October 2021

EQT MONTHLY SUMMARY

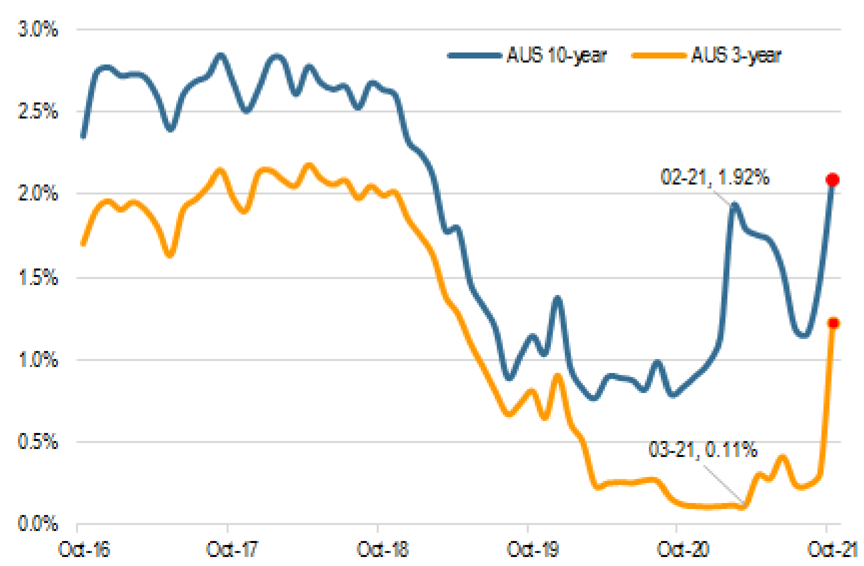
Year-to-date the ASX200 has gained ~14.7% and has rallied ~28% over the last 12 months. We remain cautiously optimistic heading into 2022, but gains seen over the last 12-18 months are unlikely to be repeated. Economic growth forecasts remain healthy and Covid-19 vaccination rates are progressing quickly toward reopening targets. The traditionally safe bond market has sold off from expensive and low yielding levels over the last 12 months with the Australian index returning -5.3%. We have been tactically overweight equities and underweight Fixed Interest. While bond markets are starting to price in a faster tightening cycle, monetary policy remains very loose and excess savings should offset fiscal tightening as supportive government measures put in place due to the pandemic are wound back. Further, the labour market remains well supported. Pent up demand supported by robust consumer balance sheets should drive revenue growth and companies with strong pricing power should be able to enjoy operating leverage benefits.

MARKET SUMMARY – KEY POINTS

- Australian equities fell slightly in October and underperformed most major peer markets - In local currency, the ASX200 fell 0.1%, while the US S&P 500 strongly outperformed most other global markets rising 6.9% (its largest monthly gain since Nov 2020) to close at records levels. In AUD terms, however, the MSCI World ex Australia index only gained 1.51%. Given the US' large weighting, the MSCI World ex Australia Index gained 5.7%. Japan's Nikkei fell 1.9% while Asia-Pac ex Japan rose 1.7%.
- The best performing sectors in the ASX200 for the month were Information Technology (+2.1%), Healthcare (+1.0%) and Financials ex property (+0.8%). The worst performers were Industrials (-3.2%), Energy (-2.7%) and Consumer Staples (-2.3%).
- When we take size (market capitalisation) into account, the top-five contributors to the ASX200 were Macquarie Group (+19.4bps), CSL (+11.5bps), National Australia Bank (+10.3bps), Newcrest Mining (+6.5bps) and Wesfarmers (+6.0bps). The bottom five contributors were Rio Tinto (-13.0bps), BHP Group (-10.8bps), Transurban Group (-7.8bps), Fortescue Metals Group Ltd (-6.2bps) and Domino's Pizza Enterprises (-5.6bps).
- Economies have continued to "re-open" as vaccination rates surge - Covid cases have fallen in a number of countries and hospitalisations continue to diverge highlighting the effectiveness of vaccines. Boosters are also now starting to be rolled-out. Australia, in particular, has seen a very strong take-up. International borders will be re-opening earlier than expected.
- Inflationary pressures emerging - Inflation is a global theme with labour shortages, supply chains constraints, greenflation, rising energy prices and housing costs all impacting. The market is attempting to determine to what degree these pressures are "transitory" or more permanent. Headline CPI in Australia came in at 0.8% quarter-on-quarter (QoQ), 3.0% Year-on-Year (YoY), but core measures surprised positively at 0.7% QoQ, the strongest print since 2014, moving annual inflation (2.1% YoY) back in RBA's target band. This print clearly challenges RBA's cautious inflation outlook (1.75% YoY core Inflation for 4Q).
- The Australian bond market experienced a rapid and broad-based sell-off across the entire yield curve providing little protection for bond investors - The yield on the

Australian 3-year bond climbed nearly 100bp through the month, marking one of the largest moves on record. Australian 10-year government bond yields rose a whopping 59bp to close at 2.09% - contributing to a "flattening of the yield curve". By contrast, US 10-year government bond yields only rose by 6.5bp to close at 1.55%. The Australian Index returned -3.55% (the second worst performing month since 2000). The concern that central banks are going to be forced to react more quickly on inflation than originally thought has drove sharp moves across Developed Markets. The stronger-than-expected core Consumer Price Index (CPI) print (mentioned above) was the main catalyst for the price action in October affecting RBA cash rate expectations, BBSW rates and short-dated corporate bonds. As the RBA elected not to conduct any open market operations (yield curve control bond purchases), short-dated government bonds were sold aggressively leading to a surge in yields (as per the chart below). Long-dated bond yields also sold off rapidly with the RBA surprising the market by not conducting bond purchases late in the month.

AU | 10-year / 3-year



Source: JPMorgan

- $A rose - The increase in Australian bond yields supported the Australian dollar (AUD) which rose 4.03% against the US Dollar to close at 0.7518c.
- Commodities rose – The LME Metals index and precious metals index rose by 5.6% and 4% respectively. In Energy related markets, oil prices (WTI) rose by 11.4% reaching its highest level in seven years, thermal coal prices increased another 25% but natural gas prices fell 7.5%. Energy markets impacted by rising demand and limited supply in a number of regions including China and Europe.
- Australian AGM season delivering solid updates - Companies negatively impacted by lockdowns are seeing a sales recovery, but lockdown beneficiaries may now see weaker sales growth. However, many companies called out supply chain and cost challenges, with most retailers ordering inventory early to be ready for the peak season.
- The Value of Mergers & Acquisitions (M&A) in Australia has eclipsed the peak of 2007 on resilient corporate confidence, strong balance sheets and low leverage. Low leverage levels

and strong capital discipline are likely to support other forms of capital management going forward.

- US & European 3Q Reporting Season has been better than expected - About half of the US' S&P 500 have reported quarterly results in October and more than 80% of them beat earnings estimates from Wall Street analysts. S&P 500 companies are expected to grow profit by 38.6% year over year. In Europe ~68% of companies that have reported have beaten earnings estimates.
- President Biden released an updated framework for his $1.75trln (Social spending) reconciliation package - From a funding perspective the new outline highlights $2trln worth of proposals to pay for the agenda, notably a 15% corporate and global minimum tax, 1% stock buybacks tax, and millionaires' surtax. Otherwise, economic indicators in the US continue to broadly improve.
- China's economy weakened further in October, as credit tightening, regulatory impacts, power shortages and commodity prices dampened output and lockdowns curbed holiday spending. The Real Estate sector, in particular, has been weak. The official manufacturing Purchasing Manufacturing Index fell more than expected to 49.2, its second month of contraction, and the non-manufacturing also missed. As a result of power rationing and related supply constraints, the features of 'stagflation' have become more evident. Economists have been revising down their economic growth forecasts for China for both 2021 and 2022.
- The Australian Government released the long-awaited formal plan to deliver Net Zero by 2050. The plan is focused on technology not higher taxes. Over the next decade Australia will spend $20 billion in low emissions technology that is expected to unlock a total of $80 billion of private and public investment, including in clean hydrogen, ultra-low-cost solar, carbon capture and storage, and energy storage.
- Over the past month, global dividend expectations for the MSCI World were flat. All key global markets saw positive DPS revisions in October, except for the FTSE 100 and the ASX 200. On consensus earnings expectations in the near term, F2022e EPS growth for the ASX200 is now at 15.6% and F2023e at 2.1%. The 12-month forward market P/E is 17.55x, with Industrials ex-Financials at 30.4x.

Markets are watching closely any signs to show whether supply-related goods inflation will ease next year, and underlying wages growth will not exceed 3% (a key criteria for a RBA cash rate lift-off). A number of economists have brought forward their expectation for the first cash rate hike from late 2023 to 4Q22 (and relative to RBA guidance for 2024).

Offshore, central banks have indicated an end to Quantitative easing but suggest there will be a pause between tapering and lifting cash rates. Company results have been strong relative to expectations at the top and bottom line, company guidance remains constructive and investment activity (capex, buybacks) is robust. As supply chain issues eventually subside, top-line growth may re-accelerate in a number of industries.

While the likelihood of higher bond yields and slowing growth will impact certain segments of the equity market, our approach is to invest in "quality securities at the right price" to produce sustainably stronger-than-market returns. At this point in the cycle, we believe to generate outperformance relative to the benchmark you require an experienced, fundamental and active investment manager who can find strong investments and be nimble to take advantage of them when opportunities present themselves.