Quality Listed Portfolios

2021 Market wrap and outlook

Asset Class total returns to: 31/12/2021	1M (%)	3M (%)	6M (%)	1Y (%)	3 Y (% p.a.)	5 Y (% p.a.)	Current Yield
Cash	0.0	0.0	0.1	0.1	0.7	1.1	0.1%
Fixed Term Bank Deposit (12M)	0.0	0.1	0.2	0.4	1.0	1.4	0.4%
Australian Bonds (composite)	0.1	-1.5	-1.2	-2.9	2.9	3.4	2.1%
Australian Bank Hybrids (gross yield to call)	0.9	1.5	1.8	4.4	4.4	4.2	3.4%
Australian Property	5.2	10.1	15.4	27.0	13.4	9.9	3.7%
Australian Shares	2.8	2.1	3.8	17.2	13.6	9.8	3.5%
Global Shares (unhedged)	1.7	7.2	11.5	29.6	20.6	15.1	1.8%
Global Infrastructure (hedged)	6.8	7.6	9.3	17.1	10.2	8.6	2.9%

Key indicator movement to:	31/12/2021	1M	3M	6M	1Y
AUD/USD (cents)	0.73	0.01	0.00	-0.02	-0.04
Aust. 10-year bond yield (%)	1.68	-0.06	0.27	0.16	0.70
Gold US$/ounce	1,804	1.7%	2.7%	1.9%	-4.9%
Brent oil US$/bbl	78.5	11.2%	0.0%	4.5%	51.5%
Iron ore US$/t	113	18.4%	-6.0%	-47.6%	-27.8%
Copper US$/pound	4.36	1.8%	4.6%	1.4%	24.0%

Source: Refinitiv, relevant benchmark data. Note: Past performance is not a reliable indicator of future performance.

Asset Class Returns

Growth assets continued their recovery from the March 2020 lows to deliver double-digit returns across the board. Global shares delivered the strongest returns (29.6%) driven by US and European shares and a weaker AUD/USD. Australian shares (17.2%) lagged global shares mainly due to weakness in some of the large caps like BHP, RIO, FMG, CSL, WBC and WOW. The iron ore price fell significantly during 2021, dragging the big miners down, while CSL has been struggling with lower hospital operations and blood supply, due to the COVID pandemic. WBC was the last major Bank to face up to its issues and is hence behind the other majors on its restructure. WOW had a surprising downgrade towards the end of the year, due to COVID wreaking havoc with supply chains and increasing operating costs.

Australian property continues its strong rebound (27.0%) fueled by a recovery in market activity and very low interest rates. Infrastructure (17.1%) was solid with an increase in M&A activity, a key theme, including an Industry fund takeover of Sydney Airport, Transurban's acquisition of WestConnex from the NSW government and a private equity takeover of Spark Infrastructure.

Cash and Fixed Term deposit returns remain very low (negative after adjusting for an inflation rate of 3.0%) due to the RBA holding down the cash rate at 0.10%. The RBA is beginning to tighten but the cash rate is not expected to increase until late 2022/early 2023. Australian bond returns went negative in 2021 (-2.9%), mainly because of higher inflation, which has seen bond yields rise (and hence bond prices fall). Bank hybrids have benefited from their floating rate nature and the Banks improving their capital ratios and profitability. Bank hybrids returned a total return of 4.4% (inclusive of franking).

Macro trends

The major macro-economic trends during 2021 included:

The Coronavirus pandemic – leading to a pattern of lockdowns and reopening, increased vaccination rates, new testing regimes and antiviral medications.

Higher inflation – initially caused by supply chain issues but broadening to include labor shortages and higher energy costs.

The Fed turning hawkish – later in the year, the US Federal Reserve Chairman, Jerome Powell, was reappointed for four years and he seemed to instantly pivot from a dovish stance to a more hawkish stance on inflation. The Fed is now wrapping up its asset purchasing program and plans interest rate increases in 2022.

China shifts from markets to political/socialist policies – The Chinese government was very active in 2021, placing restrictions on Australian imports, applying a zero-tolerance approach to COVID, cracking down on Chinese technology companies and property developers. This caused a great deal of concern for foreign investors and the consensus view on China has now changed to one of caution.

The rise of ESG – climate change concerns have been escalating and it seems that governments are getting the message from the private sector to do more. The recent COP26 conference in Glasgow saw steady progress on countries adopting a net zero carbon emission policy by 2050, with Australia a notable new signatory to the United Nations climate pact.

Geopolitical change – following Brexit, the UK was keen to align with the US and Australia forming AUKUS, which led to the now infamous nuclear submarine deal with Australia. This infuriated France, who responded with a push for Europe to rearm. At the same time, China and Russia continue to press their claims for new territory (Russia/Ukraine, China/Taiwan) upping the pressure on the US. The post-World War II institutions seem to be coming under increased pressure with the rise of China and an increasingly erratic US.

Outlook

The outlook has become even more uncertain than usual. A new wave of COVID, in the form of the Omicron variant, has really complicated the growth outlook at the same time that inflation is running rampant. Central Banks are under increased pressure to act on inflation and the Fed has already blinked. Although, the RBA remains steadfast in not reacting (to date). Together, Omicron and the Fed tightening makes us more cautious on the outlook.

However, fiscal and monetary policy is still very accommodative, and the Fed is tightening from very loose conditions. In some respects, the Fed beginning to act on inflation may be a positive in that it has kept a lid on bond yields (thus far). We expect that the disruption from Omicron will see the Fed only tighten gradually. In addition, the inflation numbers are likely to retreat during the year, due to the high base effect.

Real returns from cash and bonds are still heavily negative, making the returns from equities, property and infrastructure far more attractive. This argument will only fail if there is a growth shock or interest rate shock, which will upset market valuations. This scenario still seems unlikely. We are more likely to see a ‘muddle through’ situation during 2022 and hopefully the COVID pandemic will fade later in the year.

As a result, we remain cautiously optimistic on the outlook.

The key known risks ahead seem to be:

1. COVID pandemic (should fade in 2022);
2. Inflation (supply bottlenecks, labour dislocation, ESG transition);
3. Fed tightening (wrapping up QE and the first rate hikes in 2022);
4. China (moving back to communist ideology and property market issues);
5. Regulatory interventions (related to market failures and/or ESG issues); and
6. Geopolitical tensions around trade, security and sovereignty.

The next key events on the calendar include:

- US 4Q21 reporting season – February 2022
- Australia 1H22 profit season – February 2022
- Australian Federal Election – due by May 2022
- Australian Federal Budget – May 2022

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Warnings, Disclosure and Disclaimer

Date issued: Friday, January 14, 2022

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