GREEN SHOOTS FOR NOT-FOR-PROFIT INCOME AS DIVIDENDS RECOVER

PERPETUAL PRIVATE INSIGHTS
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The June quarter provided a mixed report card for not-for-profits looking for some positive news following a challenging year. Equity markets rallied strongly over the quarter, raising the prospects that capital gains will translate into income gains in the coming months as dividends slowly recover from the early days of the pandemic.

On the other hand, record low interest rates continued to put the brakes on interest 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 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 for 2022.

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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.

For not-for-profits concerned about income, 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 out to be more persistent than transitory, interest rates are not likely to rise sooner than current 2023 or 2024 forecasts.

Going green – responsible investing continues to rise

As a not-for-profit, it's natural to consider communities and the environment in your investment decisions. That's why we're committed to offering investment solutions that are ethical, aligned to the values of your not-for-profit and still designed to meet the Board's fiduciary responsibility to optimise investment returns, for a set level of risk.

For many of our not-for-profits, interest in Responsible Investing has surged. Reflecting this increased interest and the fund's performance, the Funds Under Management (FUM) in our Direct Equity portfolio, which has an ethical focus, surged in the June quarter. Over the last 12 months, FUM grew from $84 million to $131 million at 30 June 2021.

With its popularity on the rise, in the video above we look at the four key areas of responsible investing and what a not-for-profit should consider when creating their Responsible Investment strategy.

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%.

What can not-for-profits 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 all eyes will be on inflation and whether central banks will be forced to raise interest rates sooner than expected.

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