EQUITY MARKET RALLY SET TO BOOST INCOME

PERPETUAL PRIVATE INSIGHTS
14/07/2021

For trust and income beneficiaries, the June quarter – much like the 2021 financial year – was mixed. Record low interest rates continued to put the brakes on interest income, and while there has been some recovery in dividends from the early days of the pandemic, they are still below 2019 financial year levels.

On a brighter note, equity markets rallied strongly over the quarter, raising the prospects for both capital and income gains in the next 12 months.

In Perpetual Private's quarterly investment update for April to June 2021 we look at the reasons for ongoing pressure on investment income and the outlook in 2022.

DOWNLOAD THE REPORT

Little change to income, but better days ahead

Over the June quarter, fixed income returns remained weak as the Reserve Bank of Australia (RBA) kept interest rates at record lows.

While there is little likelihood of interest rates changing in the coming year, we believe our stronger than expected economic recovery will translate into increased income from dividends, particularly from value stocks such as financials and energy companies which underperformed in 2020. Constraints on dividends that could be paid by banks have also been lifted, boosting dividends further on a 12-month basis.

The outlook for fixed income

While equity markets locked in gains, bond market fluctuations showed that investors are increasingly concerned that rising inflation could force the RBA and other major central banks to raise interest rates sooner rather than later.

As recently as the July meeting of the RBA, Governor Philip Lowe reiterated his commitment to maintaining official interest rates at 0.1% for the medium term, saying that substantial and sustained wage growth was a key variable for deciding when to raise interest rates.

In the US, the Federal Reserve has also suggested that any spike in inflation will likely be transitory and they would allow inflation to run above target for some time before intervening. These dovish views on inflation and interest rates saw bond yields ease.

This means that, unless inflation turns about to be more persistent than transitory, interest rates are not likely to rise sooner than current 2023 or 2024 forecasts.

A strong end to a record year for shares

The last quarter of the 2021 financial year saw a strong rally in Australian equity markets with the ASX/100 surging 8.5%. For the full financial year, the ASX/100 gained 27.9% – its best annual increase in over 30 years – as the market continued to rally off March 2020 lows.

Much of the quarter was characterised by a sense of calm. While the vaccine roll-out didn’t meet targets, low case numbers let investors look forward to what a post-COVID world might look like.

Together, this post-COVID optimism, high levels of government spending to support the economy and record-low interest rates combined to fuel the rally in equities. It was a similar story around the world, with the MSCI world index also posting a gain of 9.0%.

Looking beyond lockdowns

The COVID-19 lockdowns in many parts of the country in June and July have shown how fragile our economic recovery really is in the face of a COVID-19 outbreak, particularly with the emergence of the Delta strain. More lockdowns will naturally impact the economy, for the benefit of some industries, such as online shopping and the detriment of others, such as tourism.

Nonetheless, the increase of vaccine supply in the second quarter of FY22 and the acceptance that the virus cannot, ultimately, be eliminated has meant that investors are taking the long view, and COVID-19 is not likely to be a major market disruptor.

What can trust and income beneficiaries expect ahead?

The IMF and World Bank predict global economic growth of between 5% - 6% in 2021, (albeit led by a few large economies) with a sharp recovery in business activity and global economic output.

This is set to fuel equity markets and for Aussie equities the trend is likely to be ‘more of the same’. However, the emergence of the Delta variant will see some COVID-19 restrictions return and the road to economic recovery is likely to be bumpy.

Finally, for fixed income the debate continues over whether the current inflation spike is transitory or more permanent. Whatever the outcome, there is little prospect of major central banks raising interest rates in the coming financial year, however ongoing uncertainty may lead to periods of market volatility.

DOWNLOAD THE REPORT