Market Commentary – September 2021

During September, markets entered a period of increased volatility. Several reasons can be looked at as an explanation for this:

1. September and October are traditionally seasonally weak months for markets;
2. Delta infection rates continue to rise around the world;
3. Supply constraints increase, which typically means costs will rise; and
4. Central banks could soon start reducing the stimulus they are providing economies.

So, following seven consecutive months of positive gains, the writing was on the wall for a weaker September. With the odd flurry of resistance, share markets declined during the month and volatility spiked higher.

September is historically the weakest month of the year for markets, with an average decline over the past few decades of 0.55%. In fact, it is so renowned it has been coined the September effect, so we should take this in our stride as investors.

What all investors should keep in mind is that markets do not go up in a straight line, and pressure release periods are needed in order to sustain a market rally. This was the case 12-months ago, where markets declined 2.9% in September 2020. Following that pressure release, renewed buying in November and December saw the MSCI World Index rally 12.4% in final quarter of 2020.

We aren't in a position to forecast the same will happen this year, but it is important to remember to expect the ups and downs.

What happened in markets during September?

Overall, global equities fell 3.6% - the worst month since the panicked selling of March 2020. The fall was broad-based with only one sector recording a positive return, energy. We discuss the energy sector more in our next section.

The US market ended the month down 4.6%, while European stocks fared relatively better, falling only 3.1%. Australian shares finished 2.7% lower while emerging markets declined 2.8%. New Zealand shares on the other hand bucked the trend (again), finishing September 0.4% higher. After rallying strongly in August following a takeover offer, Z Energy lost some of its get-up-and-go during September, declining 2.5% to underperform the market. It's important to note that the AMP New Zealand branded funds do not invest into Z Energy as the company does not align with our sustainable investment philosophy.

US Treasury yields continued to climb higher and the New Zealand 10-year Government bond yield has also lifted. Rising yields add to the selling pressure on share markets.

Theme 1 – volatility in energy prices…

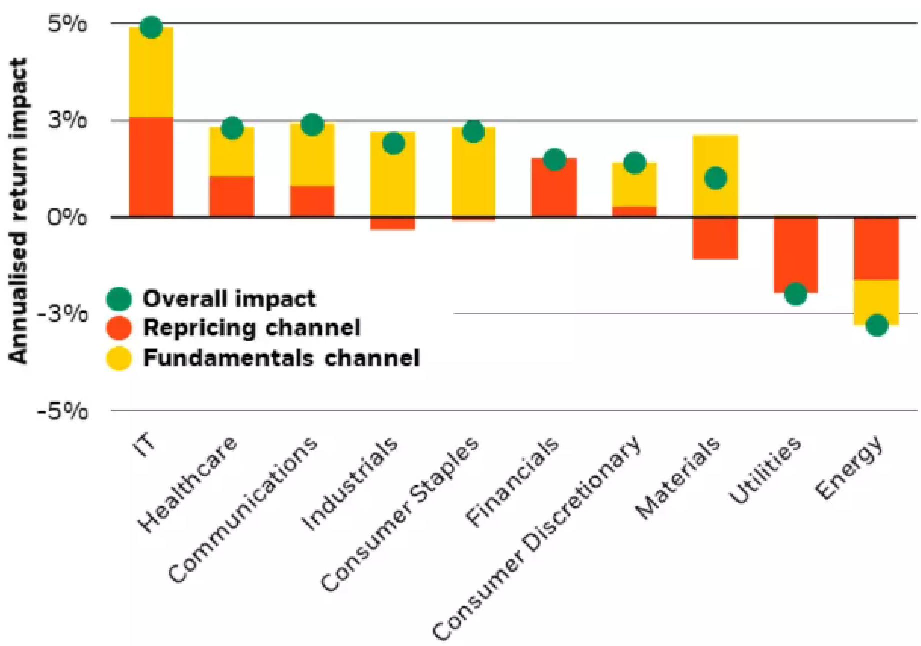
Shares in energy-related companies rose over the month as Brent Oil traded near a three-year high as demand picked up following the withdrawal of Covid-19 restrictions, while supply remains constrained. Energy is a volatile sector, and listed companies can experience rapid price swings. Overall, the energy sector rally had little impact on the broad market as the sector only accounts for 3.2% of the MSCI World Index – the most common reference point for global shares performance.

AMP New Zealand's sustainable investment philosophy prohibits AMP-branded funds from investing in fossil fuel related companies, meaning our funds do not experience the price volatility caused by the energy sector. Our funds instead focus on the long-term transition to a low carbon economy, and particularly businesses that will benefit from the changing structural environment resulting from the global focus on climate change. This sees our funds favour other sectors such as technology.

One consequence of shifting societal preferences is that the price investors are willing to pay for assets perceived to be sustainable is changing, driving differentiated returns. Capital flows toward sustainable assets are a symptom of this phenomenon.

In our view, corporate behaviour is likely to adapt to policy and regulatory changes introduced to combat climate change. As a result, profitability across sectors will be impacted, with sectoral winners and losers. BlackRock have estimated the annualised five-year return differential between the US energy and technology sectors to be 7%. This is why AMP-branded funds are tilted towards technology stocks and a cleaner greener environment.

Total return impact from the shift to a green economy over 5 years



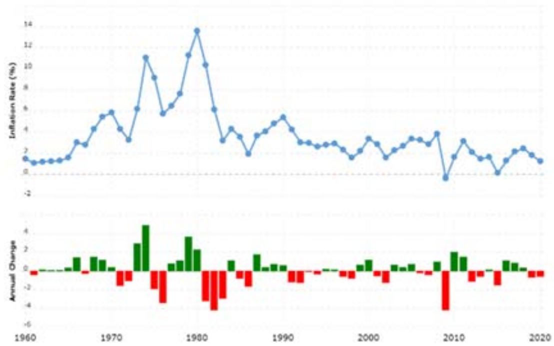
Source: BlackRock Investment Institute, February 2021

Theme 2 – the inflation story (again)

It feels like we talk about inflation regularly in our commentaries… It is probably topical because inflation has not troubled the financial markets since the 1980's.

New Zealand Inflation Rate 1960-2020 | MacroTrends

U.S. Inflation Rate 1960-2020 | MacroTrends



Despite a slightly softer US reading in August, inflation continues to remain high around the world. This has seen the tone of central banks become slightly more hawkish. In the US the expectation for the first interest rate hike has been brought forward to next year, and tapering could start as early as November. While in Europe, the European Central Bank (ECB) kept its monetary policy unchanged, announcing however a slowdown in the net asset purchases under its pandemic emergency purchase programme.

Domestically, all eyes have been on the Reserve Bank of New Zealand (RBNZ) since they were forced to maintain the Official Cash Rate (OCR) at 0.25% at its August meeting following the Delta outbreak and subsequent level 4 restrictions. With restrictions slowly being lifted and a much stronger June quarter GDP growth number of +2.8%, this all but sealed in a rate hike at the most recent RBNZ meeting on 6 October. Leading up to the meeting, banks increased their mortgage lending rates as the expectations of a rate hike were baked into the numbers. The RBNZ didn't disappoint this time, raising the OCR by 0.25% to 0.50%.

Our outlook…

Our view is that share markets will likely stabilise, but risks remain for short-term pullbacks. These pullbacks are to be expected after a sustained period of positive returns.

On the side of the challenges are:

- Chinese property markets following the Evergrande troubles;
- The energy crisis in Europe and China is still to play out;
- Central banks will start tapering soon.

On the side of the positive is:

- Even with tapering and eventual rate hikes, interest rates will remain low for the medium term;
- Companies continue to report strong profits;
- The successful vaccine rollout is leading to more sustained re-openings of borders and economies.

On balance we still favour the positive outlook over the next 12-months for share markets.

Bond yields are expected to continue their rising trend, as the market becomes more confident that the recovery in the global economy remains on track. Hence our outlook for fixed interest investments is still less positive.