Quarterly Commentary

June 2021

Entrust
WEALTH MANAGEMENT

June 2021 Quarter

The June 2021 quarter was a strong finish to a very pleasing financial year for portfolios. All asset classes added to performance but Australian equities, international equities and real estate were the standouts.

Quarter highlights:

- Within **Australian Equities** a number of economically sensitive subsectors had a strong quarter such as Automobiles and Components (+19.27%), Commercial and Professional Services (+19.27%), Media and Entertainment (+ 14.33%) and Capital Goods (+13.29%). Utilities (-4.52%) were weak with Energy (-2.83%) also a drag.

- **International Equities** were also strong with the MSCI World +7.74% as growth companies outperformed. The US S&P 500 (+8.55%) led the charge with Europe ex UK (8.4%) not far behind. In June US President Biden was able to get his infrastructure deal approved although the $1 trillion value was around half that originally proposed.

- Equity Long Short strategies were the main driver of returns within **Alternatives (Other)** and gold regained some ground after a very weak March 2021 quarter.

- **Real Estate Investment Trusts (REITS)** resumed their uptrend with the sector printing a new 12 month high and just below their pre COVID-19 trading range.

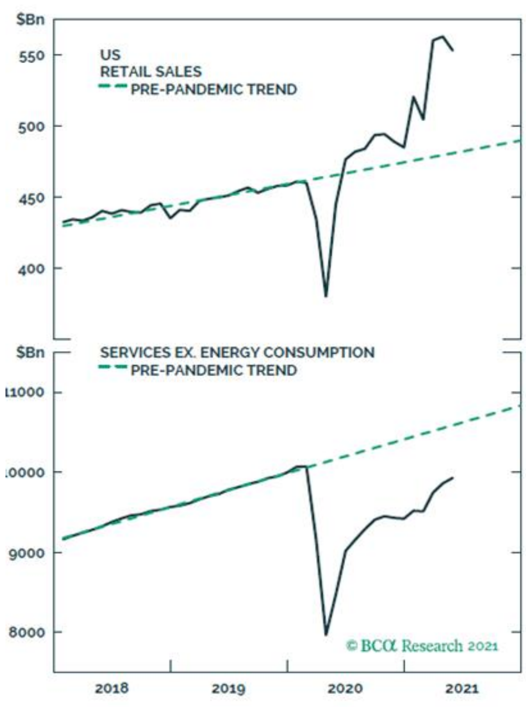
- Within **Fixed Income** government bond yields retreated providing a positive price movement for portfolios. Broader credit and hybrid exposures also generated solid returns. The end of the quarter saw some central banks, such as the US Fed and the RBA, start to change the tone of their language towards the prospect of future rate rises although all stressed the need to tread carefully and that support will be provided for as long as is required.

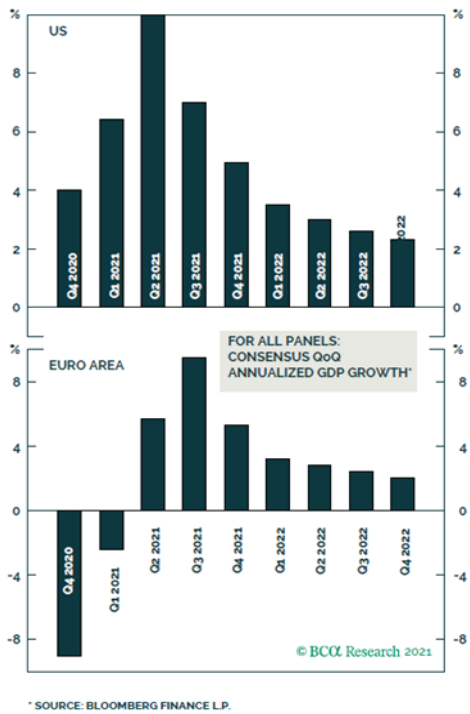
Outlook

- **Growth Moderating but Healthy Outlook Remains**
- **COVID-19 – Growth Interruptions**
- **Inflation Expectations and the Feedback Loop**
- **Implications for portfolios**

Growth Moderating but Healthy Outlook Remains

Global economic growth remains positive although from here we expect the rate of growth will start to roll over and begin to transition towards a more normalised level. Consumption should continue to be a core driver as households spend the significant levels of savings they have accumulated but as lockdowns ease we would expect a shift in focus from goods back to services. To meet this pick up in consumption and to unlock some of the current supply chain blockages, companies will need to increase their capital investments.



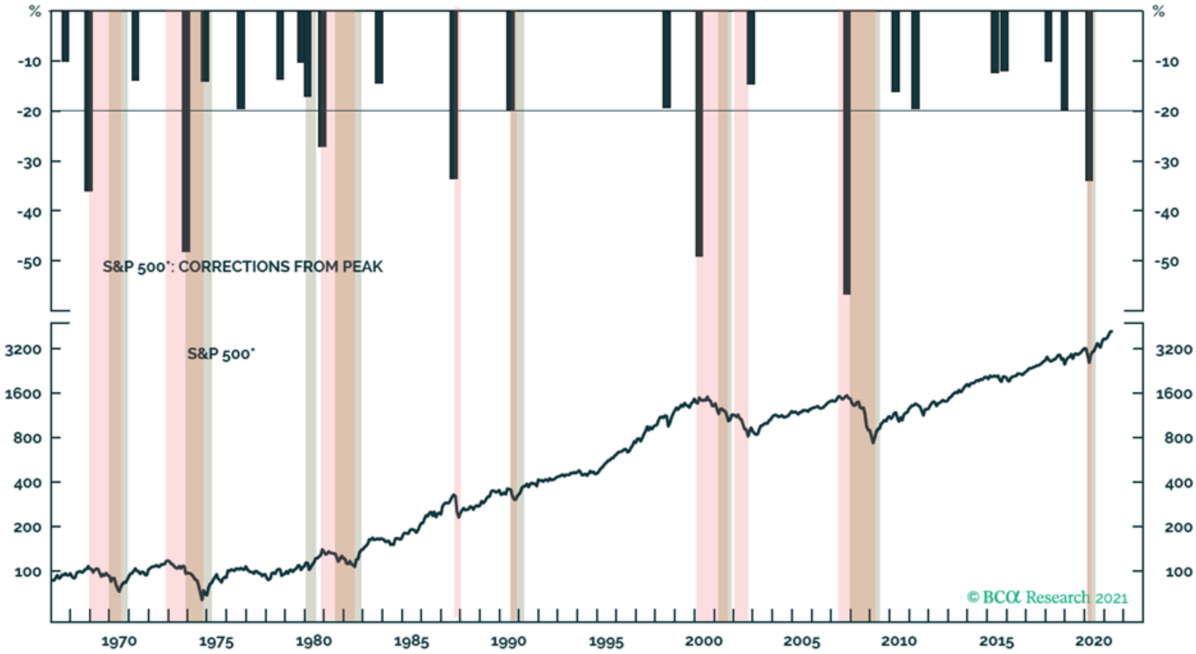


Fiscal policy remains supportive with a number of commitments to new infrastructure projects announced globally. These investments occur over a multi-year period versus the sugar hit delivered by income support so should provide a healthy undercurrent to growth.

Central banks continue to be accommodative, albeit a number are starting to discuss when and how they might withdraw this support. The path of least resistance for interest rates is higher but central banks are understandably treading cautiously given there remains some uncertainty around the near-term impacts of COVID-19 and the risks of cutting off the growth impulse prematurely.

With that backdrop, it is hard to foresee another widespread recession in the near term. As the following graph from BCA Research highlights, equity bear markets (defined by a greater than 20% drawdown) tend to happen just before and during recessions suggesting the outlook for equites remains constructive. However, the graph also shows that investors should be prepared for some reasonably large pullbacks along the way.

Equities Outperform Except Before And During Recessions

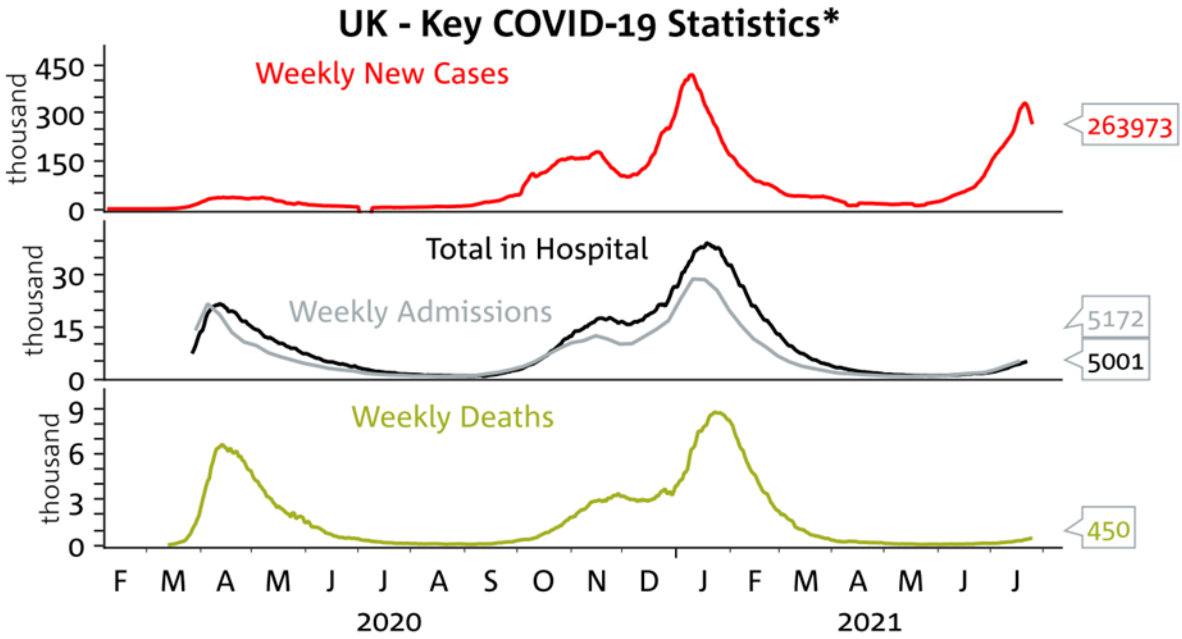


* SHOWN IN LOG SCALE.
NOTE: LIGHT RED SHADING INDICATES BEAR MARKETS; GREY SHADING INDICATES NBER-DESIGNATED RECESSIONS.

COVID-19 – Growth Interruptions

We are not overly concerned about a major COVID-19 related market correction but do acknowledge that there is little margin for error priced into markets should growth expectations disappoint because of reopening disruptions. The sooner governments can move away from using snap lockdowns and other restrictions to manage community spread of the virus and ultimately the hospitalisation and death rates, the better. Vaccine success is clearly a key factor on this front.

All eyes are on the UK following its ‘Freedom Day’ removal of COVID-19 related restrictions. At present around 56% of the UK population is fully vaccinated with 69% having at least one dose. Case numbers have risen but so far, the growth in hospitalisation and deaths remains relatively low. As lagging indicators, authorities around the world will be monitoring this apparent weakening link to gain confidence in the ability to live with and manage the virus via vaccines.



*Note that hospitalisations data is reported with a lag
Source: National Australia Bank, Our World in Data, Public Health England

Two of the biggest challenges governments and health authorities face with transitioning back to a more normalised economic environment is to first determine what the appropriate vaccination threshold for the population should be and secondly to get the population across it. For those countries further down the track we have generally seen a burst of vaccination activity initially followed by a plateauing in momentum somewhere short of the desired level.

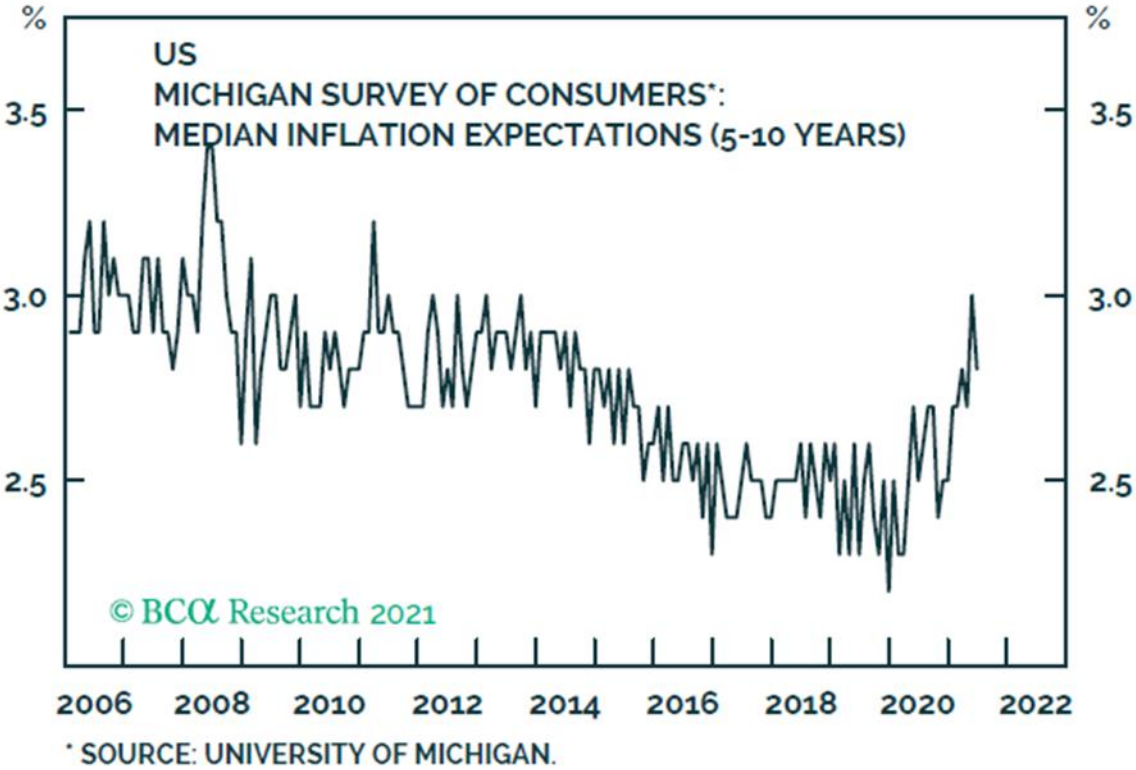
Inflation Expectations and the Feedback Loop

For several months inflation has been the hot topic among investors with many concerned about the amount of liquidity in the system. To temper some of the fears, central banks have been pushing a theme that any short-term lift in inflation is likely to be transitory.

So far, this view seems plausible. We have seen a sharp spike in inflation prints recently but this has largely been due to increases in the prices of items affected by supply chain bottlenecks (used cars) or because of demand surges as economies reopen (airfares, accommodation and other entertainment products). These pressures are expected to normalise as the economic barriers subside.

The peaking of growth expectations and the rise in COVID-19 cases discussed above has seen some of the inflation concerns ease more recently with bond yields falling as a result. Perhaps ironically, therein also lies some of the longer-term risks for inflation.

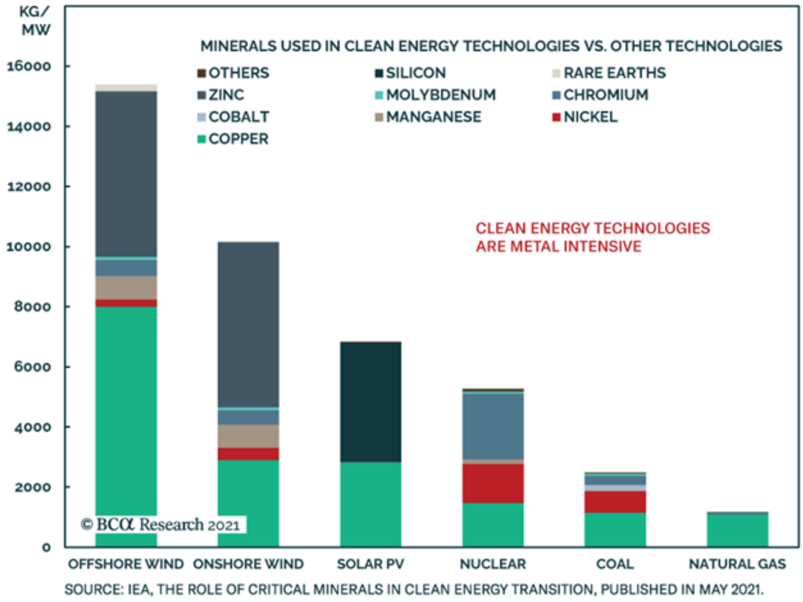
If the economic frictions caused by managing COVID-19 continue, supply chain blockages may not be resolved as quickly as expected meaning prices remain elevated for longer. Consumers may then start building these elevated prices into their future expectations. If the flow of human capital across borders also remains restricted countries may not have enough workers to fill their available jobs providing a strong bargaining position for higher wages. Businesses will look to pass on these additional costs through higher prices creating a feedback loop where 'transitory' inflation becomes baked into the system. Household inflation expectations and its effect on wages growth will therefore be important indicators to monitor in the near term.



Overall, we remain comfortable with the near-term inflationary outlook but do foresee some longer-term risks so when constructing portfolios we believe it is important to continue to maintain appropriate inflation hedges.

Implications for Portfolio

- With global growth moderating and the risk to yields to the upside we expect markets will move into more of a consolidation phase.
- The path to higher yields is likely to be a protracted one and capped to some degree.
- In this environment equities will continue to look attractive relative to bonds.
- Given current valuations and the uncertainties around achieving appropriate vaccination thresholds, snap lockdowns and other restrictions pose the potential of unforeseen risks that may extend the recovery phase causing periods of heightened volatility for markets.
- Inflation hedges:
    - *High quality equities*: Ability to pass on price rises and maintain margins.
    - *Commodities*: We acknowledge a slowing growth impulse in China presents some near-term risks for commodities but we remain comfortable given the outlook for global growth is healthy while the multi-decade transition to sustainable energy will require a significant infrastructure build. This will consume large volumes of commodities and approaches at a time when commodity companies have largely underinvested in new supply.



    - *Real estate*: We used the COVID-19 market correction to lift our real estate exposure but this has had a largely Australian focus to date. Global real estate markets offer attractive sector diversification benefits so we are currently in due diligence of some more global exposures.
    - *Infrastructure*: As well as having long term stable cash flows, infrastructure assets have inflationary benefits with revenue models that often include CPI+ rachet clauses. We are starting to see a rise in corporate actions in the sector as large super and endowment funds bid for assets. With an outlook of subdued bond yields and large amounts of capital within these funds, we believe this infrastructure M&A cycle will be an ongoing thematic. In a consolidation phase, investors will also be drawn to the relatively attractive yields offered by the sector.
- Decarbonisation:
    - Post the release of the Sixth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC), it would appear that firmer and more urgent action on emissions reduction is required to tackle climate change. This is an evolving theme that we already have some exposure to but continue to actively consider for new investment opportunities.

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