Investment Watch

Spring 2021 Outlook

morgans

Welcome

Markets are set to close 2021 with a renewed sense of optimism as the debilitating lockdowns in Victoria and NSW are set to end. The domestic recovery had been stronger than anticipated prior to the recent outbreak and the economy is expected to bounce back strongly when restrictions ease. Economist Michael Knox explains why he believes we are moving into a three-year golden period for the Australian economy. Global markets have been reintroduced to volatility as various macroeconomic risks to the economic restart emerge. We explain why we slightly pare back our pro-risk view and look at the tactical implications for asset allocation and equity sector positioning over the next quarter.

Recently published research

- **Equity strategy** – Q4 sector outlook and strategies 1/10
- **Equity strategy** – Morgans best ideas 1/10
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- **Economic strategy** – Australia's second wave commodities boom 23/8
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Recent corporate offers

Step One Clothing Limited (ASX:STP) - Initial Public Offer

STEP ONE™

Morgans role	Offer size	ASX listing date
Sole Lead Manager & Underwriter	$81.3 million	29 October 2021

Morgans Corporate Limited is acting as Sole Lead Manager and Underwriter to the Initial Public Offer of Step One Clothing Limited, raising $81.3 million at $1.53 per share. Step One is a leading direct-to-consumer online retailer for men's underwear in Australia and the UK, with plans to expand into the USA. The Company offers an exclusive range of high quality, organically grown, sustainable and ethical underwear that suit a range of body types. Step One will list on the ASX under the code STP.

Economics – the Australian economy enters a world trade boom

High prices for Australian metals and farm exports will generate higher living standards and lower unemployment over the next three years.

We have been asked: "Well you've got your commodity boom. Is it over now?" and we said "no, it's just starting". And the view that emerges recently is that we're really at the beginning of a generalised world trade boom which begins this year and continues for at least three years.

What's driving this is the enormous expansion of the US budget deficit. Last time during the previous resources boom we had one year in which there was an enormous budget deficit, but this time we've already had two years of very large budget deficit stimulus by the US. If the budget for 2022 is passed through the House of Representatives in the Senate some time before the end of October, it looks like we will have a third year of significant budget deficits. We have a longer and sustained level of stimulus this time and a larger resources boom than we had earlier this century.

It's very interesting to look at what our commodity models show. Interestingly, despite all the media about the collapse of the iron ore price, our model shows that the iron ore price is about $US40, a tonne below fair value right now. It may have a rough period ahead for a few months. Still we think iron ore will then stabilise around the range of $US120-$US140 per tonne over the next couple of years.

Some people think that copper is overbought. Still, the copper stocks-to-consumption ratio is near the lowest level this century and that generates high equilibrium prices. So even though the price of copper is high, it's not overvalued at any statistically significant level. When you go through the other metals like nickel, zinc and lead, even though the prices are significantly higher, our models tell us they are all around about fair value. There's been a generalised increase in demand and that's because of the high level of international stimulus.

What is also interesting is when you look at the soft commodities, the agriculture exports that Australia has, you've got the same kind of structure of very low world stocks. The biggest agricultural export that Australia has is actually wheat. World wheat stocks have fallen dramatically this year and are equal to the lowest levels of stocks-to-consumption ratio this century. This means the equilibrium price of wheat is now $US8.74 a bushel which is the highest model price ever in the history of the model. Even though the wheat export price has rallied, it's about US70c below the model estimate. In the last resources boom the wheat price overshot this model by a considerable factor. Some say that we haven't had this kind of combined rural and mining boom in export prices in Australia since the 1950s.

Even in the 1950s where we had what was called a wool boom, really there was a mining boom and a wheat boom at the same time. That's the kind of period for the Australian economy we're entering. Where we get to is three years of very strong growth in the Australian economy and very low unemployment.

Leading economists have suggested that we might get unemployment around 3%, that is to say, levels which haven't been seen since the 1960s and when you have low unemployment you have very high growth in real wages. You can see a bit of a reflection of this in what the RBA is doing. The RBA is tapering, it's reducing the rate in which it's buying Australian treasury bonds.

Up until the recent shutdowns in Sydney and Melbourne, our GDP estimate was 5.3%, dropping down to 4% next year. As a result of the shutdowns we've had so far, we've cut the growth rate down to 4.8% this year, rising to 5% next year. Some economists think that growth might fall to about 3% and a bit this year. The result could be a rebound to more than 5.0% next year.

Now imagine the Australian economy after two years of recovery from this pandemic and then you hit 5.0% growth next year on top of everything else. On top of the property boom, the employment boom and we hit 5.0% growth next year! That's the type of future we are just going to have to live through.

We are entering a period of improving living standards. We are looking at one of the better periods in many of our lifetimes. We see this scenario playing out over the next five years until all of this US budget stimulus is exhausted and the economy will be slowing down to normal levels. But that's not the Australian economy we're going to be living through for the next three years.

Economic forecasts

	Morgans (CY22)	Consensus (CY22)
GDP Growth	5.0%	3.4%
Inflation	1.8%	2.0%
RBA Cash Rate	0.1%	0.1%
AUD	90c	76c
ASX200	8100	7800

Source: Morgans, Bloomberg

We are entering a period of improving living standards. We are looking at one of the better periods in many of our lifetimes.

For more economic coverage subscribe to our podcasts.

Asset allocation Q4 – upward ride will be bumpier

Global markets have been reintroduced to volatility as multiple macroeconomic risks to the economic restart emerge. While we have moderated our pro-risk stance slightly with markets likely to face some near-term hurdles, we continue to advocate looking through the noise and continue to see risk assets outperforming defensive positions over the next three to six months.

Tactically, we stay overweight equities as we expect the powerful economic restart to overshadow the near-term risks. We tilt toward cyclicality and maintain a bias for quality. We like having some inflation protection in the portfolio with rising prices unlikely to unwind on strong demand dynamics and supply chain constraints.

Higher inflation regime to test market stability

The powerful economic restart after the COVID-19 shock is playing out. We remain pro-risk as the restart broadens. However, the next important consideration for investors is "what comes next?". An economic restart is not a traditional business cycle recovery as economist Michael Knox has argued ("is the pandemic more like a natural disaster than the Great Recession?") therefore the usual recovery playbook does not apply here. Instead, we see persistent near-term inflation from the rebound in demand as economies reopen.

Central banks have pledged a more muted response than in the past allowing inflation to overshoot targets to make up for past misses, yet markets have not yet bought the narrative and are pricing in a more rapid lift-off in interest rates. This mismatch and resulting uncertainty will stoke volatility.

To be clear, there remains a strong chance that equities record new highs as recession risk remains low. But the upward ride will likely be bumpier. Therefore, while maintaining a mild overweight in both global and domestic equities, investors should think carefully about the protection that they apply.

Positioning for a weaker USD and tightening global liquidity

The USD should weaken once investors look past Fed tapering and emerging economies overcome challenging pandemic dynamics.

Improving global growth and high structural US fiscal deficits will put downward pressure on the USD and thus a higher AUD. We expect the AUD to trend back toward 80c by Q1 2022. To mitigate short-term risks, we prefer hedged away currency risk.

US inflation should stay above target as the US labor market starts to tighten and the GDP output gap closes. We continue to expect some near-term winding back of stimulus measures (central bank asset purchases, fiscal stimulus) but the hurdle for a lift in interest rates remains high. We think the Fed will act to anchor US inflation expectations and lift interest rates but not until 2023.

Given the gradual tightening in global liquidity conditions, assets with long-dated cash flow that involve interest rate/inflation risk should be kept short. We maintain an underweight exposure to fixed assets with a preference for floating-rate instruments. However, on a tactical basis, the implicit solvency guarantee by governments and central banks will limit defaults and provide opportunities in the high yield credit space.

Key changes to our asset allocation settings

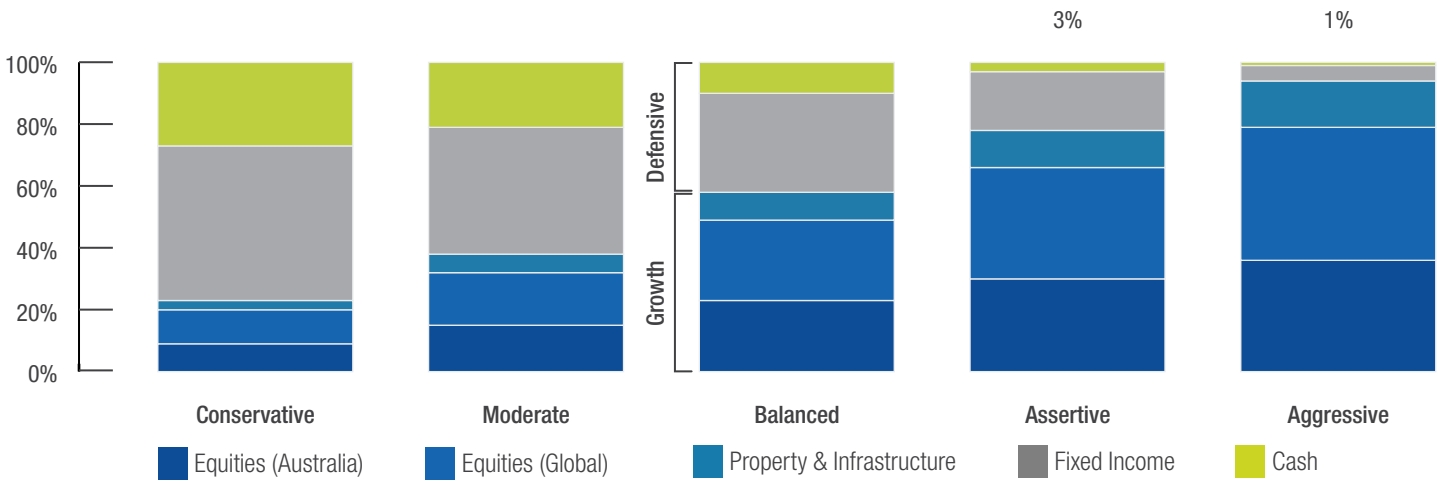
We decrease our underweight to cash. With global short interest rates edging ever so higher and conditions in place for a return of pricing volatility, we see the need to build up some dry powder. We trim our strong overweight position in Australian equities to build cash. See below for our asset class views.

The Morgans Strategic Asset Allocation methodology takes a systematic approach in optimising exposure to the various asset classes at different stages of the Economic cycle. Refer to our full publication Asset Allocation Update – Q4 2021 for product recommendations.

Global Equities	−− − + ++	As the pace of lockdown restrictions eases in developed markets, we think the cyclical 'rotation' in global stock markets has further to run, given the upbeat prospects for the recovery coupled with significant pent-up demand. With governments unwilling to tolerate further lockdown restriction and central banks prepared to let inflation run hot, we think the reflationary economic backdrop will continue to favour being invested in global equities. The key risk to the outlook is a significant slowdown in China, which is a scenario that has increased in probability over the last quarter. We see a strengthening AUD as a headwind for US exposure, so tactically we prefer hedged exposures. Longer term as the effects of the pandemic fade, old problems will start to resurface. The biggest challenge facing advanced economies before the pandemic was the extremely weak rate of productivity growth across the developed world.
Australian Equities	−− − + ++	Australian equities enjoyed 11 straight months of gains to September 2021, but as volatility returns and risks around Chinese growth resurface, we moderate our strong overweight position this quarter. Resources, energy and financials have benefitted from the bounce back in economic activity, but a potential tightening in lending standards for residential housing and a slowdown in China will limit the upside for the key sectors of the Australian economy. On the flipside, household balance sheets are in great shape, which should continue to support the recovery in consumption. We also see upside risks to dividends as uncertainty from the virus clears, keeping payout ratios elevated. Accordingly, we prefer a targeted portfolio approach favouring reflation (financials, energy) and COVID-19 reopening beneficiaries (travel, gaming, traditional retail).

Fixed Income		We are underweight nominal government bonds as their ability to act as a portfolio defence is diminished with yields at current levels and rising debt levels may eventually pose risks to the low-rate regime. We prefer inflation-linked bonds as we see risks of higher inflation in the medium term. We are underweight long-duration bonds on a tactical basis as we anticipate gradual increases in nominal yields supported by the economic restart. While underweight government bonds, we are more constructive in corporate floating rates (hybrids) and sub-investment grade credit. On a tactical basis, the implicit solvency guarantee by the Fed will limit defaults and provide opportunities in the high yield credit space.
Infrastructure		A recovery in broader risk appetite should see infrastructure benefit relatively less than other assets. However, infrastructure is also an inflation-sensitive asset class with the opportunity for upside participation given the pass-through structure of many contracts. If inflation rates hold on better economic growth, it would be positive for asset class returns. We remain neutral infrastructure with a preference for assets better linked to economic activity such as tollroads, airport and data.
Property		We are neutral on the Australian property sector. At the same time, we see some strength in housing and the industrial sub-sectors. However, the sector is a reopening play that investors are lukewarm about. The uncertain environment for commercial real estate is justifiably the reason. Office buildings will likely suffer as companies allow work-from-home options and the population moves away from large cities. Likewise, the pandemic sped up the adoption of e-commerce, raising questions regarding the amount of needed retail real estate space.
Cash		We pare back our strong underweight position this quarter. With global short interest rates edging ever so higher and conditions in place for a return of pricing volatility, we see the need to build up some dry powder. Cash acts as a buffer against rising interest rates driving both stocks and bonds lower.

Recommended asset allocation and tactical tilts



Benchmark long-term asset allocation and tactical tilts

	Conservative	Moderate	Balanced	Assertive	Aggressive	Tactical Tilts (Aggressive*)
Equities (Australia)	9%	15%	23%	30%	36%	4% (2%)
Equities (Global)	11%	17%	26%	36%	43%	4% (2%)
Property and Infrastructure	3%	6%	9%	12%	15%	0% (0%)
Fixed Income	50%	41%	32%	19%	5%	-7% (-3%)
Cash	27%	21%	10%	3%	1%	-1% (-1%)

*Implemented tactical tilts for the aggressive risk profile

Equity strategy – uncertainty provides opportunity

Morgans research analysts re-set their equity sector views, strategies and best stock ideas as we close out the year. As lockdown restrictions continue to ease, we think the cyclical "rotation" in equities has further to run, driven by a strong economic recovery coupled with significant pent-up demand.

Australian equities have not been immune to rising bond yields in the global reflationary backdrop. Resources, energy and financials have benefitted from the bounce back in economic activity. Household balance sheets are in great shape, which should continue to support the recovery in consumption. We also see upside risks to dividends as uncertainty from the virus clears, keeping payout ratios elevated.

Equity portfolio construction

Recent adjustments to the Morgans equity model portfolios reflect shifts in our sector preferences.

Strong arguments can be made around both the opportunities and risks of equity strategies exposed to opposing inflationary and deflationary environments. We think that a "barbell" approach to equity portfolio construction is prudent, to both capitalise on the tendency for markets to "over-shoot" in mis-pricing each of the above scenarios through the cycle and to insulate against "all-in" bets on a particular scenario providing capital preservation. We therefore continually re-balance exposure to all of yield, value, cyclicals and growth. Ultimately we're looking for best-of-breed companies capable of thriving regardless of the macro-economic backdrop.

Our approach to balanced portfolio construction continues to favour the beneficiaries of reflation (banks, financials, energy) balanced against stable yielders. For growth portfolios we like higher exposure to "re-opening" plays (travel, gaming, traditional retail).

Refer to updated Q4 Sector Outlooks for more coverage.

Key sector outlooks

Category	Sector	Rating	Best ideas	Overview
Financials	Banks	−− − + ++	ANZ, MQG	Their increasingly robust dividend outlook and potential for capital management supports ongoing rotation into the banks. While balance sheet strength and dividend yield are the key attractions, improvement in system home loan growth is supportive of earnings growth.
	Diversified Financials	−− − + ++	TYR, QBE, MME, HUB, KSL	The operating backdrop for financials has progressively improved with stronger markets, upward pressure on interest rates and improved sentiment. A gradual lift in bond yields reflecting steadily improving economic activity would be broadly positive for the sector.
Defensives	Consumer Staples	−− − + ++	EDV, TWE	Near-term demand should remain solid due to lockdowns. However, as economies reopen this is likely to see a redirection of spending to other food service providers (eg, restaurants, pubs, eateries). A slowdown in sales growth could put a limit on further sector gains.
	Healthcare	−− − + ++	RMD, SHL, M7T, VHT	Appetite for healthcare's defensive attributes has fluctuated with broader risk appetite through the pandemic. Long-term exposure is justified by the re-assertion of strong underlying structural fundamentals driving organic growth in the sector.
	Telco	−− − + ++	TPG, NXT	The investment community is now acknowledging the tailwinds that will drive meaningful growth in telco. Digital infrastructure like NEXTDC continues to be in high demand.

	Infra & Utilities	−− − + ++	TCL, DBI	Critical service providers with regulated revenues, resilient demand, or long-term take-or-pays should remain in-demand. Ultimately, ultra-low interest rates can re-intensify appeal for strong cash generators once volumes recover.
	A-REITs	−− − + ++	AQR, HPI, HDN, WPR	Capital performance will fluctuate with bond rate expectations but REITs continue to offer attractive distribution yields to investors with the sector average around 5%.
Cyclicals	Consumer Discretionary	−− − + ++	LOV, UNI BLX, TAH	Spring will see retailers assess the impact of lockdowns on sales, margins and inventories. This could drive downgrades to consensus estimates, reminding us that earnings are going to be well down on FY21. However, the end to lockdowns provides cause for optimism.
	Industrials	−− − + ++	CTD, ANN, RWC, AQZ, ACF, PTB	Despite higher supply chain and raw materials costs, we maintain a preference for high-quality industrials with defensive characteristics. We are biased toward ongoing momentum in the packaging, housing and civil infrastructure segments.
	Online	−− − + ++	FDV, BKG	The consumer shift to online and buoyant end markets sees the sector well placed to continue to grow ahead of market expectations. This dynamic does however look well captured in current pricing, with the smaller-caps offering better opportunities.
	Technology	−− − + ++	TNE	Selective exposure to technology stocks remains attractive given that global economic growth remains anaemic, which sees 10-year bond yields across the world all trading sub 2% and having remained negative in Japan for the last 10 years.
	Agriculture	−− − + ++	IPL, GNC, NUF	Following successive years of drought, robust seasonal conditions combined with strengthening soft commodity prices (economic reflation, USD weakness) combine to offer strong sector tailwinds into 2022.
Resources	Metals & Mining	−− − + ++	BHP, RMS, WHC, PAN	Iron ore demand loss from lower steel activity is showing no signs of slowing in the short term, meaning we are not yet buyers of the sharp dip in iron ore prices (BHP and RIO). We see better relative opportunities in base metals and energy in the near term.
	Energy	−− − + ++	WPL, STO, KAR, SXY	We think broad sector underperformance has been driven by local energy stocks' large exposure to upstream, which requires greater conviction in prices. We expect that strengthening oil/gas prices will drive a gradual re-rating in Australian energy stocks.

Fixed interest education – diversification and income

To protect a portfolio against share market volatility, investors can hold cash and deposit products which are generally immune to market fluctuations. However, investors are often reluctant to hold cash in excess of their immediate liquidity needs. Additionally, while cash products will maintain their value in a market downturn, they do not help offset the potential loss of value in risk assets such as equities by delivering a corresponding increase in value.

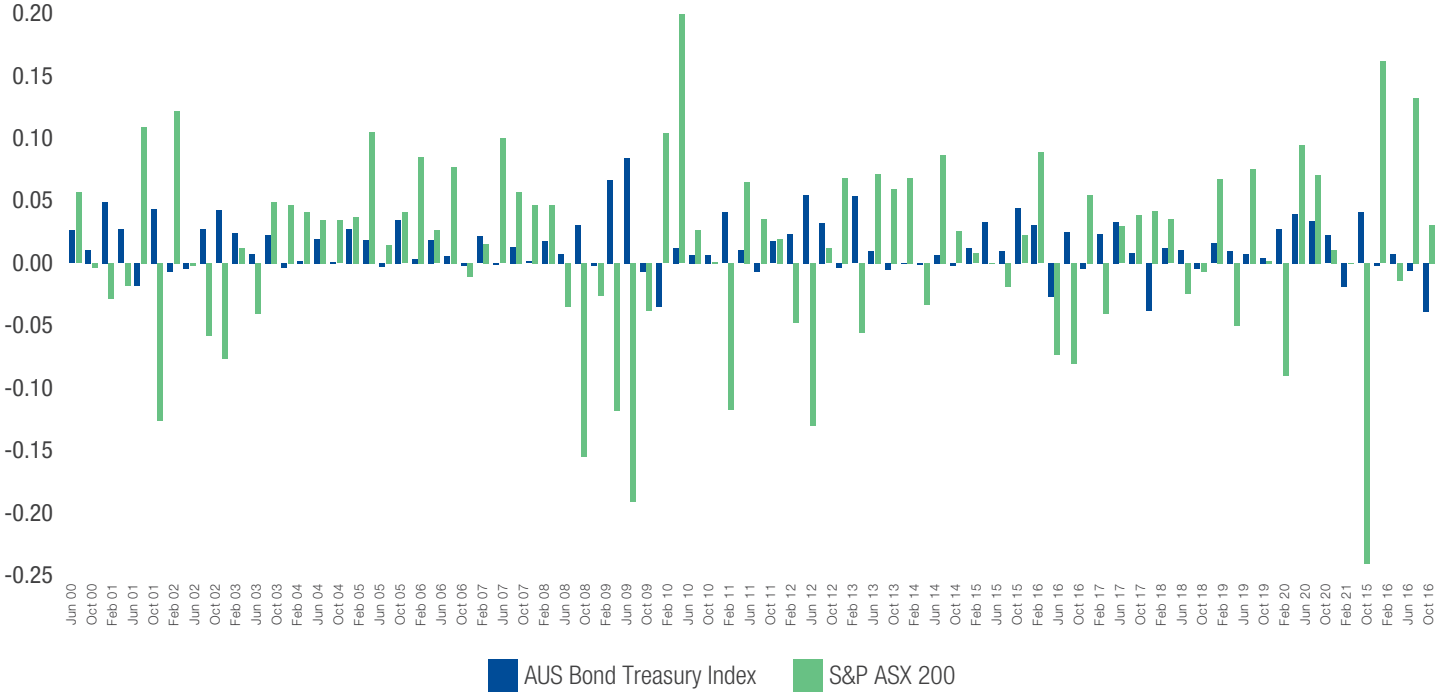
As an alternative to cash products, investing in government bonds can provide positive returns that may go some way to offsetting losses in other parts of a portfolio during periods of volatility. The chart below shows the performance of the Australian share market and 10-year bond yields over the last 20 years. It is evident that there has been a negative correlation between the two asset classes over this period. You should note that as bond yields fall, their value rises, thus providing an offset to losses generated in other parts of a portfolio.

Figure 1: S&P ASX 200 and Australian Government 10-year Bond Yields

Source: IRESS, Morgans

The chart above shows, unsurprisingly, growth in the Australian share market over the longer term. We can also see the longer-term trend down in bond yields, reflecting the structural decline in inflation. Looking more closely though, we can see that particularly in periods of share market weakness, bond yields decline rapidly as investors move to safe-haven assets. If we look back at quarterly returns of the ASX 200 and the Australian Government Bond market (below), we immediately see the rationale for including bonds in a diversified investment portfolio. With few exceptions, in quarters where the share market delivered a negative return, bond returns provided a positive contribution, helping to smooth total portfolio returns. You can read the full article **here.**

Figure 2: Bonds vs Equities - Quarterly Returns



Source: IRESS, Morgans

For more information, contact your Morgans adviser.

Banks – strong capital and dividend outlook

Our investment thesis for the major banks sector has been largely predicated on the following factors: balance sheet strength; sound asset quality; attractive and robust ordinary dividend yields and capital management potential. We believe these four factors still hold.

While Sydney and Melbourne are currently in the midst of lockdowns, the take-up of loan repayment deferrals this time around has been significantly lower than that seen during the national lockdown last year. We have also seen ANZ, NAB and CBA conduct capital management during the current lockdowns, signalling to us that the banks are not too concerned about the asset quality outlook.

While ANZ, NAB and CBA have already announced capital management initiatives in the form of on-market and off-market share buybacks, we see potential for further capital management from each of these banks over our forecast period. We expect WBC to announce a $5bn off-market share buyback when it announces its FY21 result on 1 November 2021, and we expect WBC to conduct a further $3bn of off-market share buybacks in FY22F.

We expect capital management and attractive ordinary dividend yields to be supportive of bank share prices. With the RBA reiterating that it does not expect to increase the official cash rate before 2024, the ordinary dividend yields on offer from the major banks are quite appealing. In the event the official cash rate does rise, we do not view this as a negative scenario for bank share prices as long as asset quality does not deteriorate; as we expect rising interest rates to be supportive of bank net interest margins (NIMs).

While macroprudential tightening may be around the corner in Australia, and this may serve to contain credit growth, we believe it may be an opportunity for banks to reprice loans and support NIMs.

APRA recently announced some modest macroprudential measures to tighten lending standards, and this may serve to contain credit growth, we believe it may be an opportunity for banks to reprice loans and support NIMs.

Recent publications

WBC
ADD TP A$29.50
Expecting capital management in November.

CBA
REDUCE TP A$80.00
Nabbing business banking market share.

Ranking	Stock	Recommendation	Share price	Target price	Dividend yield	Gross yield	12m Forecast TSR
1	WBC	ADD	$25.81	$29.50	4.3%	6.2%	21%
2	ANZ	ADD	$27.83	$34.50	5.2%	7.5%	31%
3	NAB	HOLD	$27.78	$27.50	4.5%	6.4%	5%
4	CBA	REDUCE	$105.50	$80.00	3.3%	4.7%	-19%

Source: IRESS, Morgans. Data at 6 October 2021.

Diversified financials – a solid operating backdrop

The insurance and diversified financials sector, as whole, arguably continues to be somewhat of a laggard in its recovery post COVID-19. We think this means there remains selective opportunities across the space to find solid value despite signs of an improving operating environment overall, e.g. continuing price increases (particularly in insurance), benefits of increased economic growth and tentative signs of rising global inflationary pressures which could lift global bond yields.

We see three key sector themes at present:

1. We think the outlook for the general insurers is one of likely underlying margin expansion from here as they push through solid price increases across their books. We think the resolution of COVID-19 cases on business interruption claims, as they advance through the courts, will also be a positive removing future uncertainty.
2. The potential for rising yield curves globally, noting the Federal Reserve talked last week to tapering in the middle of 2022. We note that nearly all the insurance/diversified financial stocks would see improved earnings from higher interest rates, none more so than QBE and CPU.
3. The health insurers continue to see a favourable environment linked to COVID-19 with low elective surgeries reducing claims, coupled with improved industry participation rates.

Given that insurance/diversified financials stock prices have been slower to recover than those of the major banks, post COVID-19, coupled with a similarly improved earnings outlook, means they probably deserve a larger weighting than usual in the "financial" segment of a portfolio. The insurers/diversified financials also retain their defensive earnings characteristics, strong balance sheets and reasonable dividend yields, which positions them relatively well to weather any market shakes.

For more information refer to our reporting season wrap, published 6 September 2021.

Resources – cycles within cycles

Remaining overweight metals and mining has proven effective since the start of the cycle in 2016. However after such a strong run-up, we do not expect it all to be smooth sailing and now see potential for 'cycles within cycles'.

While strong fundamentals support cyclical upside, we also note several metals (iron ore, copper, gold, aluminium and zinc) trading well ahead of marginal production costs, which is essentially the level we view as the long-term sustainable price for a metal with few exceptions. This dynamic leaves potential for volatility in some metals pricing even if the underlying fundamentals remain intact and the upcycle then subsequently resumes.

Major commodity-consumer China, whose economy has now fully recovered from the pandemic, looks set to ease the stimulus measures it has effectively used to support its economy. This paves the way for China's economy to switch gears away from infrastructure/property growth and back towards domestic consumption. This poses risk for high-flying raw material iron ore, particularly given that global supply is recovering. This is an important consideration given iron ore is a core business segment for Australia's largest miners.

Over the medium and longer term, we continue to expect physical assets like metals to outperform, supported by a global recovery (ex-China), continued synchronised stimulus, and a weaker US dollar.

In portfolio construction terms, we're comfortable with the long-term fundamentals supporting resources and recommend core holdings in the diversified miners and large-cap energy stocks for Balanced investors. More nimble/Growth oriented investors should consider tactical exposure to our favoured copper, nickel, and lithium stocks exposed to growth in battery markets. However given the broad strength across the sector, we recommend investors remain patient and wait for potential better buying opportunities.

Unsurprisingly record demand conditions and unprecedented growth in China steel activity proved unsustainable. After expanding 12% in the first half of 2021, Chinese steel production has hit the brakes so far in the second half. Steel output has fallen hard on China shifting policy away from stimulus to protect its property market and economy from overheating. This risk has become clear with the emergence of the Evergrande issue, which remains unresolved and risks material impact to China's property and financial markets (and global financial markets). While iron ore has already fallen by >50% over the last four months, we are still pessimistic on the short-term outlook. We base this on demand constraints over the remainder of 2021, namely winter supply restrictions in the lead up to the February 2022 Winter Olympics as well as power shortages in steel-heavy regions of China. High steel prices have helped to maintain steel industry profitability, while the uncertainty from key demand sources such as property remains large.

On a micro level, we expect the sudden iron ore demand loss has been added to by steel mills now adding expensive priced iron ore inventories (+$200/t) and iron ore traders dumping extra tonnes onto the seaborne market.

This points to a recovery in the first half of 2022. Of course, all traded markets are relative with buyers capable of looking ahead of prevailing fundamentals. Balancing this with the risk of further downside, we are on the lookout to gain better conviction over the coming months. in the meantime we recommend investors remain cautious while we get a better idea of the depths of the current downcycle. Our top preference remains BHP (over Rio Tinto and Fortescue), given its superior diversification, while in the short term we remain cautious on all three given the prospects of their key market exposure.

For more information, refer to our report on Iron Ore – No choice but to obey, published 17 September 2021

Travel – share prices are flying

The Australian travel stocks are viewed as a COVID-19 reopening trade. With plenty of good news about borders reopening in key markets around the world and even Australia, the share prices of the travel stocks have risen strongly over the past month.

Under the national plan, Australians are set to be able to travel internationally once 80% of adults aged 16 and over have been fully vaccinated. However, some state premiers may take a different view (WA and QLD). Qantas recently released its international flight schedule from 18 December 2021. The most exposed to both Australian outbound and inbound travel is **Helloworld (HLO)**, followed by **Flight Centre Travel Group (FLT)**. We expect that pent-up demand for international travel will be enormous and given it will be complicated, you will require a travel agent.

The Biden administration recently announced that it will remove travel restrictions for international visitors who are fully vaccinated from entering the US in early November, including those from the UK and Europe, China, Iran, India, South Africa and Brazil. The travel industry has been eagerly awaiting for the reopening of the trans-Atlantic market. The US-UK travel routes are among the most profitable in the world. The key beneficiary of trans-Atlantic travel is **Corporate Travel Management (CTD)**, followed by **FLT**.

The UK government also recently made some big announcements regarding international travel, including simplifying its traffic light system from 4 October 2021 and removing the need for PCR tests for fully vaccinated travellers. The current system is separated into green, amber and red-listed countries; each with their own requirements when it comes to quarantining, PCR testing and vaccination status. But from October, there will be just a single red list, meaning all other destinations will be considered 'open'. In addition, fully vaccinated travellers won't need to take a PCR test before travelling to the UK, unless they are coming from a red list country. Day 2 tests, currently an obligatory PCR test taken after arriving in the UK, will be replaced with a cheaper lateral flow test. These changes have kickstarted a much-needed upturn in time for the industry to capitalise on demand for half-term and winter holidays, particularly for key tourist destinations such as Turkey and Egypt.

Recent publications

Corporate Travel Management
ADD TP A$25.25
In a class of its own.

Flight Centre
HOLD TP A$18.60
A long journey back.

Helloworld
ADD TP $3.03
Poised and ready for borders to re-open.

Property – an eye on bond yields

The property sector has delivered returns in line with the broader market through 2021 as bond yields continue to move around. After bond yields moved up strongly at the start of 2021 they steadily declined through to mid-August, however since then have begun to move up, although they do remain low versus historical levels. Distribution yields remain attractive for the sector at around 5%.

Reporting season saw most groups provide FY22 guidance except for those REITs exposed to the NSW and VIC lockdowns particularly in the retail and office space. While some groups have only given DPS guidance, REITs that did provide strong growth into FY22 include fund managers (GMG, CHC) and residential developers (MGR). However, once there is further clarity regarding lockdown exit we expect further updates around earnings to be provided.

Post reporting season, many groups have taken advantage of strong security prices and revaluations and raised new equity for acquisitions (CIP, ADI, HPI, HDN). YTD M&A has been largely focussed on the listed property fund managers (CNI/Primewest, Dexus/APN Property Group). While M&A has been quieter elsewhere in the listed property space, Charter Hall Long WALE REIT recently announced a proposal to acquire ALE Property Group so there may be further M&A activity ahead in 2021 (we note the current activity in the listed infrastructure stocks). HealthCo REIT (HCW) which owns a portfolio of healthcare and wellness assets also listed successfully in September.

Reporting season saw some large moves in revaluations/NTA uplifts particularly for REITs exposed industrial/logistics, large format retail, convenience retail, social infrastructure, pubs and self-storage. The favourable tailwinds for industrial/logistics assets remain in place with significant demand for the asset class given the growing shift to e-commerce and increased focus on supply-chain resilience. While valuations for retail and office assets were relatively stable, REITs exposed to these sub-sectors continue to trade at discounts to NTA given ongoing headwinds.

Overall, balance sheets remain sound with debt costs low. Near term unknowns and risks include: 1) movement in bond yields; 2) the general economic environment/recovery coming out of COVID-19 and 3) impacts on leasing/rental markets, particularly for office.

Our preferred REITs under coverage are:

- **Specialised** – Waypoint REIT, APN Convenience Retail REIT (service station assets)
- **Fund Manager** – Home Consortium (funds management, convenience retail and health/wellness)
- **Retail** – Aventus Group – (large format retail centres); HomeCo Daily Needs REIT (convenience retail)
- **Industrial** – Centuria Industrial REIT (pure play Australian industrial assets)

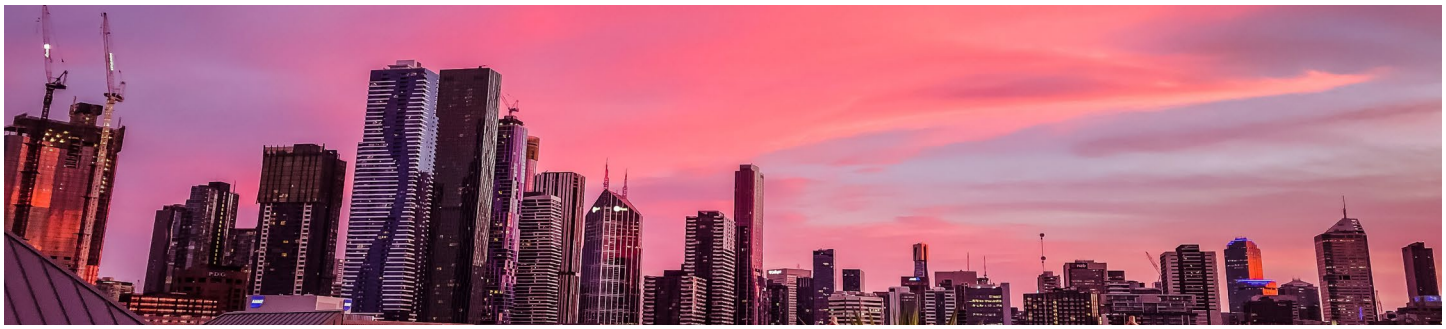
Recent publications

Waypoint REIT
ADD TP A$3.00
CY21 guidance upgrade

Home Consortium
ADD TP A$6.71
Ready to accelerate AUM

Aventus
HOLD TP $3.34
In a strong position with ability to evolve

Centuria Industrial REIT
HOLD TP $3.87
Upside potential in new acquisitions



Recent initiations

Endeavour – HOLD
PT A$6.65
EDV is Australia's largest retail liquor and hospitality business with a retail network of 1,630 stores across two key brands – Dan Murphy's and BWS – and operates a portfolio of 332 licensed venues.

Swoop – HOLD
PT A$2.43
SWP owns and operates one of Australia's largest fixed Wireless Internet Service Providers. It is focused on regional areas where there are low internet speeds.

Silk Logistics – ADD
PT A$2.82
SLH is a logistics business, generating its earnings from Port Logistics (road transport of containers to/from port and associated services) and Contract Logistics (warehousing and distribution).

Camplify – ADD
PT A$1.99
CHL is one of Australia's leading digital peer-to-peer marketplace platforms that connects recreation vehicle (RV) owners to hirers.

BlueBet – ADD
PT A$2.57
BBT is an Australian online bookmaker. BBT's scalable, cloud-based tech platform has been developed based on a 'mobile-first' strategy and its direct control over its tech enables dynamic product development product development.

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