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Fiducian Monthly Economic Commentary Report

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Conrad Burge, Investment Manager, Fiducian Investment Management Services Limited

ECONOMIC OUTLOOK

GLOBAL ECONOMY

The global economy is continuing to recover from last year's recession, which saw the biggest downturn since the Second World War. US recovery is forecast to be particularly strong, as is forecast growth for the two largest developing economies, China and India. However, much depends on the continuing rollout of large-scale vaccination programs that have so far proved effective in lowering hospitalisation and death rates and which have enabled the re-opening of economies across the world. As recovery accelerates, it is expected that what has been an unprecedented level of monetary and fiscal stimulus will be steadily wound back.

While the major central banks, notably the US 'Fed', appear close to beginning a reduction of expansionary monetary policies, government spending programs remain very much in place. The IMF, however, remains relatively sanguine about inflation, which it expects to subside.

The global economy is continuing to recover from last year's recession, which was the most severe since the Second World War. According to the International Monetary Fund (IMF) in its latest report (July), the world economy is forecast to expand by 6% this year (rebounding from last year's low base) and by around 5% in 2022. The advanced economies as a whole are forecast to grow by 5.6% this year and 4.4% next year, with US growth expected to be particularly strong at 7% this year and 5% in 2022. While UK growth is forecast to match the US, growth in the Euro zone (4.5% and 4.3%) and in Japan (2.8% and 3.0%) is expected to be less robust. Much of the developing world is also recovering well, with China forecast to grow by 8% this year and 5.7% in 2022 and India forecast to do even better, with growth rates of 9.5% and 8.5% over this period. This general forecast of a strong global recovery though is predicated on the effectiveness of vaccination programs to counter the COVID-19 coronavirus that originated in China and spread around the world from early last year. So far, these programs have been the key to a significant drop in hospitalisation and death rates in most countries, leading to the lifting of 'lockdowns' and the resumption of economic activity. As this recovery gathers pace, there is expected to be a steady winding back of highly expansionary monetary and fiscal measures that have sustained employment and underpinned share and property markets since the advent of the pandemic.

As Jerome Powell, Chairman of the US central bank (the 'Fed'), noted on 27 August, 'it could be appropriate to start reducing the pace of asset purchases ('QE') this year.' On the other hand, the US administration is still trying to push some highly expansionary government spending programs through the Congress that could in time have an impact on inflation. Despite this, the IMF observes that 'in most cases inflation should subside to its pre-pandemic ranges in 2022 once the transitory disturbances (which largely reflect pandemic-related disruptions) work their way through prices.' One cost of historically large fiscal stimulus measures though has been a huge rise in government debt levels that eventually will have to be reduced.

AUSTRALIAN ECONOMY

The Australian economy has also been heavily affected by the coronavirus pandemic but a nation-wide vaccination program could lead to re-opening soon.

The Australian economy was recovering strongly until the recent spread of the 'Delta' variant of the virus, which has led to further lockdowns and likely economic contraction in the September quarter. Vaccination rates though have been accelerating, which could soon lead to re-openings, although monetary and fiscal stimulus is likely to be needed through 2022.

MARKETS

Major share markets have been rallying since March last year and could potentially rise further over coming months assuming that highly expansionary monetary and fiscal measures remain in place.

While major sovereign bond markets have seen yields rise above their lows, they mostly remain historically low as a result of central bank bond purchases.

Most share markets fell heavily early last year before rebounding, with most major markets rising in 2020. This year, up to 27 September, market movements have included rises of 18% for the broad US market (S&P500), 16% for the technology-focused Nasdaq, 9% for the UK, France 20%, Germany 14%, Japan 10%, China 3%, India 24% and Australia 12%. Although valuation measures now appear elevated, share markets could have further upside, assuming expansionary monetary and fiscal policies remain in place.

Major sovereign bond markets saw yields reach record lows in March 2020. Central banks have since tried to keep rates low to lift economic activity, although longer-term bond yields in some cases have risen this year. The US 10-year Treasury bond yield fell to an historic low of 0.54% on 9 March 2020 but was 1.54% on 28 September 2021. Similarly, the Australian 10-year bond yield was 0.57% on 8 March 2020 but was 1.48% on 28 September, although below the level reached in March. Most bond markets continue to look expensive.

FIDUCIAN FUNDS

The Fiducian Funds are currently overweight equities, underweight bonds and overweight cash.

Fiducian's diversified funds are currently above benchmark for international and domestic shares, around benchmark for listed property and well underweight fixed interest sectors, while cash weightings remain well above benchmark.