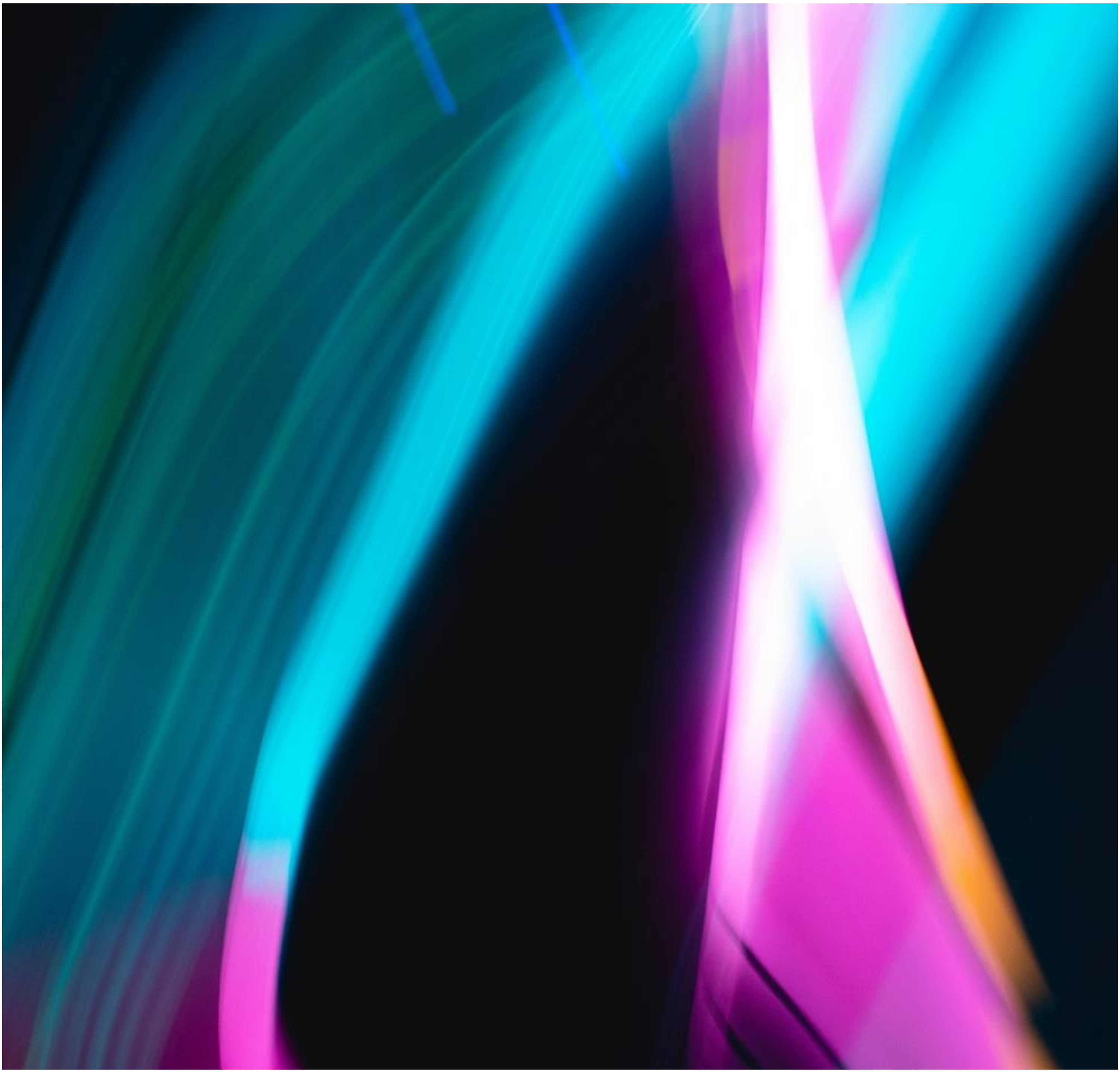
INVESTMENT ENVIRONMENT UPDATE

NOVEMBER 2022

PATRIZIA ADVISERS



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Investment Environment Update

Global economic uncertainty continued over November. While data releases in a number of countries suggest a potential peak in inflation and a central bank 'pivot' toward a slower pace of rate hikes, employment data remains relatively sanguine, indicating limited slack persists in labour markets and that further rate hikes are nonetheless required. The global economy accordingly faces a material possibility of recession in 2023, with central banks and governments required to undertake a delicate balancing act to engineer a soft landing. Additionally, the conflict in Ukraine continues to become increasingly protracted as the northern winter commences, with little sign of resolution on the horizon.

The Australian economy continued to reflect an uncertain economic outlook, with weakening sentiment and retail sales suggesting that the RBA's policy tightening may be starting to slow the economy. By contrast, jobs data remains robust, and the RBA's latest guidance suggests much remains to be done to contain inflation.

Third quarter GDP data released in early December was slightly below forecasts, rising by 0.6% over the September quarter and 5.9% for the year. Consumer spending performed well over the past year, with the rise in household spending driven by a surge in hotels and restaurants, car sales, and transport spending.

Australian inflation measured by the CPI, which has started monthly releases since October, recorded a downside surprise, rising by 0.2% month-on-month compared to consensus forecasts of 0.6%, and with a number of key categories such as fuel, housing, food and travel all weaker than expected. That said, a number of basket components are not recorded each month and remain on quarterly update cycles – including electricity.

Despite the weaker inflation and retail sales data, the Australian jobs market remains in relatively robust health. October labour force data, released in mid-November, revealed that the unemployment rate declined 0.1% to just 3.4% - equaling the July 2022 figure for the lowest rate since 1974. 32,000 jobs were added over the month, just over double consensus forecasts, while the participation rate remined steady at around 65.5%.

Asset Class Returns	November (%)	3 Months (%)	12 Months (%)	3 Years (% p.a.)
Cash	0.25	0.64	1.01	0.49
Australian Fixed Interest	1.55	1.09	-7.72	-2.74
Overseas Fixed Interest	2.37	-1.59	-11.51	-2.84
Australian Equity *	6.49	5.74	4.27	5.97
Developed Overseas Equity (unhedged) *	2.02	6.43	-5.89	7.93
Developed Overseas Equity (fully hedged) *	5.43	2.97	-10.14	6.59
Emerging Markets Equity (unhedged)*	9.65	0.55	-12.58	0.47

** Returns reflect the relevant accumulation indices.*
Source: Bloomberg, Datastream, PATRIZIA Advisers.

Nevertheless, consumer sentiment is starting to weaken, suggesting policy tightening may be starting to curb consumption. The Westpac-Melbourne Institute gauge recorded a nearly 7% fall in November to a reading of 78 – lower than levels reached during the height of the GFC. Surveyed households recorded a sharp fall in the state of family finances over the next year, and nearly half expect to curb their Christmas expenditure. Similarly, October retail sales fell 0.2% - the first negative monthly print for 2022. Data suggests that the weakening is broad-based across segments. Business sentiment as recorded by the NAB survey was more mixed, with business conditions edging down one point to +22, while business confidence fell five points to a below-average reading of zero, albeit remaining out of contractionary territory.

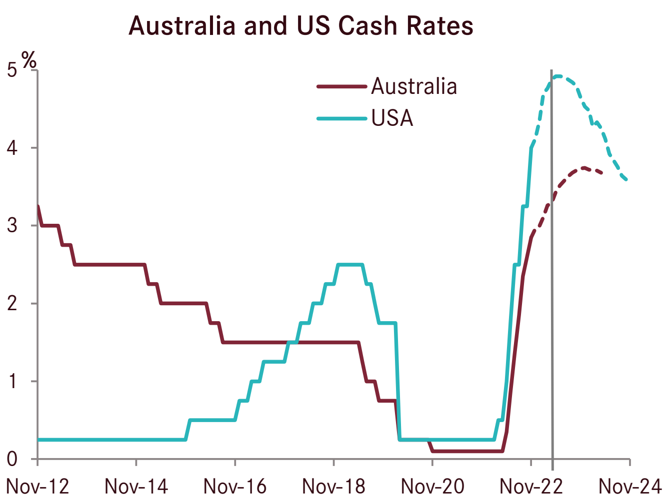
The RBA board's final meeting for 2022, in early December, saw it resolve to hike rates for an eighth consecutive time, lifting the official cash rate to 3.1% - the highest level since November 2012. After a below-consensus inflation print and what markets had perceived to have been a dovish tilt to signaling in recent weeks – with a number of economists suggesting a terminal rate of 3.1% or even the chance of no hike at the December meeting - the RBA's post-meeting statement was somewhat hawkish, noting that it expects to increase rates further in the period ahead, but is not on a pre-set course. While the central bank acknowledged that the impact of prior rate hikes is yet to fully affect the economy, it also anticipates further increases in inflation to a peak of around 8% before falling to just over 3% per annum over 2024.

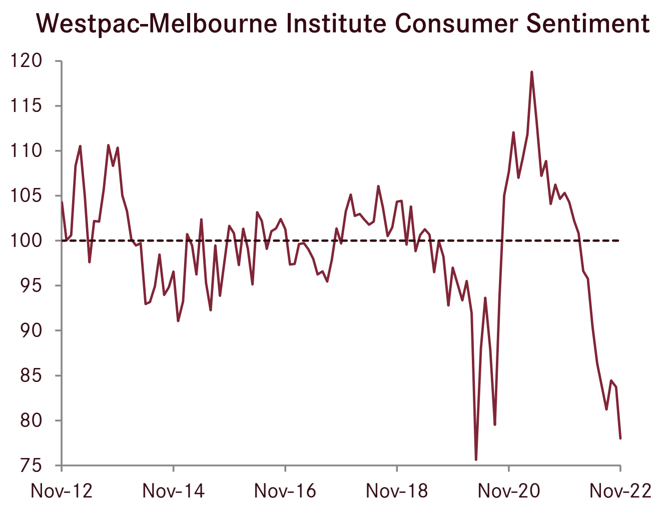
The nation's housing sector has also continued to slow. CoreLogic data across the eight capital cities recorded prices falling 1.1% in November, taking the nationwide decline from the peak in April 2022 to 7.5%, with prices in Sydney falling by over 11% since January 2022. Data suggests transaction volumes for residential property are down over 13% compared to the same time last year, with the monthly value of mortgages falling 18% since the first RBA rate hike in May. Meanwhile, dwelling approvals fell by 6% in October, also suggesting a slowdown in activity in the sector.

The US mid-term elections on 8 November proved favourable for the Democratic Party, with a much-anticipated 'red wave' failing to materialise, and candidates backed by former President Donald Trump losing popularity. The Republican Party secured a majority in the lower house, albeit gaining a less-than-expected 9 seats to give them a slim majority of just 3 seats. Meanwhile the Republicans failed to take a majority in the Senate, unexpectedly losing a seat to the Democrats. The mid-term results suggest limited scope for changes in legislation by Congress in the two years ahead of the next Presidential election in 2024.

October inflation came in below expectations for the US, with headline prices rising by a still high 0.4% for the month, but below the 0.6% consensus. The result suggests inflation may be starting to peak, especially given energy and food prices posted strong price growth over the month. Despite the unexpectedly low inflation print, US employment data pointed to strength in the economy. Non-farm payrolls soared by an above-expected 263,000 over November, while the unemployment rate remained steady at 3.7%. Data from payrolls processor ADP was less sanguine, recording a 127,000 jobs increase; half the October figure.

Following a 75 basis point rate hike in early November, the release of the Federal Reserve's Open Markets Committee meeting minutes revealed a dovish tilt, with the majority considering that a slowing pace of rate increases would soon be warranted. Accordingly, market pricing suggests that only a 50 basis point hike will be agreed at the Fed's December meeting, with a terminal rate of around 5% expected in early- to mid-2023. That said, the minutes did flag uncertainty around the outlook given the lagging impact of policy tightening and unpredictability of employment and inflation.





Source: Bloomberg

The European Central Bank (ECB)'s October meeting minutes were released mid-month, and reflected rising concerns over the increasingly broad-based nature of inflation while having to simultaneously balance growth risks. Anticipating a weakening economic picture, the ECB has signalled a potential slowing in the pace of rate hikes in December from 75 to 50 basis points, although ECB President Lagarde has reiterated the bank 'is not done' raising rates. The latest inflation data is likely to support the ECB's case for a smaller hike in December, with the November CPI coming in at a below expected 10% year-on-year, with energy prices easing amid a relatively mild autumn, though the region is now approaching its seasonal peak period for energy usage over the winter.

Following an ill-fated 'mini-budget' that cost both the new Prime Minister and Chancellor of the Exchequer their jobs, new UK Prime Minister Rishi Sunak deliver a fiscal update in November that was contractionary overall. An estimated £55 billion of fiscal tightening over the next five years is expected, consisting of spending cuts and tax hikes – the latter of which will be the largest tax increase since the early 1990s. With the latest inflation print above forecasts at a 41-year high of 11.1% coming despite the government's Energy Price Guarantee program, the impetus for fiscal austerity is elevated.

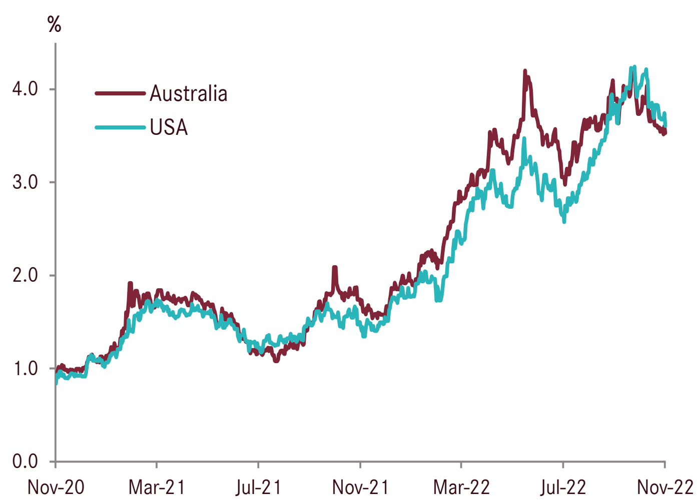
In China, there were signs of considerable signs of social unrest over the month, with widespread protests against the government's strict 'zero COVID' approach ultimately leading to an unexpected government relaxation in some restrictions. There are some concerns, however, around a surge in cases, particularly among the elderly, which as a cohort have relatively low vaccination rates. Sentiment indicators remain close to neutral, albeit slightly contractionary overall. The official manufacturing PMI gauge edged downward 1.2 points to 48 in November, while the Caixin measure increased 0.2 points to 49.4.

The pivot by central banks served to buoy risk assets over November, lifting overseas developed market equities by 5.4% on a fully AUD-hedged basis, and local equities by 6.5%. Emerging market equities benefitted even more, rallying nearly 10% for the month on an AUD-unhedged basis. Annual returns for overseas equities nonetheless remain in negative territory; for the year to 30 November, developed markets returned -10.1% fully hedged back to Australian dollars, although domestic equities, with a stronger skew to commodities producers that have benefitted from rising prices, are in positive territory, and returned 4.3% for the twelve-month period.

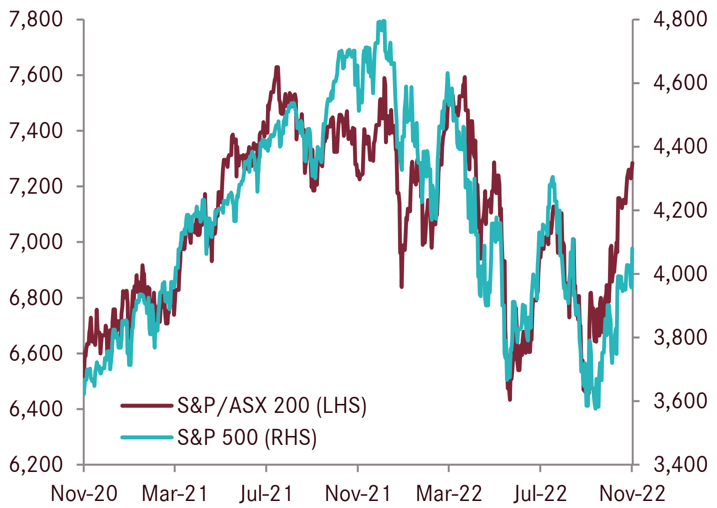
Fixed interest returns were also favourable for the month, with a dovish tilt in expected policy settings leading to a decline in bond yields and credit spreads, meaning Australian and overseas fixed interest posted positive returns of 1.6% and 2.4%, respectively. That said, returns for both remain firmly in negative territory on a year-on-year basis at -7.7% and -11.5%, respectively.

It has been an atypical year for global equities and fixed interest. While in recent decades they have exhibited a negative return correlation, even in periods where they have exhibited a positive correlation, returns have tended to be positive. However, for US stocks and bonds at least, 2022 is likely to be the third calendar year in modern history – after 1931 and 1969 - where both have recorded negative returns.

10 Year Government Bond Yields



S&P/ASX 200 (Aus.) and S&P 500 (US) Equity Indices



Source: Bloomberg

Index Returns to 30 November 2022

	MONTH (%)	3 MONTHS (%)	FYTD (%)	12 MONTHS (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	6.5	5.7	13.4	4.3
S&P/ASX Small Ordinaries Accumulation Index	4.9	-0.8	11.2	-14.0
International Equities				
MSCI World (ex Australia) Index (hedged A$)	5.4	3.0	7.2	-10.1
MSCI World (ex Australia) Index (unhedged A$)	2.0	6.4	10.4	-5.9
MSCI Emerging Markets Index (unhedged A$)	9.6	0.5	1.0	-12.6
Property				
S&P/ASX 200 A-REIT Accumulation Index	5.8	0.4	8.4	-13.0
FTSE EPRA Nareit Developed ex Aus Rental hedged AUD	4.9	-5.1	-3.5	-18.5
FTSE EPRA Nareit Developed ex Aus Rental unhedged AUD	1.6	-1.8	-0.4	-14.6
Australian Fixed Interest				
Bloomberg AusBond Composite Index	1.5	1.1	1.8	-7.7
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	2.0	-1.9	-2.8	-12.8
Barclay's Global Capital Aggregate Bond Index (hedged A$)	2.4	-1.6	-1.9	-11.5
Cash				
Bloomberg AusBond Bank Bill Index	0.2	0.6	0.9	1.0
Commodities				
Gold (US$ per ounce)	7.0	2.2	-3.5	-2.8
Copper (US$ per metric tonne)	10.6	5.6	-0.2	-12.7
WTI Crude Oil (US$ per barrel)	-6.9	-10.1	-23.8	21.7
RBA Index of Commodity Prices (A$)	-6.8	-0.4	-8.4	22.3

Australian Dollar versus Foreign Currencies to 30 November 2022

AUSTRALIAN DOLLAR VERSUS	AS AT 30 NOVEMBER 2022	MONTH (%)	THREE MONTHS (%)	FYTD (%)	12 MONTHS (%)
US Dollar	0.67	4.7	-2.3	-2.6	-5.5
British Pound Sterling	0.56	1.3	-4.6	-0.7	4.9
Euro	0.65	0.5	-4.6	-1.1	3.3
Japanese Yen	93.45	-1.7	-1.7	0.0	16.1

Source: Bloomberg

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