akambo FINANCIAL GROUP

THE MONTHLY VIEW

A look back at last month and an outlook on the months ahead

WHAT WE LIKED

- Australia's unemployment rate in June fell below 5% for the first time in a decade. Importantly, the lower unemployment rate was not due to a reduction in labour-force participation, with the participation rate steady at 66.2%
- Australian Markit Manufacturing PMI for June came in with a reading 58.6 (a reading above 50 indicates expansion). The domestic manufacturing sector continued to expand at a strong pace despite some signs of disruption from the Victoria lockdown that lingered into June.
- U.S. job growth leaped higher in June as businesses looked to keep up with a rapidly recovering economy. Nonfarm payrolls increased 850,000 for the month, compared with the Dow Jones estimate of 706,000 and better than the upwardly revised 583,000 in May. The unemployment rate, however, rose to 5.9% against the 5.6% expectation.
- The US services industry extended its resurgence from the troughs of the Covid pandemic into June. The IHS Markit US Services PMI reached 64.6 in June, the third highest since the survey began and only behind May and April's readings of this year.
- Euro area Markit manufacturing PMI readings for July showed factory activity continuing to accelerate despite shortages of raw materials and rising costs. The final reading came in at 62.8, down from June's all-time high of 63.4 but ahead of a preliminary estimate of 62.6. This follows Euro zone manufacturing activity expanded at its fastest pace on record in June,
- Euro zone retail sales rose by 4.6% month-on-month in May, beating expectations of a 4.4% rise. The increase in sales more than reversed April's 3.9% drop and left annualised sales 3.4% above their pre-pandemic level in February 2020.
- China's GDP expanded 7.9 percent year-over-year in the second quarter of 2021, continuing a streak of robust growth. In the April-June period, factory output rose 8.9 percent year-on-year while retail sales were up 13.9 percent

WHAT WE DIDN'T

- Australia business confidence weakened in June due to rising number of infections in New South Wales and subsequent lockdowns. The business confidence index dropped to 11 from 20 in May. The decline in confidence was led by declines in NSW and Queensland. Confidence weakened in all industries except mining and manufacturing. Nonetheless, overall confidence remained around twice its long-run average after strengthening in early 2021.
- The economic activity in the US manufacturing sector continued to expand in July albeit at a softer pace than it did in June with the ISM's Manufacturing PMI declining to 59.5 from 60.6. This reading came in slightly lower than the market expectation of 60.9.

- Growth in China's June services sector slowed sharply to a 14-month low, after a resurgence of COVID-19 in southern China. The Caixin/Markit services Purchasing Managers' Index (PMI) fell to 50.3 in June, the lowest since April 2020 and down significantly from 55.1 in May.
- The German Factory Orders unexpectedly fell in May, suggesting that the manufacturing sector in Europe's economic powerhouse is still in the doldrums. Contracts for goods 'Made in Germany' arrived at -3.7% on the month vs. 5.0% expected and -0.2% last month.
- The German ZEW headline numbers for July showed that the Economic Sentiment Index worsened more than expected to 63.3 from 79.8 previous while missing estimates of 75.2. German business confidence is an important indicator for global economic activity as Germany is a manufacturing powerhouse.
- China's factory activity expanded in July at the slowest pace in 17 months as higher raw material costs, equipment maintenance and extreme weather weighed on business activity, adding to concerns about a slowdown in the world's second-biggest economy. The official manufacturing Purchasing Manager's Index eased to 50.4 in July from 50.9 in June.

BASE CASE

Our view of the most likely scenario for markets over the coming months, for which our portfolios are currently positioned.

72% Probability

Generally improving vaccination rollouts in different global regions leads to a reduction in COVID induced economic impacts. Economic activity is expected to remain robust, as social normalisation and stimulus provide support. While the speed of the economic improvement is expected to show some signs of slowdown, it will be coming off record levels of economic activity over the past few months. Following strong economic and financial market performance, focus will move to the sustainability of growth levels and potential for input price increases to negatively impact profit margins.

Globally, central bankers continue to reiterate their accommodative policy stance, but markets will begin to question the sustainability of this level of support as economies show strong growth and inflationary pressures build. This is expected to create increased volatility over the coming months. On the fiscal front governments have indicated they are willing and able to step up with spending to support their economies. This is expected to continue globally as governments look to sustain employment and wage growth as well as supporting long-term objectives such as carbon reduction and social inequality.

Risks remain. Those we view as most prominent include increased China and Australia/U.S. trade tensions, faster than expected increases in government bond yields (due to inflationary pressures building), the increase of COVID-cases across different regions pressuring health systems and stimulus packages that underwhelm expectations.
This scenario is likely to see us maintain a constructive medium-term view on growth assets, using any volatility to increase exposure to growth assets. Capital preservation will be targeted through appropriate company and sector allocations. Overall asset allocation will retain a bias to growth assets.

BEAR CASE

Our worst-case scenario for the coming months, which we are prepared to position for should conditions deteriorate.

14% Probability

The health and economic effects of the pandemic last longer than expected, with countries across the globe struggling to control further outbreaks of the delta variant. In addition, the manufacturing and distribution of a vaccine proves to be more difficult than anticipated, delaying the economic recovery further.

This scenario may see central bank stimulus and fiscal support from governments as lacking the required potency to provide economic stabilisation and provide further improvement in consumer confidence. Additionally, a premature withdrawal or reduction of central bank liquidity could derail financial markets which have become accustomed to liquidity support. Any failure of governments across the globe to extend or further stimulate their economies through fiscal spending would further erode confidence in further economic improvement. Such a scenario would likely see a level of dislocation in financial markets across the spectrum.

An emerging risk is rising government bond yields. The disruption of supply chains and high input costs is expected to place upward pressure on bond yields, particularly if judged to be more sustainable. While considered unlikely, an acceleration of bond yields from current levels could see valuation compression in financial markets. This would be more pronounced in high valuation stocks and sectors in markets, such as high growth non-profitable technology stocks.

Left-field events such as a rapid escalation in geo-political tensions (especially between the US and China) or a significant or systemic corporate default (especially due to over-indebtedness in an environment of rising bond yields) could see a liquidation of risk assets in a compressed period of time.

Above scenarios will see us take a more defensive position and reduce equity exposures replacing them with defensive assets, such as cash. The accelerating bond yield scenario would require a more nuanced shift toward companies and sectors that would be the greatest beneficiaries of such a move. The overall focus will remain on capital preservation.

BULL CASE

Our most optimistic view for markets over the coming months.

14% Probability

Economies across the developed world continue to exhibit strong economic growth. Strong fiscal support from governments around the world combine with historically high cash levels on household and corporate balance sheets to sustain the speed of the global economic recovery. In the event central banks maintain measures aimed at supressing interest rates we would expect this to further fuel asset appreciation, while any extension of these accommodative policies would further accelerate the expected upward re-rating of asset values.

Such a market dynamic would see substantial improvement in economic activity globally. This would occur as pent-up demand from business and consumers combined with massive government and central bank stimulus measures create a potent environment for risk assets as strong demand is sustained. Sectors expected to benefit most in this environment are those leveraged most to economic activity, in many cases these are the same companies that were most adversely affected by the COVID-19 induced lock downs.

This scenario would be cheered by financial markets as a combination of monetary and fiscal stimulus act to fuel demand for growth assets in a low to negative real interest rate environment. We would act by reducing our cash levels further and adding to the growth asset allocation at the expense of cash and other defensive asset.

STOCK IN FOCUS

Lend Lease Group is a property and infrastructure development company with global reach. It engages in the development, investment management, project and construction management and asset and property management capabilities. The company operates its business through four segments: Development, Construction, Investment Management, and Infrastructure Development. The Development segment involves in the development of urban communities, inner-city mixed-use developments, apartments, retail, commercial and healthcare assets. The Construction segment provides project management, engineering and construction services. The Investment Management segment involves in property and infrastructure investment management, property management and asset management. The Infrastructure Development segment manages and invests in public-private partnership projects.

The Company was established by Dick Dusseldorp in 1958 to provide finance for building contracts being undertaken by Civil and Civic. In 1961 the Company acquired Civil and Civic from Bredero's Bouwbedrijf.

In 1999 the Company formed Actus Lend Lease with the acquisition of Actus Corporation's MILCON and technical service construction management business, and augmented this business with professionals from Lend Lease Design and Lend Lease Development. Also, in 1999 the Company acquired Bovis from P&O, which now forms Lend Lease Project Management & Construction. Then in 2000 it bought AMRESCO's commercial mortgage business. In 2001, Lend Lease acquired Delfin Property Group (now Lend Lease Communities) for $172 million. It went on to buy Crosby Homes (now Lend Lease Residential Development) for circa £240 million in 2005.

In 2005 the company moved its headquarters from Australia Square in Sydney to The Bond on Hickson Road.
In 2009, Lend Lease Corporation acquired Babcock and Brown Communities, rebranding the business as Lend Lease Primelife. At the time, this acquisition made Lend Lease Australia's largest provider of retirement villages.
As of 17 Feb 2011 Lend Lease announced wide ranging changes to its group of brands. This announcement means the retirement of the Bovis, Delfin, Vivas, Catalyst and Primelife brands which are now referred to using the unified Lend Lease brand.

In late February 2011, Lend Lease acquired DASCO in order to position itself to take advantage of the impending Obama administration Health sector boom. The company was immediately rebranded as Lend Lease DASCO, and operates independently of the Lend Lease Americas business.

In March 2011, Lend Lease completed the acquisition of Valemus Group (previously known as Bilfinger Berger Australia) from Bilfinger Berger Group, subsidiaries of Valemus include: Abigroup, Baulderstone and Conneq (formerly Bilfinger Berger Services). The Valemus brand was retired and replaced with Lend Lease in 2011.