akambo FINANCIAL GROUP

THE MONTHLY VIEW

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

WHAT WE LIKED

- Australian federal budget extended its fiscal support measures. Higher spending in key areas such as aged care, women and families, infrastructure, income tax support and education contributed to an economically positive budget.
- Australian gross domestic product advanced 1.8% from the final quarter of 2020, when it rose a revised 3.2%, according to the Australian Bureau of Statistics. Economists had forecast a first-quarter gain of 1.5%. from a year earlier, the economy expanded 1.1 % vs an estimated 0.6% increase. This is further evidence of a stronger than expected rebound in the domestic economy.
- The 2020-21 Commonwealth deficit has been revised down by $52.7 billion from $213.7 billion to $161 billion, a massive improvement because of higher employment rates and a higher-than-forecast iron ore price.
- Australia's unemployment rate has fallen to 5.5% as the nation records an unprecedented return from the economic damage wrought by COVID-19. The Australian Bureau of Statistics showed between March and April the nation's unemployment rate fell by 0.2 percentage points. It is the sixth consecutive fall in the unemployment rate after it peaked in July 2020 at 7.4%.
- Business activity across the Eurozone posted the fastest expansion seen in more than three years during the month of May, powered by a strong rebound in the services sector even as manufacturing continues to grow. Eurozone's IHS Markit flash composite PMI surged to 56.9 in May from 53.8 during the previous month.
- In the Chinese services sector, activity expanded for the 15th straight month, and at a faster pace, with the non-manufacturing PMI index rising to 55.2 from 54.9 the month before. A good barometer that Chinese domestic demand remains on a strong footing.

WHAT WE DIDN'T

- Following the budget spending net debt is now expected to peak at $980.6 billion in 2024-25, or 40.9 per cent of GDP. While that is a revision down of debt reaching 44 per cent of GDP projected in last year's budget, it is a long way from budget surplus.
- U.S. retail sales unexpectedly stalled in April as the boost from stimulus cheques faded. Economists polled by Reuters had forecast retail sales would rise 1.0%, while economists polled by Dow Jones had expected a more modest 0.8% increase.

- U.S. homebuilding fell more than expected in April. Housing starts tumbled 9.5% to a seasonally adjusted annual rate of 1.569 million units last month. Economists polled by Reuters had forecast starts would fall to a rate of 1.710 million units in April.
- Euro zone industrial production rose much less than expected in March, with month-on-month growth held back by a slump in the output of capital and durable consumer goods. Industrial output in the 19 countries sharing the euro rose 0.1% month-on-month for a 10.9% year-on-year surge. Economists polled by Reuters had expected a 0.7% monthly rise and a 11.6% annual gain.
- The European Union's statistics office Eurostat said gross domestic product in the 19 countries sharing the euro contracted 0.6% quarter-on-quarter for a 1.8% year-on-year fall, putting the single currency area in a second technical recession in 12 months. The positive being that economists polled by Reuters had expected a more severe 0.8% quarterly and a 2.0% annual decline.
- Chinese retail sales rose 17.7% last in April. A strong number but missed expectations of 24.9% growth in April, according to analysts polled by Reuters.

BASE CASE

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

74% 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 provides support. While the speed of the economic improvement is expected to show some signs of slowdown, it will be coming off record 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.

Global 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.

Risks remain. Those we view as most prominent include increased China and Australia trade tensions, faster than expected increases in government bond yields (due to inflationary pressures building), the increase of COVID-cases across different regions 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.

12% Probability

The health effects of the pandemic last longer than expected, with countries across the globe struggling to control further outbreaks. 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 economic improvement. Such a scenario would likely see further dislocation in financial markets across the spectrum.

An emerging risk is rising government bond yields. 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.

Anglo American is a multi-national mining company with annual earning of circa USD$10 Billion and over 95,000 employees worldwide in operations across 45 countries. Anglo American focuses on natural resources with six core businesses: Kumba Iron Ore, Iron Ore Brazil, coal (thermal and metallurgical), base metals (copper, nickel, niobium and phosphates), platinum, and diamonds, through De Beers, in which it owns an 85% share.

Sir Ernest Oppenheimer, a Jewish German émigré, founded the Anglo American Corporation (AAC) in 1917 in Johannesburg, South Africa, with financial backing from the American bank J.P. Morgan & Co. and £1 million raised from UK and US sources to start the gold mining company; this fact is reflected in the company's name. The AAC became the majority stakeholder in the De Beers company in 1926, a company formerly controlled by Alfred Beit, also a Jewish German émigré.

In 2008, Anglo American (excluding De Beers) spent $212 million on exploring 21 countries for resources including copper, nickel, niobium phosphates and zinc. The two main types of exploration for the company are greenfield and brownfield, with nearly 70% devoted to greenfield projects.

Anglo American, along with De Beers, backed the manufacturing of a superconducting quantum interference device (SQUID) to help improve the sensitivity of exploration surveys. Anglo American established Boart Products South Africa Limited in 1936 (later named Boart International) to turn the company's stockpile of boart, or low-grade natural diamonds, into drilling products. This initiative resulted in the development of the first mechanically set diamond drill bit and later led to additional research into cutting and abrasive tools.

In December 2010, following delays and high costs, Anglo American gained a key licence from the Brazilian government that would allow work to start on the Minas-Rio iron ore project. As of October 2014, Minas-Rio is operational and shipping ore.

In July 2018, Anglo American announced that it would spend $5.3 billion on developing the Quellaveco copper mine in Peru, which the company acquired in 1992, with the Japanese conglomerate Mitsubishi funding 40% of the total cost. As part of the project, Anglo American also committed 650 million soles (USD$195 million) towards local community developments projects in Moquegua, where the Quellaveco mine is located.