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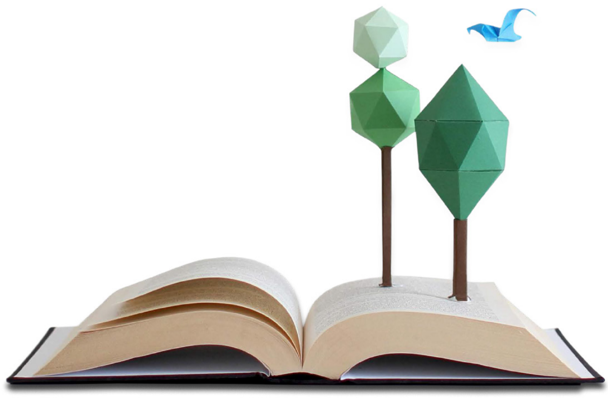
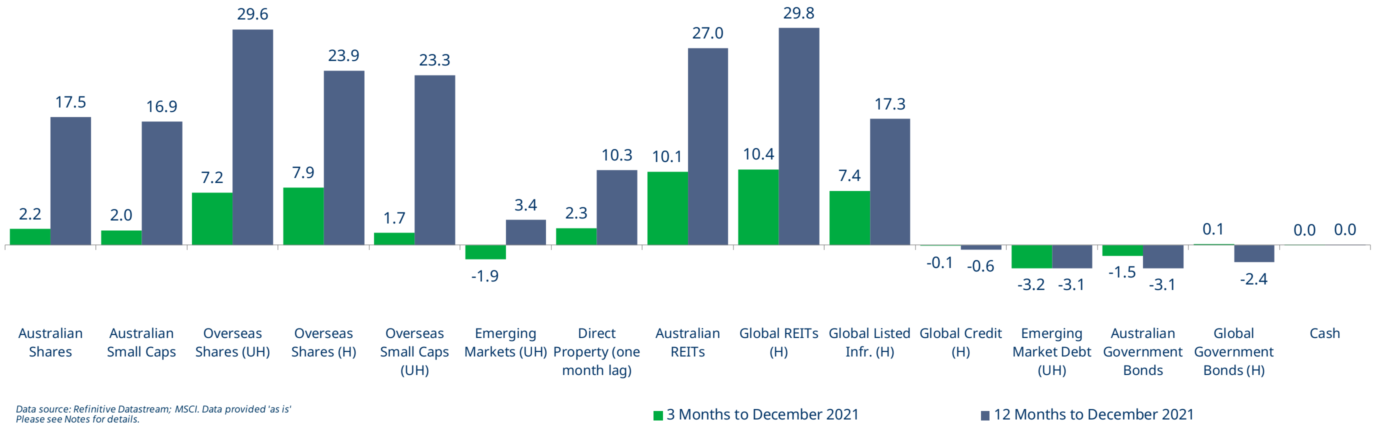
Q4 2021

Market and economic conditions



Selected market indicators commentary

Asset class returns as at December quarter 2021



In a high inflationary and high volatility market environment, global equity markets rallied over the fourth quarter and finished the year with strong positive returns. Investors remain optimistic about the earnings growth outlook and the threat of faster monetary policy tightening appearing to be priced in.

Hedged Developed Market Overseas Shares returned 7.9% for the quarter, mainly driven by the US as the S&P 500 Composite Index returned 11.0%, in local currency terms, over the same period. The strong performance from the US equity market is due to its heavier weight in growth stocks and the IT sector. The renewed recovery and open economies pushed growth stocks to outperform value, and IT was one of the strongest performing sectors. On a larger scale, the strong global equity market performance was driven by earnings optimism. The year-on-year 2021 earnings growth figure was reported at 45% and analysts expect a 10% earnings growth for 2022.

Emerging market equities underperformed both overseas and Australian shares, returning -1.9% over the quarter. This is largely due to China, which continues to weigh negatively on emerging market equity returns. China's economic growth has now begun to slow down due to the decline of its equity market and further lockdown restrictions. However, strong performance from Taiwan, Indonesia and Mexico helped partially offset China's negative performance.

Fixed income appeared to be impacted more by central bank actions than equities over the quarter. With ongoing volatility, global government bond markets returned mixed results. Major developed market 10-year government yields were largely unchanged over quarter, whilst domestically, Australia's 10-year government bond yield increased by 18bps to 1.7%. In emerging markets, those nations that have continued to raise interest rates have also witnessed a rise in bond yields.

The Australian share market lagged its hedged overseas counterpart over the December quarter. The S&P/ASX300 returned 2.2% over this period with all other domestic indices posting positive returns, the strongest performer being the S&P/ASX Mid 50 Accumulation Index (5.8%). The strongest performing sectors over the quarter were Materials (12.7%) and Utilities (11.4%), whilst the worst performing sectors were IT (-4.6%) and Energy (-7.5%).

Significant Developments

- During its early December 2021 meeting, the Reserve Bank of Australia (RBA) decided to maintain the current target cash rate at 0.10% per annum and the interest rate on exchange settlement balances of zero. The RBA will continue to purchase government securities at the rate of $4bn per week until mid-February. The Australian economy is recovering after the interruption caused by the Delta outbreak with high vaccination rates and substantial policy aiding this recovery. The emergence of the Omicron strain is a new source of uncertainty but it is not expected to derail the recovery. The economy is expected to return to its pre-Delta path in the first half of 2022. Wages growth has picked up and a further pick-up in wages growth is expected as the labour market tightens. Inflation has increased slightly at 2.1% and the headline CPI inflation rate is 3.0%. The central forecast is for underlying inflation to reach 2.5% over 2023. Housing prices have risen strongly over the past year, although the rate of increase has eased over recent months. Globally, bond yields have declined over the past month due to concerns around the Omicron variant. The Australian dollar exchange rate has depreciated and is currently sitting around its lows of the past year. At its February 2022 meeting, the Board will consider the bond purchase program and by then will hold a total of $350bn of bonds issued by the Australian Government and the states and territories. While inflation has picked up, it remains low in underlying terms. The board are committed to maintaining highly supportive monetary conditions and will not increase the cash rate until actual inflation is sustainably within the 2-3% target range. For this to occur, the labour market will need to be tight enough to generate wages growth that is materially higher than it is, which will likely take some time.
- Australian seasonally adjusted employment increased by 366,100 in November, above expectations for an increase of 200,000 and above the prior month's decrease of 56,000 (revised). The unemployment rate decreased to 4.6% for November, below expectations for 5.0%. The participation rate increased to 66.1%, above expectations of 65.5%. Part time jobs increased by 237,800 and full time jobs increased by 128,300.
- Australian house prices increased by 5.0% in the third quarter of 2021, taking it 21.7% higher from a year earlier and in line with expectations for quarter-on-quarter (QoQ) and in line with expectations for year-on-year (YoY). Australian building approvals increased by 3.6% month-on-month to November, compared to the decrease of 13.6% for October.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 58.7 in December, below consensus for 62.0 and below the 61.1 recorded in November. Of the 18 manufacturing industries, Apparel, Leather & Allied Products and Furniture & Related Products were the two industries that reported the highest growth. The three industries that reported a contraction over the December period were Wood Products, Printing & Related Support Activities and Paper Products. The ISM Services Index recorded 62.0 in December, below consensus for 67.0 and below the 69.1 recorded in November. Of the 18 services industries, the top performers were Accommodation & Food Services and Wholesale Trade. The only industry reporting contraction in December was Mining.
- US Non-Farm Payrolls increased by 199,000 in December, below the 249,000 increase (revised) recorded for November. The unemployment rate decreased to 3.9% over December, below expectations of 4.1%.
- US GDP third estimate for Q3 2021 is 2.3% quarter on quarter (QoQ) annualised, above expectations of 2.1%.
- US headline consumer price index (CPI) increased to 0.5% MoM and increased to 7.0% YoY in December.
- The Caixin Manufacturing PMI in China recorded 50.9 in December, above expectations of 50, with production increasing at it quickest rate for a year.
- Chinese GDP increased 4.9% YoY for Q3 2021, below expectations for 5.0%. Seasonally adjusted GDP increased 0.2% QoQ for Q3 2021, below expectations for 0.4%.
- The preliminary estimate of the European Core CPI recorded 2.6% over the year to December, above expectations of 2.5%. The unemployment decreased over the month to 5.1% in December 2021.
- The Eurozone composite PMI increased to 53.3 in December, below expectations for 53.4.
- The Final estimate recorded for Q3 2021 Eurozone seasonally adjusted GDP is 1.1% QoQ and 3.6% YoY.

Australian Equities

Australian shares were positive over Q4 2021 as the S&P/ASX 300 Index returned 2.2% for the period. The S&P/ASX Mid 50 Accumulation Index was the best performer for the quarter returning 5.8%, while the worst performer was the S&P/ASX 50 returning 1.6%.

The best performing sectors were Materials (12.7%) and Utilities (11.4%), while the weakest performing sectors were Energy (-7.5%) and IT (-4.6%). The largest positive contributors to the return of the index were BHP Group, Fortescue Metals Group and Goodman Group with absolute returns of 13.3%, 35.9% and 22.6% respectively. On the other hand, the most significant detractors from performance were Westpac, Commonwealth Bank and Afterpay with absolute returns of -17.1%, -3.2% and -31.6% respectively.

Global Equities

The broad MSCI World ex Australia (NR) increased 7.9% in hedged terms and increased 7.2% in unhedged terms over the quarter, as the AUD achieved positive returns against major currencies over the period. The strongest performing sectors were Information Technology (12.6%) and Utilities (10.5%), while Communication Services (-2.4%) and Financials (3.4%) were the worst performers. Other global shares were mixed as the MSCI Small Caps (TR) Index returned 1.7% and the MSCI Emerging Markets (NR) Index returned -1.9% over the quarter, all in AUD terms.

Over the December quarter, the NASDAQ increased 8.3%, the S&P 500 Composite Index increased 11.0% and the Dow Jones Industrial Average increased 7.9%, all in USD terms. European markets also experienced positive returns, with the FTSE 100 (United Kingdom) increasing 4.7%, the CAC 40 (France) increasing 9.9% and the DAX 30 (Germany) increasing 4.1%, all in local currency terms. Equity returns were broadly negative across Asia as the TOPIX (Japan) (-1.7%), Hang Seng (Hong Kong) (-4.7%) and S&P BSE 500 (India) (-0.5%) decreased, all in local currency terms. In comparison, the SSE Composite (China) increased over the quarter, in local currency terms, returning 2.0%.

Real Assets

Domestic listed property experienced strong performance over the quarter and returned 10.1%. Global REIT's returned 10.4% (in AUD hedged terms) over the December quarter. The Australian unlisted property sector (NAV) increased 2.3% over the quarter on a one month lagged basis and the FTSE Global Core Infrastructure 50/50 Index increased 7.4% for the quarter in hedged AUD terms.

Fixed Interest

Global sovereign bonds produced broadly flat returns over the December quarter for hedged Australian investors. Ten-year bond yields increased in Germany (+1bp to -0.18%), returned flat in Japan (0.07%), and decreased in the US (-3bps to 1.50%) and the UK (-5bps to 0.97%). Two-year bond yields increased in Japan (+4bps to -0.09%), Germany (+8bps to -0.66%), the US (+39bps to 0.66%) and the UK (+27bps to 0.68%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index returned flat and the FTSE World Government Bond (ex-Australia) Index increased by 0.1% over the December quarter, both on a fully hedged basis.

Domestically, the Australian 10-year bond yield (+18bps to 1.67%), five-year bond yield (+56bps to 1.34%) and two-year bond yield (+33bps to 0.37%) all increased. The Bloomberg Ausbond indices returned broadly negative results over the quarter, with the Bloomberg Ausbond Composite Bond, Bloomberg Ausbond Treasury and Bloomberg Ausbond Credit, all returning -1.5%. The exception being the Bloomberg Ausbond Inflation Index achieving the highest return of 2.3%.

Currency Markets

The Australian Dollar (AUD) appreciated against major developed market currencies over the December quarter, finishing at US$0.73. The AUD appreciated against the USD (0.7%), the Pound Sterling (0.2%), the Japanese Yen (3.9%) and the Euro (2.6%). On a trade-weighted basis, the local currency appreciated 0.5% over the quarter.

Commodities

The S&P GSCI Commodity Total Return Index increased by 0.9% over the quarter. Gold prices finished the quarter at US$1,822.4 per ounce with a 3.5% increase. Meanwhile, Iron Ore prices increased by 5.5% to US$116.0 per metric tonne over the period and Oil decreased slightly by -0.2% to US$78.4 per barrel.

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Chart Constituents

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Net Index: Total Return (Net Dividends Reinvested).*
- *Total Return: Total Return Index with Gross Dividends.*
- *Where a lag exists, the performance period start and end dates are shifted accordingly.*

Asset class	Benchmark	Data type
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
Overseas Shares (UH)	MSCI World ex Australia	Net Index
Overseas Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
Overseas Small Caps (UH)	MSCI World Small Cap	Total Return
Emerging Markets (UH)	MSCI Emerging Markets	Net Index
Direct Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian REITs	S&P/ASX 300: Industry Group: A-REIT	Total Return
Global REITs (H)	FTSE EPRA/NAREIT Developed Hedged	Total Return
Global Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Total Return
Global Credit (H)	Bloomberg Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
Overseas Government Bonds (H)	FTSE WGBI Non Australia	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

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- Investments denominated in a foreign currency will fluctuate with the value of the currency.
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- Certain investments, such as illiquid, leveraged or high-yield instruments or funds and securities issued by small capitalization and emerging market issuers, carry additional risks that should be considered before choosing an investment manager or making an investment decision.
- For higher volatility investments, losses on realisation may be high because their value may fall suddenly and substantially.
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