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 fell to 4.6% in July as the economy added 2,200 jobs. July's figure is a decrease from the 4.9% unemployment rate recorded in June and significantly better than the market expectation of 5%. Expectations are for weaker numbers going forward as lockdowns, particularly in NSW stunt job growth.
- Australia’s accelerating vaccination rollout. With the current run rate seeing vaccinations targets being hit in November. This should result in easing of lockdown measures and a pick-up in economic activity.
- U.S. Federal Reserve chair Jerome Powell reiterated that interest rate rises will not come into play until full employment is achieved. While the jobs situation is improving the U.S. is far from full employment following the economic dislocation the pandemic has created. This provides comfort to any market concerns of potential for rising rates over the next 12 months.
- U.S. Nonfarm payrolls increased by 943,000 in July while the unemployment rate dropped to 5.4%. The payroll increase was the best since August 2020. Economists surveyed by Dow Jones had been looking for 845,000 new jobs and a headline unemployment rate of 5.7%.
- Supporting the strong US jobs figures was the number of job openings on the last business day of June which reached a new series-high of 10.1 million jobs. This reading came in higher than the market expectation of 9.28 million jobs.
- IHS Markit’s euro zone final manufacturing PMI dipped to 62.8 in July from June’s record high of 63.4. Manufacturing activity across the euro zone continued to expand at a blistering pace in July as the reopening of the economy led to very strong demand.
- Euro zone retail sales grew in June, signalling that the reopening of non-essential shops in several countries is helping to drive the region's economic recovery. The European Union's statistics agency said that the volume of retail sales rose 1.5% in June compared with May, in line with the forecasts of economists.

WHAT WE DIDN’T

- Australian retail sales fell sharply in June as coronavirus lockdowns shut whole sectors of retailing, a disappointing end to what had been a strong quarter for spending. Adjusted for inflation, sales were still up 0.8% for the entire June quarter, thanks to growth in April and May.
- Australian business confidence crumbled in July as the shock from pandemic lockdowns rippled through the economy. National Australia Bank’s business confidence index tumbled by 19 points to minus eight in July, while its business conditions index dropped 14 points to 11.

- The business activity in the US service sector expanded at a softening pace in August with IHS Markit's flash Services PMI falling to 55.2 from 59.9 in July. This print fell short of the market expectation of 59.4, indicating the increased spread of the Delta variant was impacting service industry activity.
- Shoppers in the U.S. cut back their purchases in July even more than expected as worries over the delta variant of Covid-19 dampened activity and government stimulus dried up. Retail sales for the month fell 1.1%, worse than the Dow Jones estimate of a 0.3% decline
- Eurozone industrial production declined again in June, missing expectations of an increase as supply-chain bottlenecks hindered activity. Output from factories, mines and utilities across the single-currency area in June fell 0.3% from the previous month. Economists polled by The Wall Street Journal had forecast a 0.2% increase.
- The Caixin China purchasing managers index dropped to 50.3 in July from 51.3 in June, missing consensus expectations of 51. July's reading was the lowest in the past 16 months, but still held above the 50 mark that separates expansion from contraction.
- Retail sales rose by 8.5% in July from a year ago, lower than the forecast 11.5%. The data showed consumers cut back on spending across the board, whether it was on big-ticket items like cars or lower-cost products like cosmetics that can be bought through online e-commerce platforms.

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 acts to temper negative 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 may 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 unexpectedly swift 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. Substantial 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

Volkswagen Group, also called Volkswagen AG, major German automobile manufacturer, founded by the German government in 1937 to mass-produce a low-priced “people’s car.” Headquarters are in Wolfsburg, Germany.

The company was originally operated by the German Labour Front (Deutsche Arbeitsfront), a Nazi organization. The Austrian automotive engineer Ferdinand Porsche, who was responsible for the original design of the car, was hired by the German Labour Front in 1934, and ground was broken for a new factory in the state of Lower Saxony in 1938. The outbreak of World War II in 1939 occurred before mass production could begin, and the factory was repurposed to produce military equipment and vehicles. Volkwagen’s military involvement made its factory a target for Allied bombers, and by the end of the war the factory was in ruins. It was rebuilt under British supervision, and mass production of the Volkswagen began in 1946. Control of the company was transferred in 1949 to the West German government and the state of Lower Saxony. By that time, more than half of the passenger cars produced in the country were Volkswagens.

Volkswagen production expanded rapidly in the 1950s. The company introduced the Transporter van in 1950 and the Karmann Ghia coupe in 1955. Sales abroad were generally strong in most countries of export, but, because of the car’s small size, unusual rounded appearance, and historical connection to Nazi Germany, sales in the United States were initially sluggish. The car began to gain acceptance there as the 1950s progressed, however, and Volkswagen of America was established in 1955. The American advertising agency Doyle Dane Bernbach was hired to represent the brand in 1959, and the result was a landmark advertising campaign that helped to popularize the car as the “Beetle” and promoted its size and unconventional design as an advantage to the consumer. The campaign was very successful, and the Beetle was for many years the most-popular imported automobile in the United States. Although Volkswagen made many detail changes to the Beetle, the basic rear-engine design and rounded shape remained the same. The company developed other rear-engine models with more-modern styling and improved engineering, but none were as successful as the Beetle.

Competition from small cars with more-modern designs and the company’s increasingly troubled finances eventually dictated a change in corporate philosophy toward developing more-contemporary and sportier car models. As a result, Volkswagen began phasing out its rear-engine cars in the 1970s, replacing them with front-engine front-wheel-drive designs. The first of those new cars was the short-lived K70 in 1970, followed by the Passat in 1973. Most significant, however, was the Golf, initially called the Rabbit in the United States, which was introduced in 1974. The Golf was an instant sales success, effectively replacing the Beetle in the company's line-up and ultimately becoming Volkswagen's best-selling model worldwide.

Joint ownership of Volkswagen by the West German government and the state of Lower Saxony continued until 1960, when the company was mostly denationalized with the sale of 60 percent of its stock to the public. Since the 1950s Volkswagen has operated plants throughout much of the world, including in Mexico, Brazil, China, and the United States. In addition to passenger cars, the company also produces vans and commercial vehicles. Volkswagen owns several other automotive companies, including Audi and Porsche in Germany, SEAT (Sociedad Española de Automóviles de Turismo) in Spain, Škoda in the Czech Republic, Bentley in the United Kingdom, Lamborghini in Italy, and Bugatti in France.

In mid-2015 Volkswagen briefly held the distinction of being the world's largest car manufacturer by volume after surpassing Toyota Motor Corporation. However, shortly thereafter Volkswagen faced a public relations crisis when the U.S. Environmental Protection Agency (EPA) determined that the manufacturer's diesel-powered cars contained software that altered the vehicle's performance in order to pass emissions tests. Volkswagen admitted to installing the "defeat device," and it recalled more than 10 million automobiles worldwide. In the United States alone, the carmaker faced fines of more than $4 billion, and several Volkswagen officials later were found guilty of various crimes. Despite the scandal, Volkswagen sales worldwide continued to increase.

In 2019 Volkswagen ended production of the Beetle, which had undergone various redesigns over some eight decades.
Source: Encyclopedia Britannica