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Summary of Key Views

Insights from our CIO: The winds of change are coming

Years of accommodative monetary policy combined with ample liquidity from central banks, remnants of the global financial crisis of 2008, may be coming to a gradual end. We are arguably entering a transition period in the economic environment from one of low inflation, low interest rates backed by unconventional monetary policy (quantitative easing), to one of higher inflation and the potential of higher interest rates. Adding fuel to inflationary pressures has been a global pandemic where supply chains have been disrupted like never before, heightened geopolitical risks with the Russian invasion of Ukraine, known as the breadbasket of Europe, putting price pressures on everything from crude oil, wheat to sunflower oil, and globalisation, the accepted mantra for economic growth for decades, which is now under increased scrutiny with talk of a deglobalised world.

Periods of transition from a market perspective are always challenging. They are characterised by increased uncertainty and subsequently increased market volatility. In such environments it is a balancing act between defense and offence. In recent years, an offensive game has been a clear winner, however defense has become increasingly important. While we do not have a crystal ball on how high inflation will be and by how much interest rates may rise, the likely trend is up. With this in mind, considering assets that can assist in navigating a higher inflation environment is important. While there is no perfect hedge for inflation there are assets that can benefit from a higher inflation environment. Some of these include real assets such as infrastructure and property, commodities including gold, floating rate notes and inflation linked bonds.

Market developments during April 2022 included:

Australian Equities

The Australian market closed for the month of April with the S&P/ASX 200 down -0.85% with seven out of eleven sectors finishing higher. Utilities led the index (+9.33%) to continue its strong performance, with Industrials (+3.47%) and Consumer Staples (+3.29%) all performing well. The main detractors of the Index were Technology (-10.37%) and Materials (-4.33%).

High exposure to Resources shares and low exposure to Technology companies has meant the Australian Share Market remains an outperformer relative to global peers. The Technology sector suffered a sizeable selloff after strong March performance, continuing the trend of high volatility in the sector. Macroeconomic uncertainty clouded much of the month’s headlines with the inflation figures hitting 20-year highs. Australian investors took precautions flocking to defensive sectors over the month leading to the positive performance in Utilities and Consumer Staples. Market volatility is expected to remain high in the short-to-medium term with China’s COVID lockdowns hampering growth with increasing supply chain issues.

In April, Enhanced Value (+4.92%) and Low Volatility (3.10%) were the top performing factors. Neutral or negative performance was seen across most factors with Momentum (-1.95%) and Growth (-1.92%) being the weakest factors. Over the past 12 months Enhanced Value is the top performer (+22.5%).

Global Equities

Global markets descended further over the month of April as 'zero-COVID' lockdowns in China added to prolonged geopolitical risk pressures in Ukraine. Developed markets fell by -3.2% by month end, Global small caps performed modestly better than their large cap counterparts closing with a -2.5% loss. Emerging and Asian markets fared better than the previous month, falling by -0.2% and -1.6% respectively. Returns in AUD were assisted by the softer AUD over the month as signified by the local currency return of the MSCI World Ex Australia Index (LCL) of -7.0%.

Quantitative tightening signalling from central banks has joined geopolitical uncertainty as core focuses for investors as heightened inflation continues to weigh on investor sentiment. Dividend yield and value factors were the best performers over the month returning -1.8% and 2.6% respectively, whilst momentum and quality factors lagged returning -9.7% and -7.9% respectively according to MSCI ACWI Single Factor Indices reported in local currency terms.

Fixed Interest

Fixed interest markets have continued their downturn throughout April, as monetary policy tightens internationally in response to continued elevated levels of inflation. Australia saw yields rise, primarily at the short end of the yield curve, as first quarter inflation of 5.1% proved higher than expected. The yield for 2-year Australian Government bonds increased by approximately 30bps over the course of April, while 10-year Australian Government bonds increased by only around 10bps. Credit spreads also continued to widen over the month, which contributed to the Bloomberg AusBond Composite 0+ Yr Index returning -1.49% over the course of April. Market expectations of increasing interest rates proved accurate, as in their meeting on 3rd May the Reserve Bank of Australia increased the cash rate by 0.25%, an action which has seen yields shoot higher following the announcement.

Internationally the global tightening cycle has been ramping up in an effort to combat inflation. The US Federal Reserve raised the federal funds rate target by a full 50bps on the 4th of May. Rising global yields have resulted in a return of -2.88% for the Bloomberg Global

Aggregate Index (AUD Hedged), with currency fluctuations resulting in the unhedged variant returning -0.12%.

REITs (listed property securities)

The domestic and global REIT indexes slowed during April, with the S&P/ASX 200 A-REIT Index (AUD) (XJO) returning 0.6% for the month and global REIT's, represented by the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged), retracing by - 4.1%, giving back its March advances. The S&P/ASX 200 A-REIT index has returned -6.6% YTD. Global REIT's, especially within the industrial sector, experienced a sharp sell off in late April after Amazon's CFO stated "we have too much space right now versus our demand patterns" (Nareit, 2022). Australian infrastructure performed well during April, a result of strong inflation-linked revenue potential, with the S&P/ASX Infrastructure Index TR advancing 6.1% for the month, 15.9% YTD.

April was quiet on the M&A front for the Australian A-REIT sector. Dexus (ASX: DXS) announced a Share Sale and Purchase Agreement with Collimate Capital Limited, a wholly owned subsidiary of AMP Limited, to acquire their real estate and domestic infrastructure equity business. Consideration includes $250m in upfront cash and an earn out consideration of $300m, subject to various factors.

The Australian residential property market experienced a +0.3% change month on month represented by CoreLogic's five capital city aggregate. Hobart was the worst performer (-0.30%), with Sydney (-0.20%) and Melbourne (0.0%) not far behind. Adelaide and Brisbane continued to show strength, advancing 1.9% and 1.7% MoM respectively.

Alternatives

Preliminary estimates for April indicate that the index increased by 3.4% (on a monthly average basis) in SDR terms, after increasing by 7.2% in March (revised). The rural and non-rural indices increased in the month, while the base metals index decreased. In Australian dollar terms, the index increased by 1.7% in April.

Over the past year, the index has increased by 39.9% in SDR terms, led by higher LNG, coking coal and thermal coal prices. The index has increased by 39.1% in Australian dollar terms.