Monthly Market Insights -July 2021

July saw equity and bond investors arguably signalling very different outlooks for growth. On the one hand, equity investors continued to push the S&P500 to new record highs, buoyed by a strong results season. In contrast, bond yields drifted lower as the bond market has started to focus on resurging COVID-19 cases and the prospects of further restrictions. Either way, a cautious market environment saw defensive geographies and sectors outperforming cyclicals and more growth exposed regions.

However, despite an apparent weakening of conviction in the strength of the economic recovery, there remains scope for higher inflation over the medium term. Commodity prices continued to rise, and a growing list of companies flagged price rises to defend margins. This was most notable amongst the global consumer good companies with British multinational Reckitt flagging "pricing actions (price rises, in other words) implemented in the back half of the year", Unilever noting "pricing step-up [in H2]" and Nestle guiding to modestly lower FY margins thanks to "timing delays between input cost inflation and pricing". In short, inflation remains a real risk to investors.

Performance within US markets was mixed. Large-cap indices finished in positive territory, however the NASDAQ meaningfully underperformed, up only 1.2% versus 2.3% for the S&P500. While this was partly driven by the crackdown on US-listed Chinese tech companies, a series of disappointing quarterly results were also to blame. Chief amongst these was Amazon, where shares dropped almost 8% after it missed Q2 revenue estimates and provided weaker guidance. Performance in small caps was even weaker with the S&P600 Small Cap Index down 2.4%.

In Europe, the French CAC40 was the strongest among major markets, up 1.6%, with all other major bourses flat. In contrast, Asian markets were very weak through July with the Shanghai Composite and Nikkei225 both down more than 5% as China's recovery showed signs of slowing and Japan faced more COVID-19 cases.

Against the backdrop of lower yields, it was no surprise that bond-proxy sectors led the way in terms of performance. Defensives Health Care and Utilities finished up 3.6% and 2.9% respectively, with Info Tech also up a solid 3.5%. At the other end of the spectrum were Industrials, up 1.3%, and Consumer Discretionary, up 0.3%, while Financials fell 0.3% on the back of a flattening yield curve. However, the weakest sector by far was Energy, down 6.3% following the decision by OPEC+ to boost oil supplies.

The AUD was 2.1% lower against the USD. Volatility rose during the month with VIX up 2.4 points to close at 18.2. While the Bloomberg Commodity Index and WTI finished up 1.8% and 0.7% respectively, there was considerable intra-month volatility. Yields continued to trend lower finishing the month at 1.22%, down 24bps since the end of June.

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Monthly Performance Insights -July 2021

One of the biggest contributors to performance was our holding in UK commercial property owner, Landsec. While the past 18 months have clearly been difficult for landlords, Landsec remains one of the best run REITs with a world-class portfolio comprised largely of prime Central London office towers (~60%). Landsec's July rental collection data also highlighted that market conditions continue to improve with scope for this to accelerate following the removal of England's COVID-19 restrictions. As such, given the combination of a solid balance sheet (Loan-Value Ratio of ~32%) and with shares continuing to trade at a ~30% discount to net tangible assets, the stock remains a compelling investment opportunity.

The portfolio recently gained exposure to US-based global reinsurance firm Everest Re. Everest has a strong track record of delivering for shareholders having grown BV/Share by ~10% per annum over the past decade. This reflects Everest's low double-digit ROE and a modest 25% payout ratio. The combination of encouraging reinsurance pricing dynamics and a solid capital position suggests to us Everest can continue growing BV/Share at very attractive rates. Hence, given these positive attributes and some decent valuation support (stock trades at a ~10% discount to BV/Share) we think risk/reward is skewed to the upside.