

## Lonsec

### Summary of Key Views

Insights from our CIO: 2022 starts with a bang

Markets have kicked off 2022 with a bang. Inflation is on everyone's lips and we saw markets gyrate widely ahead of the US Federal Reserve's meeting in January. What is certain is that markets do not like uncertainty and in this instance the market was trying to process whether the Fed will raise rates, and if so by how much and when. Additionally, markets were eager to understand the Fed's direction on their liquidity support for the economy via quantitative easing (where the Fed buys government bonds), which has been an anchor for markets for the best part of the last decade. The Fed essentially indicated that inflation may increase further before it moderates, that a rate rise in March is possible and that liquidity support through quantitative easing will continue to slow down. In addition to inflation, the ongoing flow on effects from the pandemic and growing geopolitical tensions between Russia, the Ukraine and western powers has also contributed to market volatility.

As we have learned from previous periods of volatility, it is important not to react emotionally in such periods and focus on fundamentals. In periods of market volatility quality assets often get oversold. During the last two years we have witnessed a record level of new retail investors enter the market, as reflected by the surge in new online share trading accounts being opened and for many this will be their first encounter with a market downturn. No doubt there will be some nervous investors.

### Market developments during January 2021 included:

#### Australian Equities

The Australian share market closed out January 2022 with the S&P/ASX 200 losing -6.4% with eight out of the eleven sectors within the Index finishing lower. Specifically, Energy was the standout sector with a return of +7.9%, whilst Utilities (+2.6%) and Materials (+0.8%) also finished positive. A heavy decline in the Information Technology sector (-18.4%) and Health Care sector (-12.1%) led what was a dismal month for the broader market.

The Energy sector was boosted by surging prices and a bullish outlook for Brent and Crude Oil in light of various tailwinds for the sector such as tight supply, geopolitical tensions and reduced fear around future lockdowns. Once again, the Information Technology sector suffered substantial losses as investors rotated from growth stocks. The catalysts included rising rates along the yield curve and several central banks indicating forward guidance of tightening monetary policy and quantitative easing to combat inflationary pressures.

Growth and Equal Weight led the decline amongst factors for the month with losses of -8.4% and -7.9% respectively. All factors finished with negative returns with growth providing the largest fall. Over the past 12 months, value is the leading factor (+14.2%), with Equal Weight (-5.7%) delivering the lowest 3-month returns.

#### Global Equities

Subsequent to a positive end to 2021, global markets struggled in the first month of the year, challenged primarily by prospective interest rate hikes and geopolitical tensions in Ukraine.

As the AUD fell over the month of January, all of the following figures are in local currency terms for relative comparability. Developed markets slumped over the month of January declining by -4.9%, Global small caps continued to lag their broad cap counterparts posting a -7.0% loss for the month. Emerging and Asian markets fared somewhat better with monthly returns of -1.8% and -3.8% respectively.

The key focus for investors worldwide continues to be the impact that inflation will have on markets. This has seemingly created favourable market conditions for value stocks over the last month, with value displaying monthly outperformance of over 7.4% relative to growth according to the respective MSCI ACWI Value and Growth indices in local currency terms. This is only the second time since the inception of the index that Value has outperformed growth in excess of 5%.

#### Fixed Interest

Fixed Income markets performed poorly throughout January, as concerns surrounding high rates of inflation and tight labour markets resulted in increasing yields. The Reserve Bank of Australia recently announced an end to their quantitative easing program on 10 February, but Governor Phillip Lowe has not given any indication of an increase to the cash rate in the short term, with the Board wanting to see inflation sustainably within their 2-3% target range, and increased wage growth first. Despite these statements, markets are currently pricing in 3-4 rate hikes before the end of 2022.

Over the course of January, yields for 10-year Australian Government Bonds increased by more than 20bps. This was the primary driver behind the Bloomberg AusBond Composite 0+ Year Index's performance of -1.0% throughout January. Credit spreads also widened over the course of the month, further contributing to the Index's poor performance.

Internationally, the US has been facing high levels of both inflation and wage growth, which has driven the Federal Reserve to adopt a more hawkish stance. While there has been no rate hike yet, the Federal Reserve's forward guidance suggests that an increase will occur within the next few months, which is in-line with

current market expectations. This, among other events, resulted in the Bloomberg Barclays Global Aggregate Index (AUD Hedged) returning -1.6% over the course of January, with currency fluctuations resulting in the unhedged variant returning 1.1%.

REITs (listed property securities)

The S&P/ASX 200 A-REIT Index (AUD) started off the year with a material drawdown, finishing the first month of 2022 down -9.5%.

Global real estate equities (represented by the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)) also had a poor month, closing -5.4% lower in January. The sell-off likely stemmed from the growing concern of the Omicron variant and a hawkish Federal Reserve.

M&A activity was quieter during January across the ASX200 A-REIT sector. Centuria Capital Group (ASX: CNI) announced it has secured, off-market, the West Village in Brisbane, for \$202 million, as part of an existing institutional mandate on behalf of an international sovereign wealth fund. Centuria Industrial REIT (ASX: CIP) announced a portfolio acquisition of six

high-quality industrial assets across the eastern seaboard of Australia totalling \$132m in value.

Despite the volatility in financial markets during January, the Australian domestic housing market advanced, with all CoreLogic reported cities experiencing positive growth during the month. Brisbane led the charge, advancing 2.3% in January. Brisbane (incl Gold Coast) is on top for YoY returns, up 30.1%, closely followed by Brisbane with 29.2%. The CoreLogic 5 capital city aggregate rose by 0.8% in January.

Alternatives

Preliminary estimates for January indicate that the index increased by 3.8% (on a monthly average basis) in SDR terms, after increasing by 4.8% in December (revised). The non-rural and base metals indices increased in the month, while the rural index was unchanged. In Australian dollar terms, the index increased by 3.6% in January.

Over the past year, the index has increased by 25.3% in SDR terms, led by higher LNG, coking coal and thermal coal prices. The index has increased by 30.9% in Australian dollar terms.

**IMPORTANT NOTICE:** This document is published by Lonsec Research Pty Ltd ABN 11 151 658 561, AFSL No. 421445 (Lonsec). Please read the following before making any investment decision about any financial product mentioned in this document.

Disclosure at the date of publication: Lonsec receives a fee from relevant fund manager or product issuer(s) for researching financial products (using comprehensive and objective criteria) which may be referred to in this Report. Lonsec may also receive a fee from the fund manager or product issuer(s) for subscribing to research content and other Lonsec services. Lonsec receives fees for providing investment consulting advice to clients, which includes model portfolios, approved product lists and other financial advice. Lonsec's fees are not linked to the financial product rating(s) outcome or the inclusion of the financial product(s) in model portfolios, or in approved product lists. Lonsec may hold any financial product(s) referred to in this document. Lonsec's representatives and/or their associates may hold any financial product(s) referred to in this document, but details of these holdings are not known to the analyst(s).

**Warnings:** Past performance is not a reliable indicator of future performance. Any express or implied rating or advice presented in this document is a "class service" (as defined in the Financial Advisers Act 2008(NZ)) or limited to "general advice" (as defined in the Corporations Act 2001(Cth) and based solely on consideration of the investment merits of the financial product(s) alone, without taking into account the investment objectives, financial situation and particular needs ("financial circumstances") of any particular person. Before making an investment decision based on the rating or advice, the reader must consider whether it is personally appropriate in light of his or her financial circumstances or should seek independent financial advice on its appropriateness. If our financial advice relates to the acquisition or possible acquisition of a particular financial product, the reader should obtain and consider the Investment Statement or the Product Disclosure Statement for each financial product before making any decision about whether to acquire the financial product.

**Disclaimer:** Lonsec provides this document for the exclusive use of its subscribers. It is not intended for use by a retail client or a member of the public and should not be used or relied upon by any other person. No representation, warranty or undertaking is given or made in relation to the accuracy or completeness of the information presented in this document, which is drawn from public information not verified by Lonsec. Financial conclusions, ratings and advice are reasonably held at the time of completion (refer to the date of this report) but subject to change without notice. Lonsec assumes no obligation to update this document following publication. Except for any liability which cannot be excluded, Lonsec, its directors, officers, employees and agents disclaim all liability for any error or inaccuracy in, misstatement or omission from, this document or any loss or damage suffered by the reader or any other person as a consequence of relying upon it.

Copyright © 2020 Lonsec Research Pty Ltd (ABN 11 151 658 561, AFSL No. 421445) (Lonsec). This report is subject to copyright of Lonsec. Except for the temporary copy held in a computer's cache and a single permanent copy for your personal reference or other than as permitted under the Copyright Act 1968 (Cth), no part of this report may, in any form or by any means (electronic, mechanical, micro-copying, photocopying, recording or otherwise), be reproduced, stored or transmitted without the prior written permission of Lonsec.

This report may also contain third party supplied material that is subject to copyright. Any such material is the intellectual property of that third party or its content providers. The same restrictions applying above to Lonsec copyrighted material, applies to such third party content.