CPG Research & Advisory Pty Ltd

ECONOMIC & MARKET COMMENTARY
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Avoiding a Taper Tantrum

How did the Fed avert the 2013 Taper Tantrum?

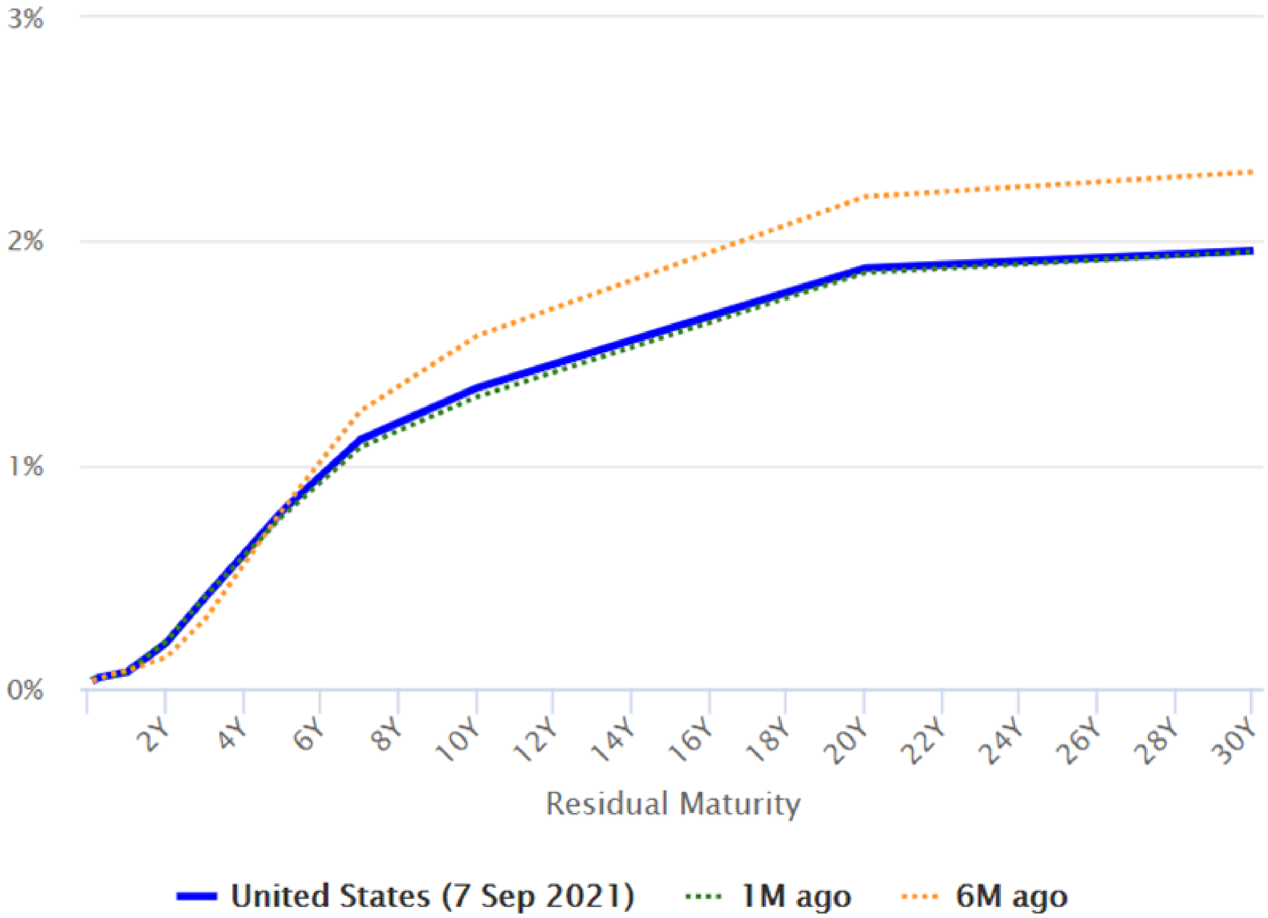
In 2013, the Federal Reserve said that at some future date (not immediately), it would reduce (not eliminate) quantitative easing.

Despite being 5 years after the GFC, this caused widespread panic including a spike in bond yields.

Bernanke did it when the market was not ready. There was a widespread view that the economy was fragile – too fragile. They also feared that during QE, the Fed was the only buyer of US bonds and if they stopped supply and demand would flip. Implicitly, they felt that yields were artificially low and distorted by Fed buying.

So what's changed?

1) Today, **the market is already assuming the easing of monetary stimulus**:



2) **The marginal buyer today is not the Fed.** Central banks, sovereign wealth funds, and other mega investors are buying US Treasuries because they don't have negative yields. A European investor faces -½% yield at home, so whether the Fed

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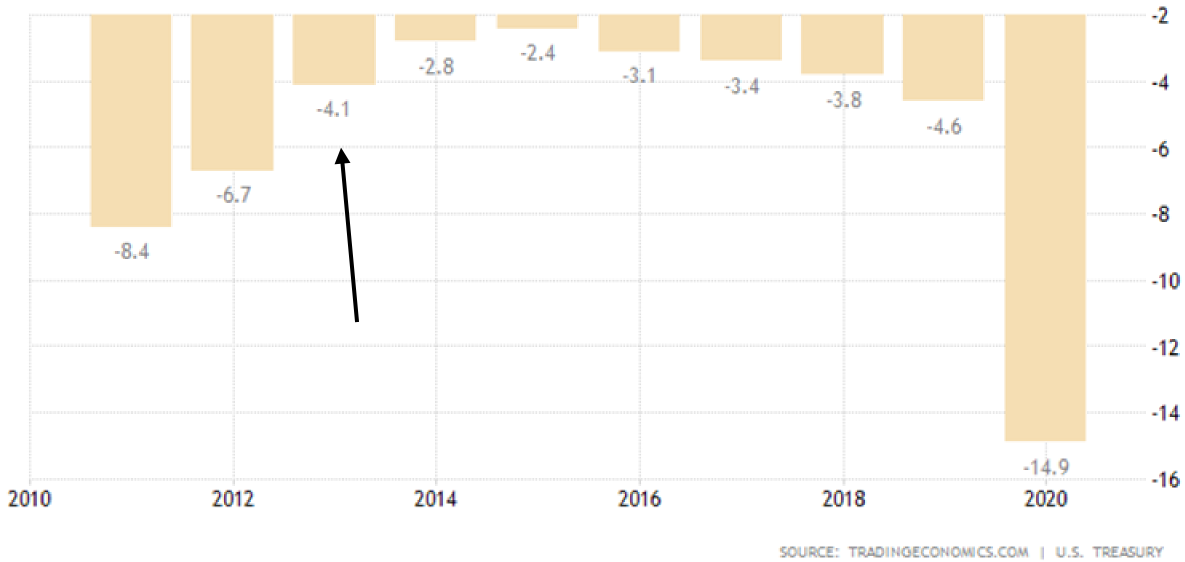
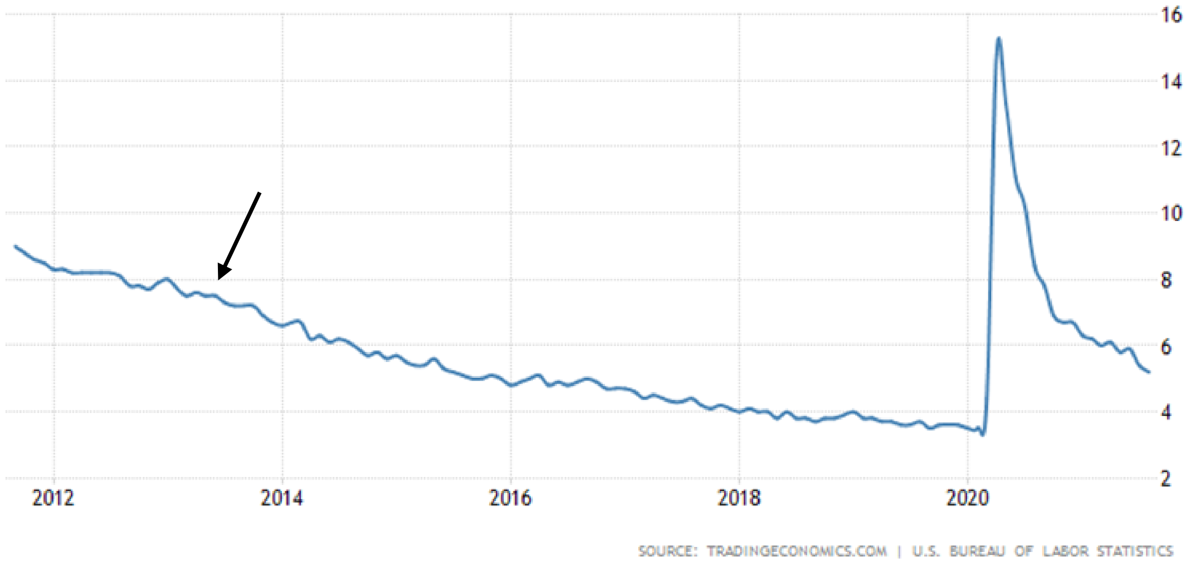
is buying or not there is comfort that someone will buy any yield that resembles their expected inflation rate.

3) The Fed will **taper at a time the economy is growing strongly**. Q3 is expected to see 5%+ annualised growth, as COVID19 restrictions are lifted. This is not a certainty – declining vaccine efficacy over time is a concern. But it can be dealt with by boosters to the satisfaction of investors.
4) While monetary stimulus is easing, **fiscal stimulus is still ramping up**. Insufficient stimulus is not a concern. The US Administration is promoting a spending plan for another $3.5tr (almost 20% of GDP). Contrast this to 2013. The US had just been through a default crisis. Since 2011, Congress was aggressively scaling back the deficit at the time of the Taper Tantrum:



5) Who cares about the Fed? If bond markets are **untroubled by 5%+ inflation** (including 4½% core inflation), Fed policy is trivial by comparison.
6) It did not actually matter last time. **Taper did not break the economy.**



<u>Powell got almost no reaction to a speech that would once have been a bombshell. Which is certainly how he likes it, after 2018.</u>

Leading Markets

The US Dow Jones, S&P500 and NASDAQ set records before closing +1.5%, +3.0% and +4.1% respectively. MSCI World ex-AUS gained +2.7% in local terms. Emerging Markets rose +2.6% in $US with China flat and Europe and ASEAN soaring. Frontier gained +2.5%.

US 10-year bonds eased to 1.30% (+6bp). High yield firmed to 321bp spread (-11bp).

Other Highlights

The IPCC released AR6 in the month.

COVID19 deaths passed 4½m (+¼m) from 218m cases (+18m). Planning for 3rd shot boosters is now advanced in some countries, and the world at 27% 2nd shot.

The disastrous end to its Afghan mission distracted the US Administration from its other agendas.

US's Q2 GDP estimate was marginally upgraded to +6.6% p.a. (+1.6% QoQ). *GDPNow* guides +5.1% p.a. for Q3, below consensus and falling.

The Fed flagged that tapering QE would likely begin in Q4.

US unemployment plunged to 5.4% (-0.5%) in July, with Non-farm Payrolls a 2021 high at +953k. Youth unemployment improved to 9.2% (-0.1%).

Inflation was steady at +5.4% YoY after a +0.5% month. A plateau is likely over 2H21. Core inflation was +4.3% *vs* +June's 30-year high 4.5%. Retail sales fell -1.1%.

Eurozone unemployment improved to 7.7% (-0.3%). Prices rose +0.4% in August and are +3% YoY. They are likely to peak in Q4 Core inflation jumped to +1.6% YoY from +0.7%, as the ECB indicated they would be "*patient*."

The Bank of England expects peak inflation of 4% in the UK by year end, up from 2.5%.

China flagged that it may ease policy, stabilising markets after stocks plunged on a regulatory crackdown. Unemployment ticked up to 5.1% (+0.1%). Inflation remains low at +1% YoY.

Japan averted recession with +0.3% growth in Q2. Unemployment fell to 2.8% (-0.1%)

Domestic

The RBA's Minutes took a long-term approach to forecasts, looking through Q3 but conservatively tipping a mid-2022 opening of international borders.

Their upside recovery case had CPI over 2½% by the end of CY23. They acknowledged forecasts of a later taper, but felt this would have minimal benefit in Q3, boosting the economy in 2022.

They affirmed the existing taper plan.

GDP will contract severely in Q3, but a solid +0.7% in Q2 has all-but ruled out a recession.

Major banks returned to market, with an FRN issued tighter than expected, at +41bp which cleared at nil premium.

The month closed with ~59% first or second COVID19 shots for ages 16+, up from 33%, suggesting a November achievement of the 80% target. Victoria joined NSW in abandoning zero COVID19.

The ASX200 gained +2.5% and the Small Ordinaries +5%. CoreLogic reports +1.5% housing gains in August, with NSW outperforming despite lockdowns. 10-year bonds rallied to 1.16% (-3bp).

July unemployment fell to 4.6% (-0.3%) on 66% participation (-0.2%), on +2k jobs (-4k fulltime). Underemployment rose +0.4% to 8.3%. Youth unemployment was steady at 10.2%. NSW payrolls fell -4.4% in early July.

Dwelling approvals were falling into the NSW lockdown, down -6.7% in June.

Average earnings rose +1.4% (all of it in the half). For the first time since 2013, private wage growth exceeded public.

June's balances of trade was a record +$10½bn (+13%).

Retail trade rose +0.8% in July.

Commodities and Currency

WTI oil slipped to $US68.84/bbl (-4.5%). Gold was flat at $1815/oz. Iron ore dived -25% to $159/t after touching $140/t.

Base metals were mixed as Nickel (-1.9%), Tin (-3.3%), Copper (-2.9%) and Zinc (-1.4%) fell. Aluminium gained (+3.4%).

The $A eased to US73.35c (-0.6%).

KEY FINANCIAL MARKET DATA – AS AT 31ST AUGUST 2021 (UNLESS SPECIFIED)

Interest Rate Markets

Index Performance	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
AustBond Bank Bill Index	0.00%	0.01%	0.02%	0.04%	0.35%	0.84%	1.22%

Key Rates	Aug-21	Jul-21	Jun-21
Australian Cash Rate	0.10%	0.10%	0.10%
90 day BBSW	0.01%	0.02%	0.03%
3 Yr Commonwealth Bonds	0.24%	0.25%	0.20%
10 Yr Commonwealth Bonds	1.16%	1.19%	1.49%
CDX North American 5 Yr CDS	46bp	50bp	48bp
iTraxx Europe 5 Yr CDS	45bp	47bp	46bp
iTraxx Australia 5 Yr CDS	58bp	63bp	58bp
US Fed Funds Rate	0-0.25%	0-0.25%	0-0.25%
US 10 Yr Bond Rate	1.30%	1.24%	1.45%

Equity Markets

Domestic	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
S&P/ASX 200 Acc. Index	2.50%	5.97%	14.96%	28.15%	10.29%	9.87%	10.94%
S&P/ASX Small Ord Acc. Index	4.98%	8.95%	15.58%	29.51%	14.97%	10.09%	10.99%
S&P/ASX 200 A-REIT Acc. Index	6.26%	12.47%	25.43%	30.75%	3.74%	8.72%	6.62%

International	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
US: S&P 500 ($US)	3.04%	7.95%	19.52%	31.17%	26.47%	18.07%	18.02%
US: NASDAQ ($US)	4.08%	11.16%	16.06%	30.49%	39.59%	24.61%	25.19%
MSCI World Acc. (Local Currency)	2.67%	6.88%	17.08%	30.12%	22.00%	14.66%	14.70%
MSCI World Acc. (AUD)	3.08%	12.14%	23.03%	31.31%	18.20%	14.56%	15.47%
FTSE 100 (£)	0.07%	1.56%	11.86%	23.26%	-0.22%	0.61%	4.90%
MSCI Emerging Markets ($US)	-6.73%	-4.40%	-2.76%	20.64%	13.38%	7.93%	10.37%

Fixed Interest Markets

Bonds	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
BarCap Global Agg Acc. (AUD)	0.16%	5.93%	6.21%	1.72%	-1.11%	4.20%	3.05%
AusBond Composite Bond Acc.	0.09%	2.55%	4.23%	1.05%	1.33%	4.52%	3.33%
ICE BoAML High Yield TR ($US)	0.55%	2.28%	3.88%	10.26%	6.93%	6.82%	6.49%

Data*	Current Period		Previous Period	
Employment Data				
Employment Growth	July	2,200	June	29,100
Unemployment Rate	July	4.60%	June	4.90%
Participation Rate	July	66.00%	June	66.20%
Lending Finance				
Housing Finance	July	0.20%	June	-1.60%
Personal Finance	July	14.20%	June	-12.60%
Business Finance	July	56.00%	June	-19.60%
Other				
Balance on goods and services	July	12,117m	June	10,496m
Retail Sales	July	-2.70%	June	-1.80%
Building Approvals	July	-8.60%	June	-6.70%

*All data is seasonally-adjusted.

Median Fund Manager Returns (Morningstar)	1 month	3 month	6 month	1 year	2 year p.a.	3 year p.a.	5 year p.a.
Australian Equity Large Cap	2.89%	5.75%	14.91%	29.78%	10.86%	8.86%	9.63%
Australian Equity Small Cap	5.38%	9.38%	16.51%	33.82%	17.43%	11.37%	10.92%
Global Equity Large Cap	2.77%	9.62%	19.91%	33.71%	16.96%	12.77%	14.24%
Global Equity Small Cap	2.95%	8.13%	18.79%	43.37%	21.85%	12.28%	13.82%
Australian Fixed Income	0.05%	2.49%	4.11%	1.21%	1.30%	4.25%	3.08%
Global Fixed Income	-0.21%	1.48%	1.55%	0.69%	1.28%	3.97%	2.64%
Australian Listed Property	6.24%	12.22%	24.87%	30.54%	3.50%	8.41%	6.31%
Australian Cash	0.00%	0.01%	0.03%	0.07%	0.31%	0.81%	1.18%
Conservative[1]	0.31%	1.63%	3.57%	4.31%	2.09%	3.33%	3.09%
Moderate[2]	0.73%	2.87%	6.14%	8.84%	4.29%	4.82%	4.42%
Balanced[3]	1.20%	3.87%	8.94%	14.60%	7.05%	6.47%	6.31%
Growth[4]	1.79%	5.11%	11.89%	20.32%	9.20%	7.78%	8.00%
Aggressive[5]	2.27%	6.22%	14.71%	26.53%	11.85%	9.41%	10.23%

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