September 2021 — Over the Horizon Market Commentary by David Offer

After a year of month on month increases for the Australian share market, September finally provided a negative month, with our All-Ordinaries index falling 193 points to close down 2.47% at 7,629 points.

The primary cause for the fall was our major Australian iron ore producers falling in line with a weakening iron ore price. This stemmed from concerns giant Chinese property developer Evergrande Group may default on its debts, having now missed multiple debt repayments.

The significance of Evergrande defaulting relates to its sheer size. The Company's $305 billion in debt represents approximately 2% of China's Gross Domestic Product. There are fears that Evergrande defaulting could result in financial contagion. As investors withdraw from the sector and cease providing funding, a number of smaller property developers have subsequently already announced defaults of their own. It is estimated that China's property sector both directly and indirectly drives approximately 25% of China's total economy.

The current thinking in the market is that due to the importance of the construction sector to China's economy, authorities will force a restructure of Evergrande to limit the fallout of the group failing. However, with concerns the volume of steel used in China's construction sector will reduce, this has not stopped the iron ore price falling hard. The resulting flow on effects for the share prices of our major miners is summarised below.

Entity	July High	September Close	Percentage Fall
Iron Ore Price	$222.50	$110.00	(50.5%)
BHP Group	$54.55	$37.61	(31%)
Rio Tinto Group	$137.33	$100.18	(27%)
Fortescue Metals Group	$26.58	$14.96	(43.7%)

We have never believed in the sustainability of the elevated iron ore price experienced in recent times and as such have stayed away from buying the above resource majors for some time. At current prices, for investors that do not hold these shares, some value is starting to emerge and as such we are willing to make tentative initial purchases at current levels, notwithstanding we expect plenty more volatility to come. In defence of Australia's major iron ore producers, they are the world's cheapest suppliers of iron ore by a considerable margin. Our miners all remain highly profitable at the current iron ore price of $129 a tonne and would remain so even if the iron ore price halved again from here.

In the event of a sustained downturn in the iron ore price, given our mining giants represent the majority of the world's seaborne iron ore supply, if need be, over time they could collectively reduce production to effectively provide a floor under the iron ore price. In effect, they could operate as an unofficial cartel a little like OPEC, which over the decades has had a strong influence on the oil price.

Away from our share markets, the major focus has been the reduction of Covid restrictions imposed by NSW and Victorian State governments thanks to vaccination rates rocketing up at a much faster rate than previously forecast. NSW's population presently sits at 90.8% having had their 1st dose with 75.2% fully vaccinated with a second dose. Victoria is not far behind with 86.2% having had their first dose and 60.4% fully vaccinated. In contrast, without the motivation of an existing lockdown, WA is lagging considerably, with 71.2% having had their first jab and just 53.2% fully vaccinated.

Lockdowns are no longer political winners and NSW and Victorian governments are racing to open up with Covid a certainty to remain in their respective communities going forward. WA and other States that focus on eradicating Covid continue to run the risk of the increasingly unpalatable situation of having to go into a lockdown should Covid enter the community prior to obtaining a satisfactory vaccination level. If so, this would contrast to our most populous States starting to return to normal. Here in WA, let's hope our borders remain secure until our vaccination rate gets to a belatedly acceptable level prior to when Covid inevitably starts to circulate.

Finally, with CBA's off-market buyback successfully completed (investors on a zero-tax rate will effectively receive $117.31 per share with the inclusion of franking credits) and the Woolworth's buyback nearing completion, all eyes will be on Westpac when it releases its full year results on 1st November. With $6 billion in surplus capital that grows to $8 billion once planned divestments are completed, coupled with a franking credit balance of approximately $3 billion, the market is expecting an off-market buyback of up to $4 billion to be announced. Should this come to fruition, we will liaise with investors who can benefit in due course.

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