akambo FINANCIAL GROUP

THE MONTHLY VIEW

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

WHAT WE LIKED

- Australian retail sales surpassed expectations in March in a positive sign for the local economy, as soaring house prices and a surge in employment boosted consumer confidence and spending. Sales rose 1.4% in March from February, outpacing forecasts for a 1% gain.
- The Australian March labour force data was strong – showing the jobless rate fell by 0.2% to 5.6%. The participation rate rose to a record high of 66.3%, providing further encouragement.
- The U.S. Institute for Supply Management (ISM) index of national factory activity jumped to a reading of 64.7 in March from 60.8 in February. That was the highest level since December 1983. A reading above 50 indicates expansion in manufacturing, which accounts for 11.9% of the U.S. economy.
- U.S. Nonfarm payrolls rose by 916,000 jobs in March, while the unemployment rate declined to 6%. The job growth was well ahead of Dow Jones estimates for 675,000 jobs and the fastest since August 2020. Gains were strongest in the leisure and hospitality sectors, while construction soared by 110,000.
- U.S. retail sales boomed 9.8% higher in March thanks to a jump in spending at bars and restaurants as well as multiple other groups. Economists already had been expecting a gain of 6.1% as consumers received their USD$1,400 government stimulus cheques.
- Euro area retail sales increased by 3.0% month-on-month, partially reversing a 5.2% slide from January. It beat expectations as economists had forecast a 1.5% rise.
- Euro zone monthly factory activity growth galloped at its fastest pace in the near 24-year history of a leading business survey last month. IHS Markit’s final Manufacturing Purchasing Managers’ Index (PMI) jumped to 62.5 in March from February’s 57.9 (over 50 indicates expansion).

WHAT WE DIDN’T

- Australian business confidence fell 3 index points in March, to +15 index points. This indicates a reduction in confidence, although it remains well above average.
- Australia’s trade balance for March comes in at a surplus of AUD $5.574bn. While in isolation this number is positive, it missed expectation of an AUD $8.2bn surplus. Exports were the standout miss with a minus 2% month-on-month move versus expectations for an increase of 4%.
- The German IFO institute said its business climate index edged up to 96.8 from 96.6 in March. This index measures German business confidence. A Reuters poll of analysts had pointed to a bigger increase to 97.8. While an improvement, it marks a slowing of improvement resulting from continued COVID lockdowns.

- India's total COVID-19 cases passed 20 million after another world record number of daily infections.
- Australian Chinese trade rhetoric continues to deteriorate. This continues to risk trade demand with China, which is Australia's largest trading partner.
- Chinese official manufacturing well and services PMIs came in under the median central estimate. The read came through at 51.1 against expectations 51.8. Non-manufacturing (services) missed also, coming in at 54.9 vs expectation of 56. While still expanding it shows slowing improvement.

BASE CASE

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

75% Probability

Generally improving speed of vaccination rollouts in different global regions leads to a reduction in COVID induced economic impacts. Economic activity should remain robust, as social normalisation and stimulus provides support. While the economic improvement is unlikely to be linear, markets will continue to focus on the likelihood of economic improvement over the rest of the year. Following strong economic and financial market performance, focus will move to the sustainability and speed of growth over the remainder of the year.

Global central bankers have reiterated their accommodative stance recently, but markets will begin to question the sustainability of this level of support as economies shown strong growth. 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, with those we view as most prominent of which include China and Australia trade tensions, faster than expected increases in government bond yields, the increase of COVID-cases in the northern hemisphere and stimulus packages that underwhelm expectations.

This scenario is likely to see us maintain a constructive 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.

10% 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.
Above scenarios will see us take an even more defensive position and potentially add downside protection. 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.

16% 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 policies would further accelerate the expected upward re-rating of asset values.

Such an environment 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.

STOCK IN FOCUS

FMG

Fortescue

Since Fortescue was established by Dr Andrew Forrest in 2003, they have discovered and developed major iron ore deposits, constructed some of the most globally significant mines and have grown to be one of the world's largest producers of iron ore. The company consists of an integrated mining, rail, shipping, and marketing segments to export 175 to 180 million tonnes of iron ore annually. A commitment to technology and innovation has ensured Fortescue remain one of the world's lowest cost iron ore producers.

Fortescue's wholly owned and fully integrated operations in the Pilbara include the Chichester and Solomon mining hubs and we are developing the Western Hub, home to the new Eliwana mine. The Iron Bridge Magnetite Project, an industry-leader in cost and energy efficiency, will be one of the highest-grade magnetite projects in the world.
Fortescue's mining hubs are connected to the five berth Herb Elliott Port and the Judith Street Harbour towage infrastructure in Port Hedland via 620 kilometres (km) of the fastest, heavy haul railway in the world, with an additional 143km under development to support Eliwana.

Fortescue's supply chain extends to an innovative tug fleet and the eight purpose-built 260,000 tonne capacity Fortescue Ore Carriers, which was designed to complement the efficiency of their port and maximise the safety and productivity of operations. The Fortescue Hive, an expanded Integrated Operations Centre, brings together the companies entire supply chain to deliver significant safety, productivity, efficiency, and commercial benefits and will underpin their future use of technology, including artificial intelligence and robotics.

World class exploration capability together with business development and projects focus has Fortescue targeting the early-stage exploration of commodities that support decarbonisation and the electrification of the transport sector.
Exploration activities are currently taking place in New South Wales and South Australia, as well as in Ecuador and Argentina, and preliminary exploration activities on tenements that are in application in Colombia, Peru, Portugal, and Kazakhstan, prospective for copper, gold and lithium.

In 2019, Fortescue established the Trading Shanghai (FMG Trading), a wholly owned Chinese sales entity, to support our customers through the direct supply of iron ore from regional Chinese ports, providing them with an option to purchase smaller volumes in renminbi.

As a large consumer of energy, Fortescue have committed to an industry-leading carbon emissions target of net zero operational emissions by 2030. To achieve this, they are investing in practical initiatives such as the development of wind and solar energy, as well as gas and battery storage hybrid projects to displace our current thermal generation. They are also investigating the next phase of hydrogen and battery electric vehicle mobility.