

Monthly Market Update – February 2022

Asset Class total returns to:	28/02/2022	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	0.3%
Australian Bonds (composite)		-1.2	-2.1	-5.1	-1.1	1.6	2.7	2.4%
Australian Bank Hybrids (gross yield to call)		0.2	0.5	1.4	3.1	4.2	4.0	3.4%
Australian Property		1.6	-3.2	-0.8	24.9	7.5	8.2	3.8%
Australian Shares		2.1	-1.7	-4.2	10.2	8.4	8.5	3.9%
Global Shares (unhedged)		-5.5	-6.1	-4.0	18.3	13.8	13.5	1.9%
Global Infrastructure (hedged)		-0.6	3.3	1.5	17.3	6.3	7.8	3.0%
Key indicator movement to:	28/02/2022	1M	3M	6M	1Y			
AUD/USD (cents)	0.72	0.01	0.01	-0.02	-0.05			
Aust. 10-year bond yield (%)	2.16	0.26	0.43	1.00	0.31			
Gold US\$/ounce	1,908	5.9%	7.6%	5.5%	10.1%			
Brent oil US\$/bbl	101.0	10.7%	43.1%	38.8%	52.7%			
Iron ore US\$/t	142	8.4%	49.5%	-10.8%	-14.3%			
Copper US\$/pound	4.45	3.0%	3.9%	3.0%	8.6%			

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

Global

Inflation and Russia's invasion of Ukraine currently dominate headlines. COVID is still an issue, but the rapid rollout of vaccines and rapid antigen testing has allowed social restrictions to be lifted in the developed world. US inflation hit a 40-year high of 7.9% in February, with a spike in food and energy prices adding to the existing trend of rising prices. The main economic impact of the Russian/Ukraine conflict has been higher commodity prices on concerns of disruption to Russian commodity supply, particularly oil, gas, metals and wheat. Europe is the most exposed to higher oil and gas prices with around 30-40% of its energy supply coming from Russia. North Africa and the Middle East are the most exposed to a potential shortage of Russian and Ukrainian wheat.

There is some concern that higher energy costs and potential disruption to energy supply in Europe could lead to lower growth, even recession. This has opened up the spectre of 'stagflation' or a combination of stagnation and inflation, previously unseen since the 1970's. The US Federal Reserve (the Fed) meets this week and is widely expected to begin the process of increasing interest rates, but new global growth concerns will make this path particularly tricky. The Fed must be seen to be acting on inflation by tightening monetary conditions, but will higher interest rates do much to reduce the price of oil and gas? And if the Fed goes too far, it risks sparking a global recession and turmoil in equity markets.

US equity markets have already been retreating, led by technology-related stocks. The S&P 500 is down around 12% from its highs, while the technology heavy Nasdaq is down around 20%. European markets have also been hit fairly hard, with the German and French markets both down around 15%. The Australian market has been holding up well thus far (down around 5%) due its greater exposure to commodities.

China is still dealing with COVID issues and has been implementing hard lockdowns, which will continue to cause issues for global supply chains. China would have seen the harsh financial sanctions imposed on Russia, particularly on its central bank foreign reserves, and is highly unlikely to move on Taiwan until it can sanction proof its economy, which will take years.

Australia

Bushfires, pandemics, floods! What's next??? It has certainly been a challenging few years for Australians. Federal and State governments have provided support, but budget deficits have blown out and public debt is rising rapidly. At the same time, the RBA has maintained the cash rate at 0.10% since November 2020. Inflation is also rising in Australia but at 3.5%, is less of a problem than in the US. The RBA is still prepared to hold off increasing interest rates until later in the year, as it wants to see a stronger recovery in the economy first.

The Federal Government is running into an election due by May 2022. With the response to the QLD/NSW floods adding further pressure on the Morrison government, it continues to lag Labor in the polls. It seems a change of government might be ahead, unless the Prime Minister can pull a rabbit out of the hat (again)!

Despite all the negative news, there are some major positives in that COVID pandemic seems to be fading and social restrictions have nearly been fully lifted. In addition, commodity prices are strong and will further boost the economy.

Outlook

The outlook has become very uncertain. The major positives are that the COVID pandemic should fade in 2022 and fiscal and monetary policy remains very accommodative. Against this, inflation is running hot and there is a risk of spillover effects from the Russian/Ukraine conflict. Central Banks are keen to tighten monetary policy, but the growth outlook may be upset by rising energy costs and further supply chain disruption, related to Europe and China.

We acknowledge the risks are to the downside, but we remain cautiously optimistic and expect a 'muddle through' situation during the year. Global equity markets have already adjusted (down 10-15%) to the increased risks and are starting to look good value versus cash and bonds. The returns from cash and bonds are still going to be relatively low, even with rate increases (negative in real terms). We would need to see a growth shock or an interest rate shock to be more bearish and that is not our base case, at this stage.

The key known risks ahead seem to be:

1. COVID pandemic (should fade in 2022);
2. Inflation (supply chain, energy, labour dislocation);
3. Fed tightening (wrapping up QE and the first-rate hikes in 2022);
4. China (moving back to communist ideology and COVID lockdowns);
5. Regulatory interventions (related to market failures and/or ESG issues); and
6. Geopolitical tensions (Russia/China vs the West).

The next key events on the calendar include:

- US Federal Reserve Meeting – 15/16 March 2022
- Australian Federal Budget – 29 March 2022
- RBA meeting – 05 April 2022
- Australian Federal Election – due by May 2022

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