphasise being fully vaccinated is curbing the worst effects of the disease reducing hospitalisations and deaths with so-called breakthrough cases (people vaccinated becoming infected) showing milder symptoms and remaining a small fraction of overall cases. This is illustrated in Chart 8 with US hospitalisations peaking in late August and subsequently declining towards quarter-end.

8. Weekly new hospital admissions per million



Source: European CDC for EU countries, government sources for other countries – Last updated 14 October, 14:02 (London time)
OurWorldInData.org/coronavirus • CC BY

Overall, the virus remains a downside risk for the US economy but one where existing vaccine options are adequate to counter current strains with the use of boosters to address newer variants. More recent efforts by the US government to compel unvaccinated persons (who work for employers with over 100 staff) to either vaccinate or take weekly coronavirus tests may also help the US improve its vaccination rate given uptake has slowed substantially relative to other developed nations since June.

Inflation

The consumer price index rose by 5.4% for the year to September (consensus: 5.3%). Notably core inflation (excluding volatile food and energy prices) was softer at 0.2% for the month and 4% year-on-year (consensus: 4.1%).

If you take a step back from current inflation trends you can also consider economic slack measures. These are excess resources within the economy that will constrain inflation until deployed. For example:

- Capacity utilisation for businesses is only now above pre-pandemic levels. Labour force participation remains below pre-pandemic levels.
- Unemployment remains above levels consistent with a "tight" labour market (as measured by a theoretical natural rate of unemployment).
- Median wage growth as tracked by the Atlanta Fed remains contained in its historical range over the past 5 years and has not shown an acceleration that implies structurally higher inflation.

Sentiment

US consumer sentiment declined from 85.5 in June to 72.8 in September according to the University of Michigan Consumer Sentiment Index. The persistence of the Delta variant in the US Southern States was a factor with both cases and fatalities concentrated there and restricting activity and businesses. Inflation concerns has been an increasing driver also as households see fiscal support continuing to unwind with enhanced unemployment benefits expiring by quarter-end (ending earlier in certain States).

Policy

At its Jackson Hole symposium Fed Chairman Powell announced Fed plans to reduce the scale of its quantitative easing (QE) program. He was at pains however to separate this from a "lift off" moment for interest rates. Given past experience, it appears that QE has become a part of market structure that cannot be easily withdrawn. Fed efforts to do so in the near term may trigger volatility across both stocks and bonds e.g., 2013 "taper tantrum".

Fiscal policy appears to be mired in negotiations between and within the major political parties, the Democrats, and the Republicans. The lack of traction has continued after months of negotiations.

A near-term downside risk for the US lies in the debt ceiling, a self-imposed limit on borrowing by the US government. We saw this extended until early December during October. While this delays default risk, we will revisit those same fears later this year and see volatility in both bond and share markets.

China

Business surveys were mixed over the quarter as countermeasures against local coronavirus outbreaks restricted business activity and limits on credit growth impacted the economy. The slowdown in the property sector related to credit restrictions emerged as an economic risk given the significant contribution of property-related activity to GDP. In addition, a growing energy crunch threatens to exacerbate the economic slowdown until sufficiency energy supply can be secured with smaller businesses facing production restrictions.

Credit growth & Evergrande

Chinese loan growth continued to slow in September with the People's Bank of China reporting social financing, a broad measure of credit and liquidity sitting at 308.05 trillion, its lowest level this year. This continues to highlight the tighter controls over financing in the Chinese property sector and arguably highlights weaker investment levels by Chinese firms.

The slowdown in credit growth has exposed troubled businesses with Chinese property developers featuring heavily given their substantial leverage. The Three Lines policy, a set of rules to lower leverage in the sector introduced late year exacerbated this trend.

China Evergrande Group was front and centre in this respect. The business has failed to repay some of its bonds thus far and it appears to be teetering on the brink of insolvency with asset and subsidiary sales being used to meet its liquidity needs. The likely outcome appears to be a gradual resolution as opposed to a direct bailout with both private and state-owned firms taking over pieces of the group themselves. The focus appears to be minimising potential for social unrest by ensuring property buyers from Evergrande are made whole. Stakeholders such as offshore creditors or shareholders may consequently struggle which is unsurprising given the selloff in Evergrande shares and debt over the course of this year, especially since June.

Energy prices

Towards quarter-end and subsequently we saw growing concerns over energy production in China. These were confirmed by numerous anecdotal reports about smaller manufacturers being forced to shut down production temporarily as electricity was rationed out. There were several drivers:

- Weaker hydroelectric production (weather-related)
- Weaker coal production from inner Mongolia amidst an anti-corruption drive and environmental restrictions.
- Chinese bans on Australian coal coupled with lower production by other coal producers forcing substitution into other energy commodities.

Chinese authorities are moving to secure additional energy supplies, but it may contribute to global supply shortages and inflation in the near term. Energy sensitive products e.g., aluminium is one example that has shown susceptibility to this shock.

Inflation

Chinese CPI data pointed a softer picture with a rise of 0.7% for the year to September (consensus: 0.9%) disappointing expectations. PPI rose 10.7% over the same period (consensus: 10.5%) with the disconnect suggesting producers have limited capacity to pass on these increases to consumers i.e., a weaker demand backdrop. Overall while there are signs of rising inflation observed in producer prices the lack of pass-through in consumer prices suggests a limited inflationary impulse and subdued demand conditions. It might also reflect those price effects being passed on to overseas buyers instead. The ongoing shock to energy prices discussed above appears likely to push PPI higher in the near term and CPI to a lesser extent.

Business activity and sentiment

The Manufacturing PMI, a measure of strength in the manufacturing sector, fell to 50 in September, down from 51.3 in June after seeing contraction during August. New business orders contracted until September with domestic demand seeing overall new work rise while new export orders softened. Pleasingly business confidence has continued to hold up. However inflationary pressures remain a headwind to Chinese firms with energy costs pressuring margins and seeing some limited passthrough to consumers. The Services PMI improved, rising to 53.4 in September, down from 50.3 in June. Efforts to contain recent coronavirus outbreaks crimped overall activity levels during August before recovering in September thanks to stronger domestic demand with foreign demand softening into quarter end. The overall Composite PMI improved to 51.4 in September from 50.6 in June thanks to the recovery in services.

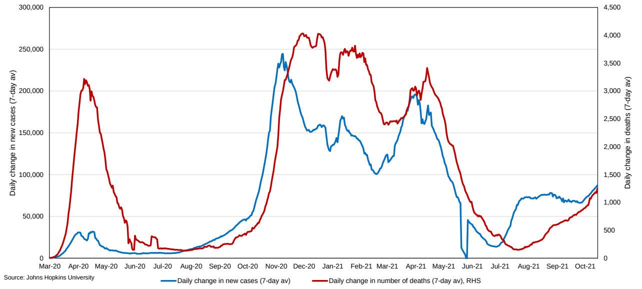
Europe

The overall growth story appears to be holding up, thanks to accelerating vaccine programs and relief from pandemic restrictions. However, a surge in energy prices threatens to drag on economic activity with limited options for near-term relief.

Coronavirus pandemic

Vaccinations continue to rise with 64% of the EU population fully vaccinated in mid-October, up from 33.6% at the end of June. Since June we have seen average daily **cases** climb from 15.2k/day to 87.2k/day as of mid-October per Chart 9. We have seen a lagged impact of the rise in case with daily **deaths** rising from 421/day to 1,247/day. Overall, these outcomes have seen an uptick in restrictions for countries such as France and Italy since early June with the former mandating compulsory mask-wearing in some regions. This does not appear to be sufficient to derail economic momentum at present but does weigh on services sector given vulnerability of people-facing firms to restrictions.

9. Europe coronavirus case and fatality trends



Policy

The ECB at its 9 September meeting announced that it was planning to scale back its net asset purchases (bond buying program) to a moderately lower pace than was seen in the first half of 2021, responding to stronger economic momentum and higher inflation. European Recovery Fund disbursements are continuing to proceed with the European Commission targeting up to €80bn this year out of the €900bn budget. This will be a useful boost in consolidating the economic recovery underway following a difficult 2020 for the continent.

Separately energy price pressures are seeing a mixed response at an individual Member State level rather than Federal level. Some countries such as Spain are working to shield consumers directly. In Eastern European countries by contrast we have seen central banks hiking in response to inflation (partly energy-related) whereas the ECB appears unlikely to follow.

Growth

The Markit PMI surveys continued to track positively implying strong growth levels for the September quarter albeit at a slower pace. The Composite PMI (for both manufacturing and services sector) remained at elevated level of 56.2, its lowest level since April. The Manufacturing PMI continued to drop back from record highs as the initial bounce back from lockdowns earlier in the year dissipated with the September reading at 58.6, down from 63.4 in June. Supply-side constraints were a notable drag with continued signs of supply side constraints particularly from Asia while new orders also moderated.

The Services PMI also moderated falling to 56.4 in September, down from 58.3 in June. A pickup in lockdown restrictions weighed on businesses with new export order growth slowing. Business confidence remains positive but has also moderated over the quarter to a six-month low.

On balance this is still a positive set of results but highlights the substantial challenges being created on the supply side with supply strains under stress globally flowing through into order delays and higher prices. These results were recorded prior to the latest leg up in energy prices which could further exacerbate these trends and drive growth levels lower.

Inflation

Inflation accelerated to 3.4% 3% (consensus: 3.3%) for the year to September, ahead of the ECB target of 2%. A key driver was rising energy prices with oil up from the pandemic lows of last year. Another factor was the impact of supply chain bottlenecks with the prices of durable goods climbing 2.3% month-on-month. Meanwhile core inflation rose 1.9% over the same period, up from 1.6% in August. The path to inflation normalising in the near-term hinges on both energy price pressures, and supply chain disruption and the time taken to resolve them. The energy price crunch will hinge in part on the Northern Hemisphere winter for instance if warmer than expected that will remove a key source of energy demand. As noted earlier this is posing some pressure for ECB policymakers although the hurdle for interest rates to increase appears unlikely to be met with officials looking at current pressures as a temporary shock that interest rates are not well-placed to resolve.

Company news - best and worst performers for the September quarter 2021

WiseTech (WTC, +68%)

WiseTech (WTC) saw its share price increase after it released positive results that were ahead of market expectations. The logistics software provider reported a sharp rise in free cashflow due to the continued digitisation of global logistics supply chains, following the catalyst provided by COVID-19 which is seeing structural changes in logistics and the consolidation and replacement of legacy technology systems. WTC revealed that it had signed contracts with large logistics providers, such as DHL and FedEx, leading to an +18% increase in Revenue to $507.7m and +63% in EBITDA to $206.7m.

Whitehaven Coal (WHC, +66.5%)

Whitehaven Coal (WHC) was the beneficiary of a rising coal price sparked by an onset of global shortages and resurgence of demand. WHC has avoided China's coal import ban as its key markets are South-East Asian countries and Japan, all of which have faced increased energy demand over the past couple of quarters. The announcement that the Federal EPBC has approved WHCs Vickery Extension Project, which is estimated to add 10Mtpa of coal per year, also drove the share price higher.

Flight Centre Travel Group (FLT, +44.5%)

Flight Centre Travel (FLT) experienced a strong rebound as the market added to the reopening trade. Increased vaccination rates, declining NSW case numbers, and evidence of reduced hospitalisation rates in other high vaccination rate countries, increased investor optimism on the travel sector and FLT benefitted from the positive sentiment.

Fortescue Metals Group (FMG, -35.9%)

Fortescue Metals (FMG) retraced some of its previous gains as demand was being impacted by power cuts in manufacturer and a property slowdown in China. Property activity has been slowing in China all year, and especially in the wake of the Evergrande collapse, and there are currently little signs of easing on the horizon. Fortescue also took the step to commit to achieving net zero Scope 3 emissions target by 2040, which addresses FMGs entire global value chain, including crude steel manufacturing which accounts for 98% of FMGs Scope 3 emissions.

Magellan Financial Group (MFG, -34.3%)

Magellan Financial Group (MFG) continued to suffer from its underperforming flagship Magellan Global Fund. The Magellan Global Fund has trailed the MSCI World Index in 10 out of the past 11 months, and its 1-year performance underperformed the benchmark by 18.8%. The fund's core underlying holdings, which include Microsoft, Facebook, Alphabet, Alibaba, and Tencent, proved resilient at the onset of COVID-19, however, have trailed the market YTD. Its key Chinese-stock holdings, Alibaba and Tencent, have also come under regulatory scrutiny in China.

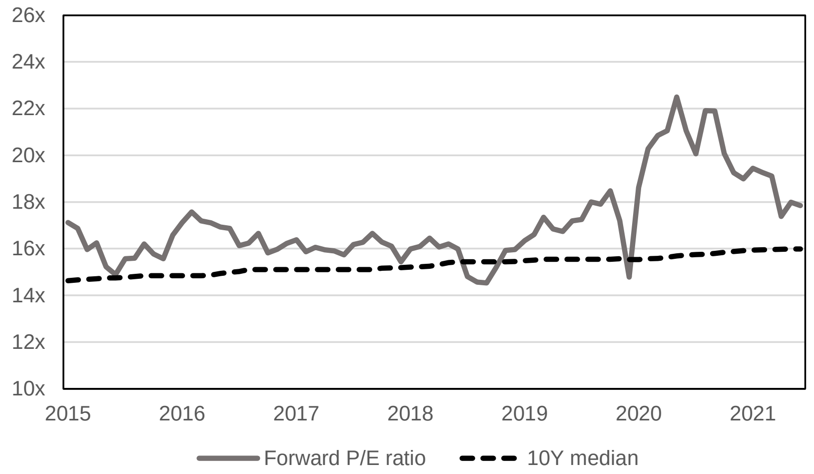
Appen Ltd (APX, -34.1%)

Appen (APX) reported a weak 1H21 result which showed revenue declining -2% to US$196.6m and NPAT declining -55.1% to US$6.7m. The result highlighted APXs key customer risk – with large clients such as Facebook, Microsoft, and Google, redirecting spending away from intrusive user tracking technology as they grapple with global data privacy changes. The company is looking to diversify its risk and showed positive results from China, where revenue grew at +60% CAGR over the past 5 quarters.

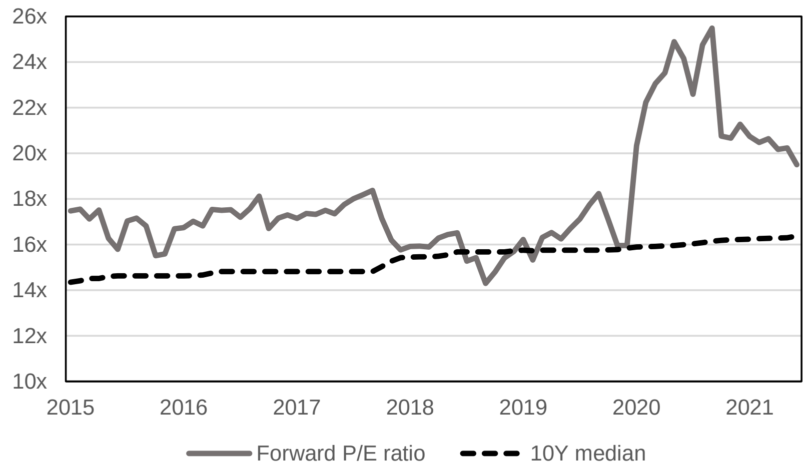
Sources: ASX company announcements, Bloomberg, Fund manager disclosures, Australian Financial Review, Sydney Morning Herald

Market valuations (Forward P/E vs 10Y median Forward P/E)

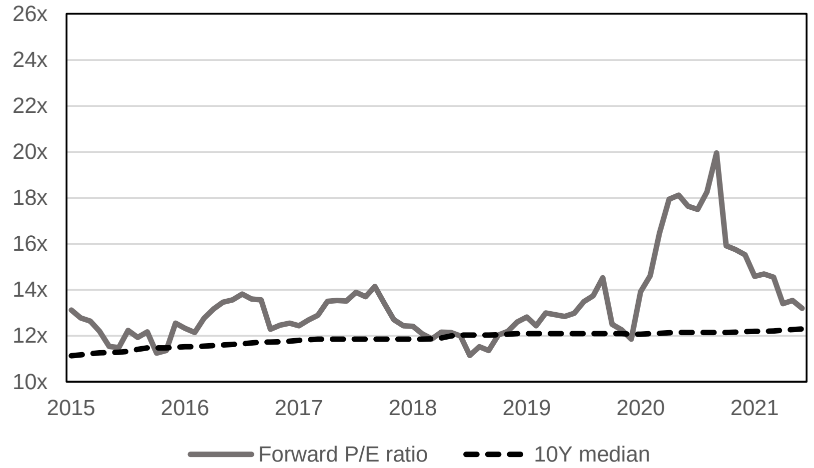
Australian Shares - Forward P/E vs trailing 10Y median (Apr-15 to Sep-21)



Global Shares ex Australia Shares - Forward P/E vs trailing 10Y median (Apr-15 to Sep-21)



Emerging Market Shares - Forward P/E vs trailing 10Y median (Apr-15 to Sep-21)



Sources: Bloomberg, MSCI, S&P

Indices (top to bottom): Australian Shares: S&P/ASX 200 Index; Global Shares ex Australia: MSCI World ex Australia Index; Emerging Market Shares: MSCI Emerging Markets index.

Asset class performance to September 2021 (Total returns in AUD)

				Annualised					
Asset class	**1-mth**	**3-mth**	**6-mth**	**1-yr**	**3-yr**	**5-yr**	**7-yr**	**10-yr**	**15-yr**	**20-yr**
Australian equities (S&P/ASX 200)	-1.9%	1.7%	10.1%	30.6%	9.7%	10.4%	9.1%	10.8%	6.8%	9.0%
Australian equities - Mid caps	-0.6%	3.9%	14.5%	34.0%	12.4%	13.2%	14.7%	13.9%	7.8%	11.4%
Australian equities - Small caps	-2.1%	3.4%	12.2%	30.4%	9.4%	10.2%	10.4%	7.7%	4.3%	7.9%
Australian equities - Micro caps	7.7%	18.8%	28.6%	55.9%	22.7%	14.3%	14.2%	7.5%	5.7%	#N/A
International equities	-3.0%	4.0%	13.7%	27.8%	13.3%	15.2%	13.7%	16.2%	7.7%	6.0%
International equities (Hedged)	-3.8%	0.6%	8.2%	28.3%	11.6%	13.4%	11.4%	14.7%	8.8%	9.1%
International equities - Small caps	-1.8%	2.5%	9.3%	39.4%	11.0%	13.8%	13.6%	16.4%	8.6%	8.8%
Emerging Markets equities	-2.8%	-4.5%	1.8%	17.3%	8.6%	10.5%	8.5%	9.3%	5.9%	8.9%
Australian REITs	-2.2%	4.2%	15.1%	29.8%	8.6%	7.1%	10.8%	13.2%	3.6%	6.9%
Global REITs	-4.7%	3.0%	14.1%	28.6%	6.2%	5.7%	8.6%	11.6%	4.0%	#N/A
Global REITs (Hedged)	-5.3%	-0.2%	8.8%	29.1%	4.8%	4.4%	6.5%	10.1%	4.5%	#N/A
Global Infrastructure	-2.5%	3.7%	8.2%	15.0%	7.8%	8.3%	9.2%	12.4%	6.4%	#N/A
Global Infrastructure (Hedged)	-3.0%	0.8%	3.3%	14.8%	6.9%	6.9%	7.4%	11.2%	9.0%	#N/A
Trend following (USD)	0.0%	-2.3%	0.7%	12.0%	4.6%	1.1%	1.6%	1.2%	3.7%	5.2%
Australian bonds	-1.5%	0.3%	1.8%	-1.5%	4.1%	3.1%	4.0%	4.5%	5.3%	5.4%
Australian bonds - government	-1.7%	0.3%	2.0%	-2.0%	4.2%	3.0%	4.0%	4.4%	5.3%	5.3%
Australian bonds – corporate	-0.8%	0.3%	1.4%	1.3%	4.5%	3.9%	4.4%	5.2%	5.8%	5.7%
Australian bonds - floating rate	-0.1%	0.1%	0.3%	0.9%	1.8%	2.3%	2.5%	3.3%	4.0%	4.4%
Global bonds (Hedged)	-1.0%	0.1%	1.0%	-0.8%	4.1%	2.7%	3.9%	4.8%	6.1%	6.4%
Global bonds - government (Hedged)	-1.1%	0.0%	0.6%	-1.9%	3.7%	2.4%	3.8%	4.7%	5.9%	6.3%
Global bonds - corporate (Hedged)	-1.0%	0.0%	2.4%	1.6%	5.7%	4.0%	4.8%	6.1%	6.7%	7.0%
Global bonds - High Yield (Hedged)	-0.7%	0.1%	3.0%	9.3%	4.8%	4.9%	5.7%	8.3%	8.5%	#N/A
Emerging Market bonds (Hedged)	-2.3%	-0.9%	3.5%	3.6%	4.6%	3.2%	4.9%	6.5%	7.5%	9.8%
Cash (AUD)	0.0%	0.0%	0.0%	0.0%	0.8%	1.2%	1.5%	2.1%	3.2%	3.7%

Sources: Bloomberg, IOOF calculations
* AUD total returns as at Sep-21 assuming reinvestment of dividends unless otherwise specified
** Returns reflect index performance excluding any fees; Actual ETF/managed fund performance will vary due to both fees and tracking error.

Appendix – Index sources

Asset class	Index
Australian equities (S&P/ASX 200)	S&P/ASX 200 Accumulation Index
Australian equities - Mid caps	S&P/ASX Accumulation Midcap 50 Index
Australian equities - Small caps	S&P/ASX Accumulation Small Cap Ordinaries Index
Australian equities - Micro caps	S&P/ASX Emerging Companies Total Return Index
International equities	MSCI World ex Australia Net Total Return (in AUD)
International equities (Hedged)	MSCI World ex Australia Hedged AUD Net Total Return Index
International equities - Small caps	MSCI World Small Cap Net Total Return USD Index (in AUD)
Emerging Markets equities	MSCI Emerging Markets EM Net Total Return AUD Index
Australian REITs	S&P/ASX 200 A-REIT Accumulation Index
Global REITs	FTSE EPRA/NAREIT Developed Index Net Total Return (in AUD)
Global REITs (Hedged)	FTSE EPRA/NAREIT Developed Index Net Total Return (Hedged to AUD)
Global Infrastructure	FTSE Global Core Infrastructure 50/50 Net Total Return in AUD
Global Infrastructure (Hedged)	FTSE Global Core Infrastructure 50/50 100% Hedged to AUD Net Tax Index
Trend following	SGI Cross Asset Trend Following Index (USD)
Australian bonds	Bloomberg AusBond Composite 0+ Yr Index
Australian bonds – government	Bloomberg AusBond Govt 0+ Yr Index
Australian bonds – corporate	Bloomberg AusBond Credit 0+ Yr Index
Australian bonds - floating rate	Bloomberg AusBond Credit FRN 0+ Yr Index
Global bonds (Hedged)	Bloomberg Barclays Global Aggregate Total Return Index Value Hedged AUD
Global bonds - government (Hedged)	Bloomberg Barclays Global Aggregate Treasuries Total Return Index Hedged AUD
Global bonds - corporate (Hedged)	Bloomberg Barclays Global Aggregate Corporate Total Return Index Hedged AUD
Global bonds - High Yield (Hedged)	Bloomberg Barclays Global High Yield Total Return Index Hedged AUD
Emerging Market bonds (Hedged)	J.P. Morgan EMBI Global Core Hedged Index Level AUD
Cash (AUD)	Bloomberg AusBond Bank Bill Index

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Research Analyst Disclosures:

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