Market Update – April 2022

Asset class total return to 30/04/2022	1M (%)	3M (%)	6M (%)	1Y (%)	3Y (% p.a.)	5Y (% p.a.)	Current Yield (%)
Cash	0.0	0.0	0.1	0.1	0.7	1.1	0.4
Fixed Term Deposits	0.1	0.2	0.3	0.5	1.0	1.4	1.9
Australian Bonds	-1.5	-6.3	-5.3	-7.5	-0.9	1.4	3.3
Australian Bank Hybrids	0.4	0.5	0.9	2.4	3.8	3.9	3.4
Australian Property	0.7	3.7	2.8	16.4	7.0	8.0	3.8
Australian Shares	-0.9	8.2	3.6	10.2	9.4	8.8	3.8
Global Shares	-3.2	-9.3	-6.5	4.7	10.1	11.4	1.9
Global Infrastructure	-1.6	5.0	6.6	11.2	6.6	8.0	3.0

Source: Refinitiv, Fixed Term 12M, Australian Bonds Composite, Hybrids gross yield to call, Property ASX 300 AREIT, Australian Shares S&P/ASX 200, Global Shares MSCI World ex-Aust unhedged, Global Infrastructure FTSE Developed Core 50/50 hedged

Financial Indicator movement	30/04/22	1M	3M	6M	1Y
AUD/USD	0.71	-0.04	0.00	-0.05	-0.07
Aust. 10-year bond yield (%)	3.18	0.39	1.27	1.11	1.48
Gold (US$/oz)	1,896	-2.1%	5.3%	5.9%	7.2%
Brent oil (US$/bbl)	108	-0.2%	18.1%	27.6%	60.2%
Iron ore (US$/t)	152	0.4%	15.8%	25.3%	-15.8%
Copper (US$/lb)	4.40	-7.3%	1.8%	0.4%	-1.9%

Note: Past performance is not a reliable indicator of future performance.

Global

Markets continue to remain volatile with the two major negatives (inflation and higher interest rates) joined by a third problem in recent weeks, being hard lockdowns in China, which will see global growth slow and further supply chain problems. The positives are a gradual recovery from the COVID pandemic in the developed world, accommodative fiscal policy and companies generally have strong balance sheets.

Markets expect the US Federal Reserve (the Fed) and the Reserve Bank of Australia (RBA) to lift the cash rate to over 2.5% by the end of 2022 and 10-year bond yields have moved above 3.0% (Australia 3.5%). Higher interest rates are negative on three fronts – a higher cost of debt, higher discount rates used to value assets and lower growth (Central Banks aim to lower aggregate demand and thus reduce inflation).

Higher bond yields lead to higher discount rates, and this explains 90% of the correction in equity markets thus far, particularly in the growth sectors. The US market has a greater growth bias and hence has been more harshly impacted than the Australian market, which has a greater value bias.

Bond funds have also moved into negative territory, as higher bond yields lead to falling bond prices. Property has also started to be impacted by higher bond yields and discount rates. Floating rate notes, Infrastructure and Gold have remained resilient. We note the yields on offer on Fixed Term deposits and Bond funds have become attractive and this provides a new opportunity for investors.

The war in Ukraine has entered its third month but Russia has retreated to the Eastern flank. It looks like this war will continue for some time and further sanctions are being placed on Russia's oil and gas exports. While this is supporting oil and gas prices in the short term, a slowdown in China could place downward pressure on commodity prices, generally.

Australia

The Australian share market continues to outperform global markets, due to a heavy exposure to resources and a lower exposure to growth stocks. Indeed, the Australian economy is performing well, despite recent floods in QLD and NSW.

That said, inflation has risen to 5.1% and the RBA has already begun the process of increasing the cash rate. As mentioned above, markets expect the RBA to be at 2.5% by the end of the year, which we find hard to believe. In addition, a slowdown in China could negatively impact commodity prices and the resources sector.

The Federal election is set for 21 May 2022, with Labor continuing to lead in the polls. While the polls are not always accurate, it does seem the Morrison government might need another miracle to stay in government, particularly with the current focus on the cost of living and higher interest rates.

The Australian economy remains robust but the first tightening cycle in more than a decade will provide a major challenge, particularly given private debt levels are now quite high. That is why we find it hard to believe the RBA would be so reckless to increase the cash rate to 2.5% by the end of the year.

The housing market looks to have already peaked on the East Coast and will likely move into a downward cycle as interest rates rise. Indeed, commercial property valuations are also likely to have downward pressure as bond yields and discount rates rise.

That said, Australian companies have strong balance sheets, and the local market has a greater value bias than the US market. We think the Australian market will continue to outperform global markets. Australia has a lot going for it, including: relatively low public debt levels (versus the developed world), a developed and diversified economy, a successful recovery from the COVID pandemic and the ability to increase immigration levels to support growth.

Outlook

The challenges are starting to stack up – inflation (higher costs), higher interest rates and a China slowdown. These are the opposite trends to what fueled the bull market that began in March 2009, post GFC. Our view is that the bull market does look late cycle; rising inflation and interest rates pose major challenges for company margins and market valuations. The positives are that economic growth is robust and should remain so (due to a recovery from the COVID pandemic) and company balance sheets are in good shape.

Equity markets had a strong run during the COVID pandemic, and it now looks like some of this excess is being handed back. The Nasdaq and Bitcoin, perhaps the leading indicators of investor exuberance, have clearly moved into bear market territory.

We have changed our view to **Cautious** (from Cautiously Optimistic) and now expect early January 2022 to mark the peak of the 13-year bull market that has now turned into a bear market. Higher costs and interest rates will likely lower company growth, while higher discount rates will lower market valuations. It is too much for equity markets to handle in the short term but eventually an equilibrium level will be found, and equity markets will stabilise and gradually rebound. We are recommending an overweight to Australian assets and review Fixed Interest as an opportunity but stay in quality exposures.

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 (increasing the cash rate and quantitative tightening);
4. China (property bubble and COVID lockdowns);
5. Regulatory interventions (in various sectors); and
6. Geopolitical tensions (Russia/China vs the West).

The next key events on the calendar include:

- Australian Federal election - 21 May 2022
- RBA meeting – 7 June 2022
- Fed meeting – 14/15 June 2022

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Market Update

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