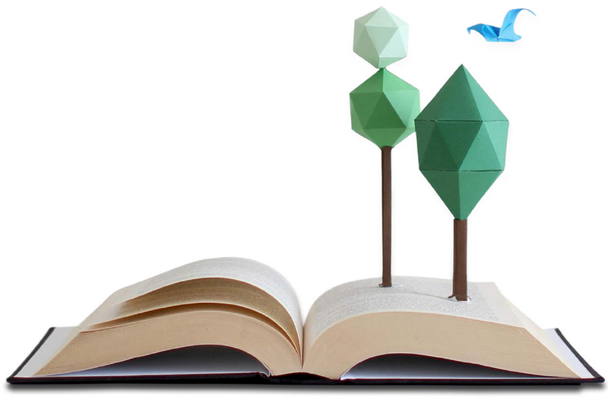
Mercer welcome to brighter

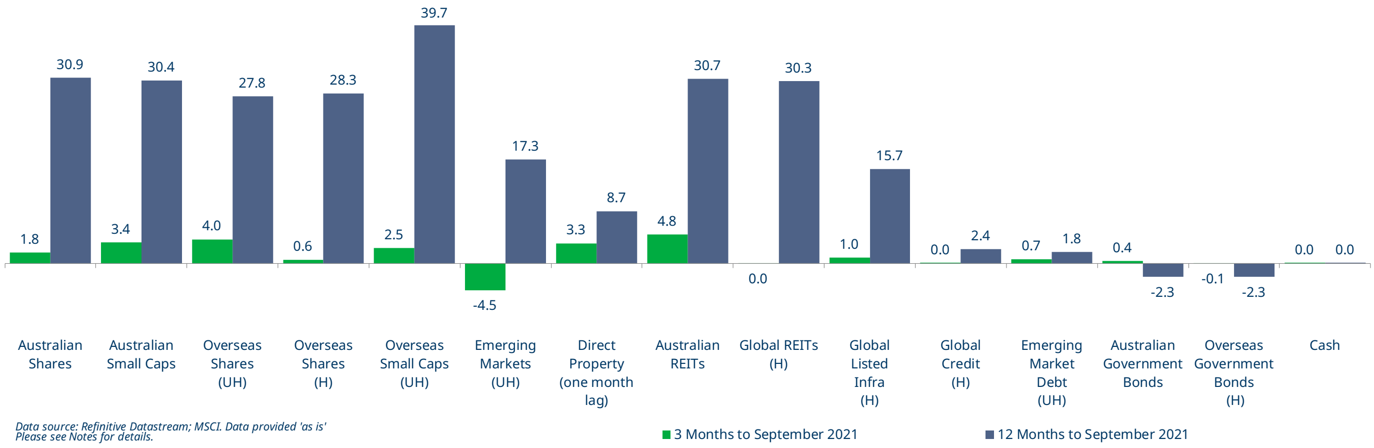
Q3 2021

Market and economic conditions



Selected market indicators commentary

Asset class returns as at September quarter 2021



Data source: Refinitiv Datastream; MSCI. Data provided 'as is'
Please see Notes for details.

Global equity markets suffered a significant sell-off towards the end of the third quarter, following a strong start and initial risk-on tone. Market sentiment soured in September as the US Federal Reserve switched to a more hawkish tone, supply chain constraints worsened and investors feared a spill-over effect from China's weakening property sector.

Hedged Developed Market Overseas Shares returned 0.6% over the quarter with the market sell-off wiping out gains made earlier in the quarter. The US Federal Reserve confirmed that it would begin tapering and potentially increase interest rates earlier than expected. Emerging Market Equities were the worst performing asset class over the quarter, returning -4.5% as China continued to negatively weigh on the region as a result of their ongoing regulatory crackdown. Market focus shifted away from China's Information Technology sector to its Real Estate sector.

As a result of tighter government policy on the Real Estate sector, one of China's biggest property developers, Evergrande, now faces potential default. Given the size of Evergrande and the share of China's property sector of its GDP, investors feared for potential ramifications and systemic risks on China's financial system, as well as broader global financial markets.

Intra-quarter volatility in fixed income markets was high due to rising policy rate expectations and inflation woes. After an initial dip, 10-year government yields for most developed markets spiked, reversing the initial decline. Consequently, both Overseas Government Bonds (-0.1%) and Australian Government Bonds (0.4%) ended the quarter close to flat. Investors continue to favour riskier assets in the current high growth environment, with annual returns for both domestic (-2.3%) and global (-2.3%) government bonds ending in negative territory.

The Australian share market led its hedged overseas counterpart over the September quarter, with the S&P/ASX300 returning 1.8%. All other domestic indices posted similar positive returns, with the exception of the ASX Mid 50 (3.9%) and ASX Small Ordinaries (3.4%), which were the top performers. The strongest performing sectors over the quarter were Energy (8.0%) and Industrials (6.3%), whilst the worst performing and only negative returning sector over the quarter was Materials (-9.6%).

Significant Developments

- Over the third quarter, the Reserve Bank of Australia (RBA) maintained the current target cash rate at 0.10% per annum and the interest rate on exchange settlement balances at zero. The RBA will continue to purchase government securities at the rate of $4bn per week until mid-February 2022. In addition, the RBA will maintain the current target of 0.10% for the April 2024 Australian Government Bond. It was noted that the Delta outbreak had interrupted the economic recovery and Australian GDP will decline over the September quarter. The setback to the economic expansion is expected to be only temporary and as vaccination rates increase further and restrictions are eased, the economy is expected to bounce back. In the RBA's central scenario, the economy will be growing again in the December quarter and is expected to be back around its pre-Delta path in the second half of 2022. Restrictions on activity has affected the labour market, with hours worked declining 4.0% in August. Wage and price pressures remained subdued over the June quarter. Inflation is around 1.75% and wages are increasing at 1.7%. Housing prices are continuing to rise, however turnover has declined in some markets. Housing credit has shown increased demand for credit by both owner-occupiers and investors. The Bank's package of policies – including record low interest rates, the bond purchase program, the yield target and the funding provided under the Term Funding Facility is providing substantial and ongoing support to the Australian economy. Borrowing rates are at record lows, sovereign bond yields are at very low levels and the exchange rate has depreciated over recent months. The board are committed to maintaining highly supportive monetary conditions and will not increase the cash rate until actual inflation is sustainably within the 2-3% target range. For this to occur, the labour market will need to tighten enough to generate wages growth that is materially higher than it is currently, which the RBA believe is unlikely to occur until 2024.
- Australian seasonally adjusted employment decreased by 156,300 in August, above expectations for a decrease of 80,000 and below the prior month's decrease of 3,100 (revised). The unemployment rate decreased to 4.5% for August, below expectations for 5.0%. The participation rate decreased to 65.2%, below expectations of 65.7% over the past quarter ending August. Part time jobs decreased by 78,200 and full time jobs decreased by 68,000.
- Australian house prices increased by 6.7% in the first quarter of 2021, taking it 16.8% higher from a year earlier and above expectations for 6.1% quarter-on-quarter (QoQ) and lower than expectations of 14.8% year-on-year (YoY). Australian building approvals increased by 6.8% month-on-month to August, compared to the decrease of 8.6% for July.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 61.1 in September, above consensus for 59.5 and above the 59.5 recorded in August. Of the 18 manufacturing industries, Furniture & Related Products and Petroleum & Coal Products were the two industries that reported the highest growth. The only industry that reported a contraction over the September period was Wood Products. The ISM Services Index recorded 61.9 in September, above consensus for 59.9 and above the 61.7 recorded in August. Of the 17 services industries, the top performers were Retail Trade and Arts, Entertainment & Recreation. The only industry to report a decrease was Agriculture, Forestry, Fishing & Hunting.
- US Non-Farm Payrolls increased by 194,000 in September, below the 1,091,000 increase (revised) recorded for August. The unemployment rate decreased to 4.8% over the third quarter, below expectations of 5.1%.
- US GDP third estimate for Q2 2021 is 6.7% QoQ annualised, above expectations of 6.6%.
- US headline consumer price index (CPI) increased to 0.4% MoM and increased to 5.4% YoY in September.
- The Caixin Manufacturing PMI in China recorded 50.0 in September, above expectations of 49.5, with operating conditions stabilising over the period.
- Chinese GDP increased 7.9% YoY for Q2 2021, below expectations for 8.0%. Seasonally adjusted GDP increased 1.3% QoQ for Q2 2021, above expectations for 1.0%.
- The preliminary estimate of the European Core CPI recorded 1.9% over the year to September, which was in line with expectations. The unemployment rate remained at 6.4% over the quarter.
- The Eurozone composite PMI decreased to 56.2 in September but above expectations for 56.1.
- The final estimate recorded for Q2 2021 Eurozone seasonally adjusted GDP is 2.2% QoQ and 14.6% YoY.

Australian Shares

Australian shares were positive over Q3 2021 as the S&P/ASX 300 Index returned 1.8% for the period. The S&P/ASX Mid 50 was the best performer over the quarter returning 3.9%, while the worst performer was the S&P/ASX 50 returning 1.1%.

The best performing sectors were Energy (8.0%) and Industrials (6.3%), while the weakest performing sectors were Materials (-9.6%) and Consumer Discretionary (2.3%). The largest positive contributors to the return of the index were Macquarie, Sydney Airport and CBA with absolute returns of 17.2%, 42.3% and 6.6% respectively. On the other hand, the most significant detractors from performance were BHP, Fortescue and Rio Tinto with absolute returns of -21.2%, -33.5% and -19.8% respectively.

Global Shares

The broad MSCI World ex Australia (NR) increased 0.6% in hedged terms and increased 4.0% in unhedged terms over the quarter, as the AUD depreciated against major developed market currencies over the quarter. The strongest performing sectors were Financials (6.1%) and Information Technology (5.4%), while Materials (0.0%), Consumer Staples (2.0%) and Industrials (2.0%) were the worst performers, in AUD terms. Other global shares were mixed as the MSCI Small Caps (TR) Index returned 2.5% and the MSCI Emerging Markets (NR) Index returned -4.5% over the quarter, both in AUD terms.

Over the September quarter, the NASDAQ decreased 0.4%, the S&P 500 Composite Index increased 0.6% and the Dow Jones Industrial Average decreased 1.5%, all in USD terms. Most European markets experienced mixed returns, with the FTSE 100 (United Kingdom) increasing 2.0%, the CAC 40 (France) increasing 0.4% and the DAX 30 (Germany) decreasing 1.7%, all in local currency terms. Equity returns were also mixed across Asia as the SSE Composite (China) and the Hang Seng (Hong Kong) decreased 0.6% and 13.9% respectively, both in local currency terms. In comparison, the TOPIX (Japan) and S&P BSE 500 (India) increased over the quarter, returning 5.3% and 11.5% respectively, both in local currency terms.

Real Assets

Domestic listed property experienced strong performance over majority of the quarter and returned 4.8%. In comparison, Global REIT's returned flat (in AUD hedged terms) over the September quarter. The Australian unlisted property sector (NAV) increased 3.3% over the quarter on a one month lagged basis and the FTSE Global Core Infrastructure 50/50 index increased 1.0% over the quarter in hedged AUD terms.

Fixed Interest

Global sovereign bonds produced broadly negative returns over the September quarter for hedged Australian investors. Ten-year bond yields increased in Germany (6bps to -0.19%), Japan (1bp to 0.07%), the US (8bps to 1.53%) and the UK (27bps to 1.02%). Two-year bond yields decreased in Japan (-1bp to -0.12%) and Germany (-5bps to -0.74%), and increased in the US (3bps to 0.26%) and the UK (36bps to 0.41%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index increased by 0.1% and the FTSE World Government Bond (ex-Australia) Index decreased by -0.1% over the September quarter, both on a fully hedged basis.

Domestically, Australian 10-year bond yields remained flat (1.49%), five-year bond yields increased (1bp to 0.78%) and two-year bond yields decreased (-3bps to 0.05%). Bloomberg Ausbond indices returned broadly positive results over the quarter, with the Bloomberg Ausbond Treasury achieving the highest return of 0.4%, and the weakest being the Bloomberg Ausbond Inflation, returning -0.4%.

Currency Markets

The Australian Dollar (AUD) tumbled against major developed market currencies over the September quarter, finishing at US$0.72. The AUD depreciated against the USD (-3.8%), the Pound Sterling (-1.4%), the Japanese Yen (-3.3%) and the Euro (-1.5%). On a trade-weighted basis, the local currency depreciated 3.0% over the quarter.

Commodities

The S&P GSCI Commodity Total Return Index increased by 9.4% over the quarter. Gold prices finished the quarter at US$1,761.0 per ounce with a 0.3% decrease. Meanwhile, Iron Ore prices decreased by 49.0% to US$110.0 per metric tonne over the period and Oil prices increased by 4.4% to US$78.6 per barrel.

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Chart Constituents

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Net Index: Total Return (Net Dividends Reinvested).*
- *Total Return: Total Return Index with Gross Dividends.*
- *Where a lag exists, the performance period start and end dates are shifted accordingly.*

Asset class	Benchmark	Data type
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
Overseas Shares (UH)	MSCI World ex Australia	Net Index
Overseas Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
Overseas Small Caps (UH)	MSCI World Small Cap	Total Return
Emerging Markets (UH)	MSCI Emerging Markets	Net Index
Direct Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian REITs	S&P/ASX 300: Industry Group: A-REIT	Total Return
Global REITs (H)	FTSE EPRA/NAREIT Developed Hedged	Total Return
Global Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Total Return
Global Credit (H)	Bloomberg Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
Overseas Government Bonds (H)	FTSE WGBI Non Australia	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

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- The value of Gilts, bonds, and other fixed income investments including unit trusts can go down as well as up and you may not get back the amount you have invested.
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- For higher volatility investments, losses on realisation may be high because their value may fall suddenly and substantially.
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