



Lonsec

Summary of Key Views

Insights from our CIO: Things to consider in the year ahead

We are observing the rise in dispersion in returns within asset classes across individual securities and sectors. We expect this dynamic to continue as market conditions evolve. For the best part of the last 10 years markets have been driven by unconventional central bank monetary policy strategies, primarily quantitative easing, which have distorted markets. This policy action has resulted in an incredible rise in the value of risk assets and for most clients it has resulted in a significant rise in their asset values.

This environment has resulted in certain investment styles and sectors dominating market returns. An example of this has been the incredible ascent of growth stocks within the technology sector.

We think that we are heading into an environment where investors will need to be more selective in security and sector allocations and that the “easy money” related to simply investing in high beta parts of the market has been made. This does not necessarily mean that value stocks will now take the mantle in terms of driving returns. It just means that investors will need to be more active in their security selection, irrespective of style.

Market developments during December 2021 included:

Australian Equities

The Australian share market closed out December 2021 with the S&P/ASX 200 gaining 2.75% with eight out of the eleven sectors within the Index finishing higher. Specifically, Utilities was the standout sector with a return of 7.9%, whilst Materials (+6.5%) and Property (+4.9%) delivered strong returns. A heavy decline in the Information Technology sector (-5.3%) failed to stop the broader ‘Santa Rally’ to close out the year.

The local miners were bolstered by the iron ore price recovery given the optimism around Chinese demand for the commodity in the intermediate term alongside the expectations for potential further stimulus measures within China’s economy. The Utilities sector pared back some heavy yearly losses and investors looked for some defensive exposure. The Information Technology sector suffered heavy declines as investors weighed up the potential central bank interest rates rises in the intermediate term.

Low Volatility and enhanced value were the strongest performing factors for the month with gains of 4.1% and 4.2% respectively. All factors finished with positive returns for the month with growth providing the lowest increase at 2.0%. Year to date, value finishes the year as the leading factor (+20.9%), albeit with the lowest quarterly performance amongst all factors.

Global Equities

Following a disappointing end to November, global markets closed out 2021 strongly posting an annual return of 29.6% in Australian dollar terms. Developed markets closed 1.7% higher by month end, trailed by Emerging and Asian markets declining by -0.7% and -1.1% respectively. Global small caps lagged their broad cap equivalents during December recording a gain of 1.1% for the month.

Markets struggled to build momentum early in the month of December as the emerging and enigmatic Omicron variant of the COVID-19 virus continued its spread across the globe. As understanding about the new strain, particularly its highly infectious but less potent nature developed, investors were reassured that economic growth would not be stalled as governments widely exercised restraint with reinstating lockdowns and restrictions abroad.

Notably, Emerging and Asian markets posted disappointing year end annual returns of 3.4% and 0.9% according to the MSCI Emerging Markets NR Index (AUD) and MSCI AC Far East NR Index (AUD) indices respectively. This is mainly attributable to the more difficult conditions that emerging economies have had to cope with in the face of a COVID-19 centric world.

Fixed Interest

December was a relatively muted month for Australian Fixed Income markets, while inflation has continued to dominate the discourse Australian yields have remained relatively static. The yields for 2- and 10-year Australian Government Bonds fell by approximately 2 and 5 basis points respectively over the course of December, although both have since increased again since January has begun. Credit spreads also tightened somewhat over the month, which aided the Bloomberg AusBond Credit 0+ Year Index in outperforming the Bloomberg AusBond Composite 0+ Year Index with returns of 0.2% and 0.1% respectively.

Internationally, inflation also dominated the discussion, but the month played out very differently, as can be seen, most evidently in the US. In its December meeting, the US Federal Reserve adopted a more hawkish approach and announced a more rapid taper of their bond purchases and alluded to the possibility of interest rate hikes later in the year. This prompted an increase in US yields across the entire spectrum of maturities with market participants pricing in three rate hikes for the year. This drove overall returns of -0.4 for the Bloomberg Barclays Global Aggregate Index (AUD Hedged), with the unhedged variant returning -2.6.

REITs (listed property securities)

The S&P/ASX 200 A-REIT Accumulation index finished 2021 with strength, advancing 4.9% in the month of December and closing out 2021 with a 26.1% gain.

Global real estate equities (represented by the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)) also finished strongly, achieving a 6.1% gain for the same month, and totalling 30.2% for the year. Whilst the Pandemic hit the retail sector particularly hard, the U.S. Census Bureau's Business Formation Statistics data shows there have been more new business applications in 2021 (through to November) than any other year on record, and with the applications being dominated by retail, it may indicate a continued recovery of the sector during 2022 (NAREIT, DeLullo, December 2021).

October A-REIT acquisitions included Vicinity centres AREIT's had a relatively busy month. Charter Hall Group (ASX: CHC) announced a 50% interest in Paradise Investment Management (ASX: PIM), an Australian and global equities manager with \$18.2bn AUM, for an acquisition price of \$207m. Centuria Capital Group (ASX: CNI) announced \$466m + of healthcare property acquisitions across various locations in Australia including a large transaction acquiring 38 NZ facilities. Ingenia (ASX: INA) announced the

completion of an acquisition of Seachange and Caravan Parks of Australia, expressing a bullish view on domestic travel.

The Australian domestic housing market again experienced positive growth last month, with the CoreLogic 5 capital city aggregate advancing 0.6%, totalling a 20.8% gain during the year 2021. Melbourne experienced a small negative change during December, recording -0.1% for the month.

Alternatives

Preliminary estimates for December indicate that the index increased by 1.5% (on a monthly average basis) in SDR terms, after increasing by 6.7% in November (revised). The rural and non-rural indices increased in the month, while the base metals index was unchanged. In Australian dollar terms, the index increased by 3.3% in December.

Over the past year, the index has increased by 25.7% in SDR terms, led by higher LNG, coking coal and thermal coal prices. The index has increased by 28.5% 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.