Monthly Performance Insights - May 2021

Equity markets generally performed well through May with rotation trades regaining momentum. Investors again grappled with higher-than-expected inflation data fuelled by input cost pressures and ongoing supply chain constraints. This in turn raised questions about the direction of interest rates.

Further complicating policy setting for central banks and governments is now growing evidence that these cost and supply chain challenges are also beginning to weigh on the pace of the economic recovery. Nevertheless, central banks globally have indicated no change to their accommodating policy stance, and there is still the boost to come from fiscal spending, both in Europe and the US.

On this basis, we believe the current economic cycle has more to play out, and the key issue for investors is not whether inflation will return but how the market is positioned. While we sense most investors still think current inflation is transitory, we are beginning to see some changes in weightings as evidenced by renewed outperformance of yield-driven, cyclically sensitive areas of the market.

One example of this during the month was the noticeable underperformance of US markets versus other regions. Weakness in the US was led by the NASDAQ which fell 1.5%, while the S&P500 was only up 0.5% and the Small Cap Index up 2%. On the other side of the Atlantic, European markets fared a lot better with the French CAC up 2.8% and German DAX up 1.9%. In Asia, China led the way in performance with the Shanghai Composite up almost 5% compared to a flat Japanese market.

The rotation tailwind was also evident at the sector level with the Energy, Materials and Financial sectors all up more than 4%. In some ways, the strength in Financials is potentially telling of the market's view on the direction of near-term rates. Surprisingly, Staples was also amongst the strongest performers, up 2.8%. In contrast, the IT, Utilities and Consumer Discretionary sectors were all down by more than 1%.

The AUD was flat against the USD despite ongoing strength in commodity prices with the Bloomberg Commodity Index up 3.7%. This strength was also reflected in oil with WTI up 4.4 %. VIX continued to fall, down 0.79 points to close at 16.76. Treasury Yields were also weaker, down 5bps to finish at 1.58%.

The biggest contributors to performance in May were our two brewery holdings, Ambev from Brazil, and Asahi from Japan. Both reported strong Q1 results which were well received by the market. Ambev managed to deliver exceptional top-line performance driven by strong pricing and volume trends, which have persisted into April. In the case of Asahi, strong performance in the recently acquired Australian business more than offset weakness elsewhere with management re-affirming FY guidance. Given the upside to returns in both Ambev and Asahi, we think both stocks continue to look attractively priced.

The portfolio recently gained exposure to Japanese security firm, Secom. While Secom's core security business (~75% of profits) is a stable, high margin, cash generative business the issue is that incremental capital is being deployed to lower margin segments. This partly reflects the mature nature of security and has been dilutive to group returns. However, Secom's balance sheet is flush with optionality (~25% of Secom's market cap is comprised of net cash). Hence, while return on assets may continue trending lower, we think there is a significant opportunity to boost return on equity should Secom decide to deploy even part of its excess cash.