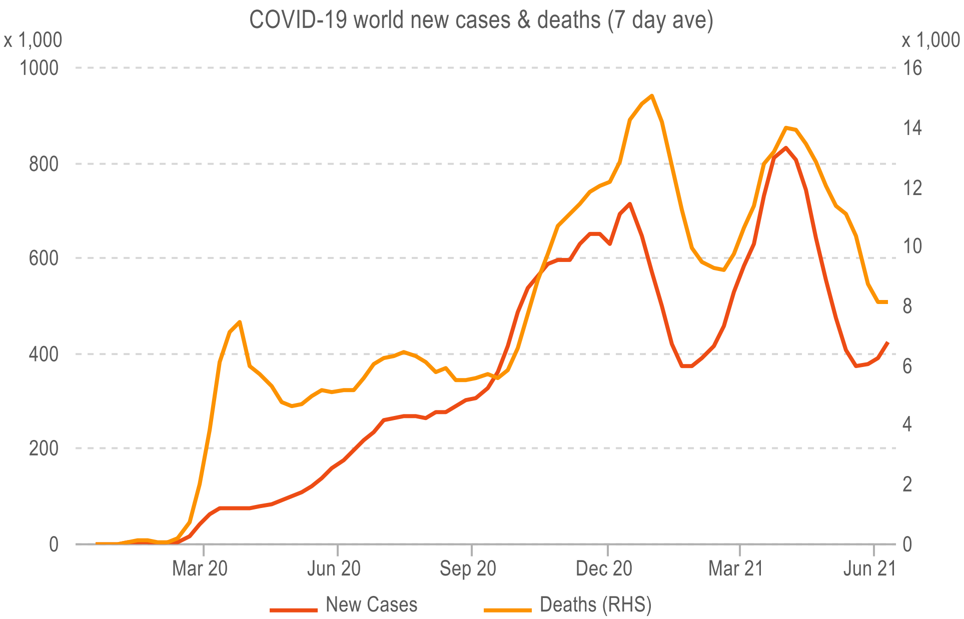
Financial year review

July 2021

frontier

COVID-19

COVID-19 vaccination roll out progressing at varying paces across countries



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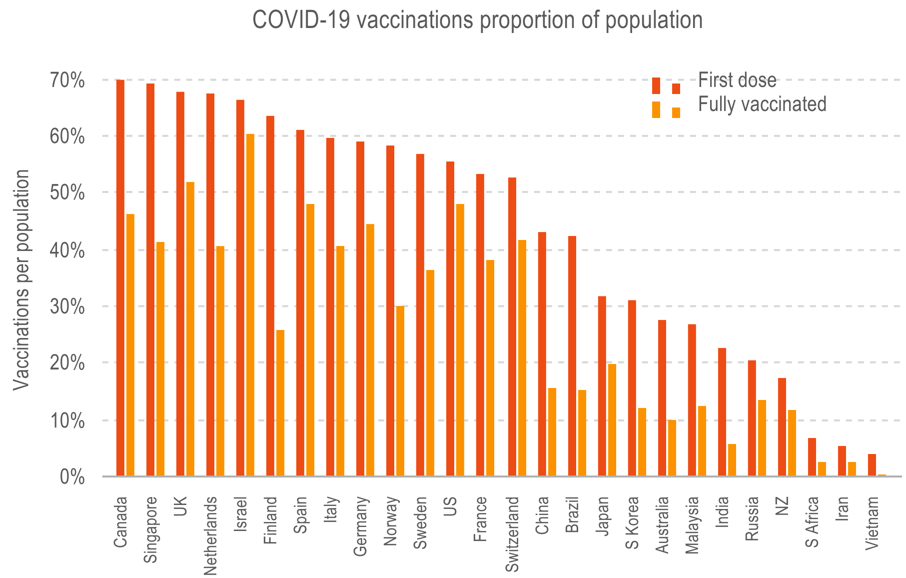


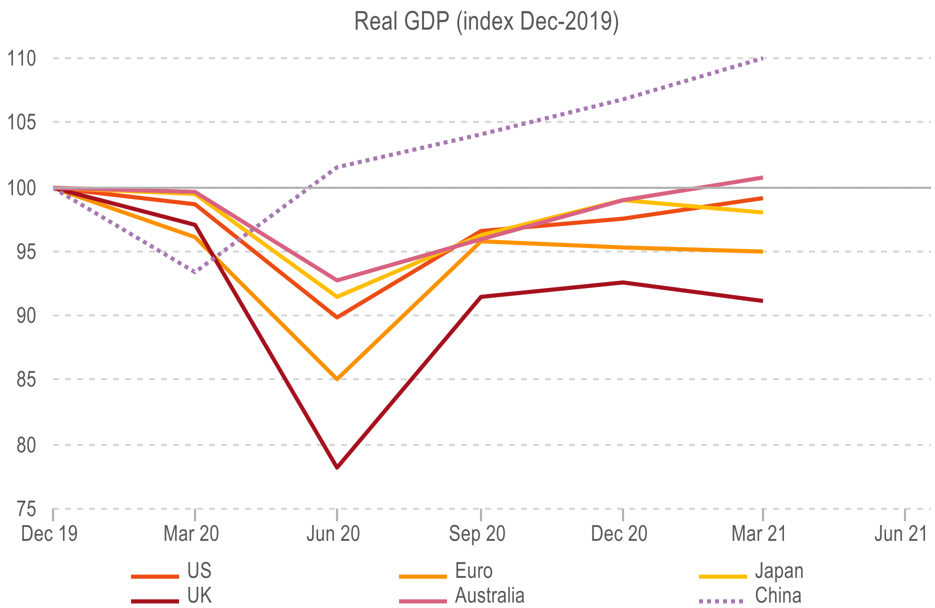
Source: Refinitiv Datastream

The financial year has been dominated by COVID-19. After the initial outbreak and lockdowns, there have been subsequent waves of new infections, including in late 2020 in the US and Europe, and in India around April 2021. COVID-19 spread has been relatively minimal in Australia, but Australia has experienced a number of contained outbreaks and lockdowns over the year.

The major development in late 2020 was the approval and release of effective vaccines. The roll out of vaccines through 2021 has been divergent with some developed markets easing restrictions as vaccination levels increase, while in other regions it has been slow, particularly in many emerging markets. New mutations of the virus, as well as vaccine hesitancy and availability, means COVID-19 is likely to remain in circulation for some time, potentially becoming endemic.

Global economy

Global GDP growth rebounded in V-shape recovery



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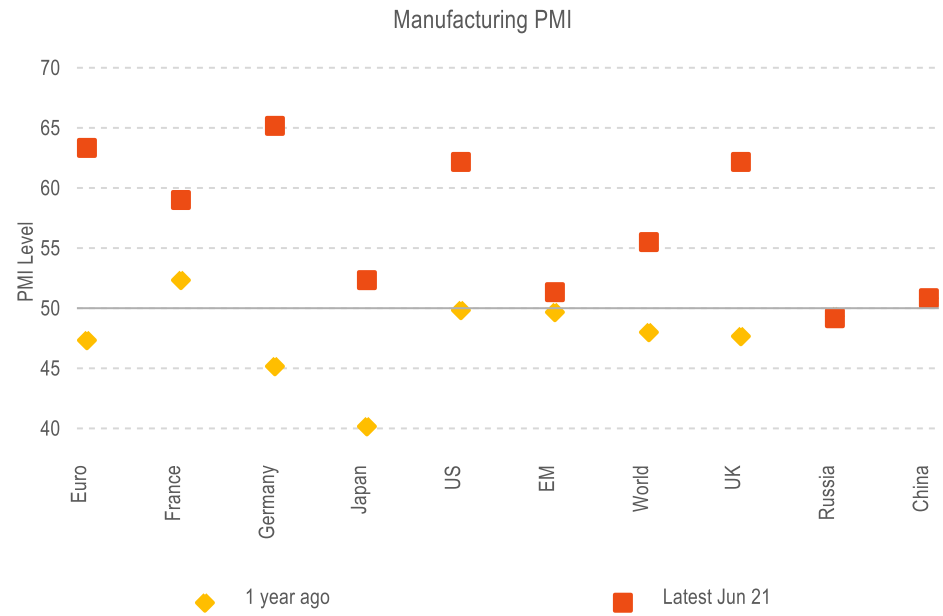


Source: Refinitiv Datastream

As initial lockdowns were released, trade and manufacturing activity rebounded in the second half of 2020. China has led through the process rebounding particularly strongly. The Australian economy has performed relatively well and GDP is now back above pre-pandemic levels. However, further lockdowns in Europe, UK and Japan, have seen secondary contractions in economic growth in early 2021.

Through the later part of 2020 and early 2021, political instability was high in the US, with the Presidential election, the disputed victory by Joe Biden, the Capitol riot, inauguration of Biden and acquitted impeachment of former President Donald Trump. Subsequently, the Biden administration has announced infrastructure spending and delivered a very large fiscal stimulus that has supported the US economic recovery.

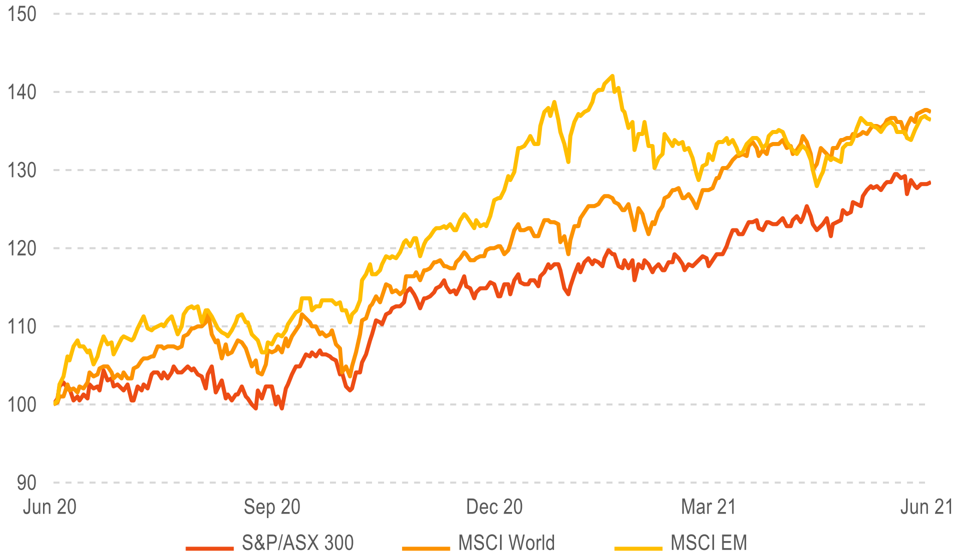
Additionally, the transition period for the withdrawal of the UK from the Eurozone (‘Brexit’) ended on 31 December 2020 and is now operating under the new agreement. This produced uncertainty leading into the date and material trade disruption around the period, although trade activity has improved somewhat more recently.

There were increasing tensions with China over the year, and Australia was impacted with restrictions on exports for a number of goods.

Equities and credit

Strong equity markets and falling credit spreads

Equities performance FY 2020/21 (local currencies)



Source: Refinitiv Datastream

US investment grade spread (bps)

Source: Refinitiv Datastream

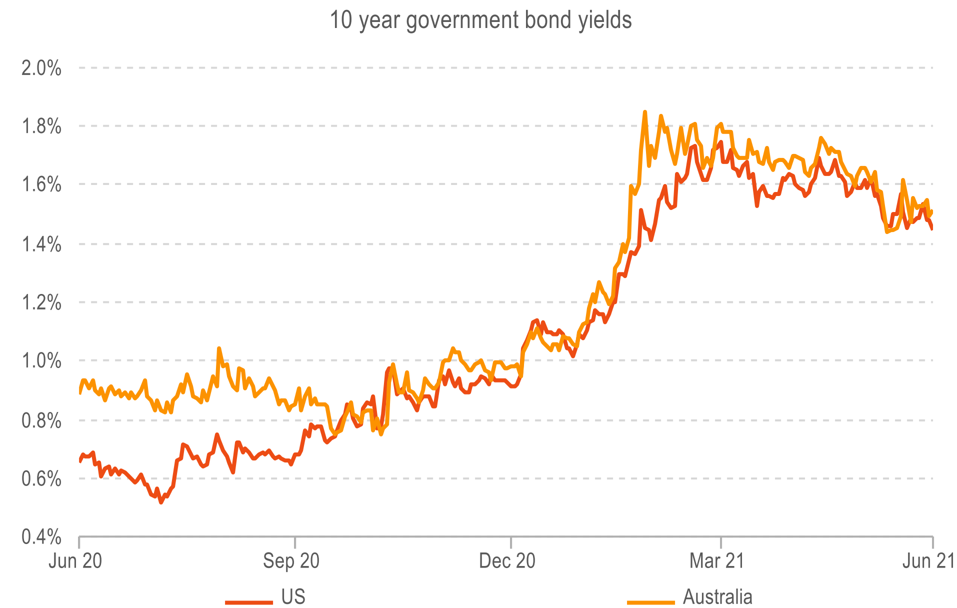
Equities produced very strong returns over the financial year. Although there was some volatility, markets managed to look through the various geopolitical and COVID-related issues, and equities benefited from the positive news of vaccine developments and a rebound in global economic growth.

Performance was particularly strong in the US and in the technology sector. However, there was some rotation in markets from around September 2020 as ‘value’ stocks performed a little better and technology stocks outperformance moderated. Australian equities’ returns were not as high as world equities over the financial year, but were still very strong.

Corporate bonds also produced strong returns over the financial year as credit spreads fell sharply. There was some increase in defaults but it was not at the scale of past downturns as the significant monetary and fiscal stimulus supported issuers.

Government bonds and cash

Rising bond yields with increasing expectations of inflation and future interest rate hikes



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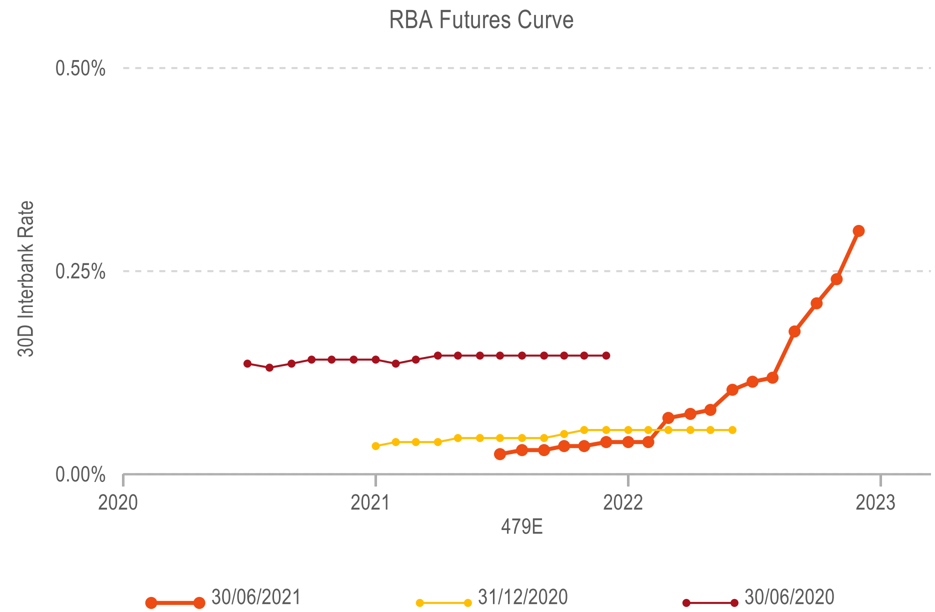


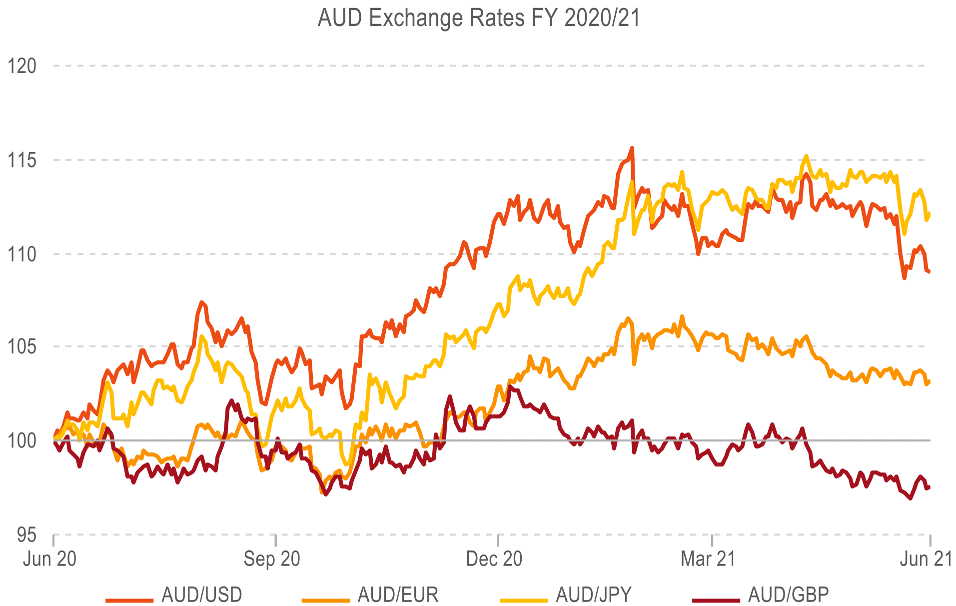
Source: Refinitiv Datastream

US and Australian government bond yields increased over the financial year, as inflation expectations increased markedly in conjunction with the faster than expected economic recovery. This led to negative returns from Australian and global nominal government bonds over the year, while inflation linked bonds produced positive returns.

The rise in inflation is partly due to base effects, but also rising commodity prices and supply chain constraints. Central banks have generally kept rates unchanged at around or below zero and provided guidance that rates will remain low for an extended period, with the expectation that current inflation rises are transitory. In November 2020, the RBA cut rates from 0.25% to 0.10% and provided additional monetary support measures, including government bond purchasing programs (or 'quantitative easing'). However, more recently, markets have started to recalibrate the likelihood of future interest rate rises, with market futures now pricing in the expectation that interest rates will rise in 2022.

Foreign currency

Sharp rise in the price of iron ore contributed to the strength of the AUD



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The Australian dollar generally appreciated over the financial year, reducing the return of unhedged international equities. The exception was the GBP which benefited from the removal of the uncertainty of how Brexit would progress.

A key driver of the Australian dollar was the rise in commodities prices, that benefited from the rebound in global growth, particularly strong demand from China. The iron ore price increased very sharply, more than doubling over the financial year.

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