INVESTMENT ENVIRONMENT UPDATE

JUNE 2022

PATRIZIA ADVISERS

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Investment Environment Update

INVESTMENT ENVIRONMENT HIGHLIGHTS

Soaring inflationary pressures, hawkish central banks and the ongoing conflict in Ukraine remain the dominant themes for investment markets. While labour markets have remained tight, especially in the US, other leading indicators have begun to deteriorate, signalling slowing growth for large parts of the global economy. Additionally, there does not appear to be a foreseeable near-term resolution to the conflict in Ukraine, which means that energy and food inflation is expected to remain elevated.

Central bank activity continues to be the predominant theme influencing consumer and business sentiment, and financial market performance. Soaring inflationary pressures, clearly not as 'transitory' as first hoped, have prompted many global central banks to adopt their most hawkish stances since the 1980s. Many developed market and emerging market central banks have begun raising cash rates. Combatting inflation that is approaching double digit levels has clearly become the dominant priority, and the aggressive hiking cycles come with the risk of tipping economies into recessions and extending sell-offs in equity and fixed interest markets. A notable outlier is the Bank of Japan – despite enormous market pressure to tighten monetary policy, it continues to maintain its ultra-accommodative settings as inflation and growth remain very low by international standards.

The Reserve Bank of Australia increased the cash rate target to 1.35%, by way of its second consecutive 0.50% increase at its early July meeting. The labour market continues to show signs of strength – the unemployment rate remained steady at a fifty-year low of 3.9% in May, while the participation rate increased by 0.3% to 66.7% and the underemployment rate fell by 0.4% to 5.7%, its lowest level since 2008.

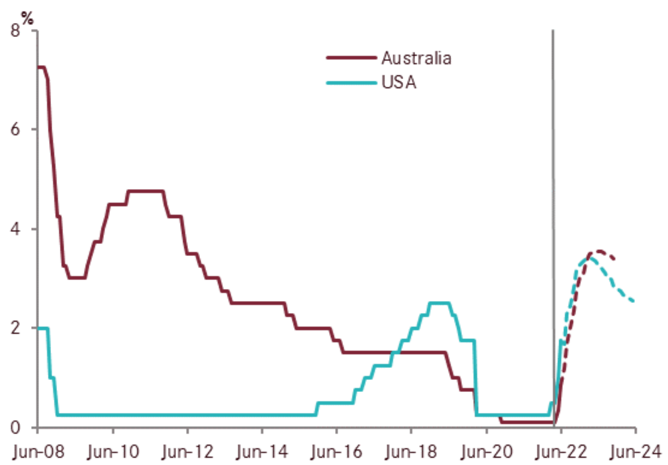
Asset Class Returns	June (%)	3 Months (%)	12 Months (%)	3 Years (% p.a.)
Cash	0.05	0.07	0.10	0.33
Australian Fixed Interest	-1.48	-3.81	-10.51	-2.58
Overseas Fixed Interest	-1.64	-4.66	-9.33	-1.63
Australian Equity *	-8.97	-12.22	-6.78	3.44
Developed Overseas Equity (unhedged) *	-4.64	-8.42	-6.52	7.83
Developed Overseas Equity (fully hedged) *	-8.10	-15.10	-12.51	6.36
Emerging Markets Equity (unhedged)*	-2.61	-3.30	-18.43	1.25

The RBA noted in its July cash rate decision that household spending is a source of uncertainty for the Australian economic outlook. Broadly speaking, the household savings rate remains above pre-pandemic levels, however household budgets are facing pressure from both higher inflation and rising interest rates. The impact of higher borrowing rates is beginning to be felt in some Australian property markets – house prices in June fell by 1.6%, 1.1% and 0.2% in Sydney, Melbourne and Hobart respectively, while all other capital cities recorded very modest gains.

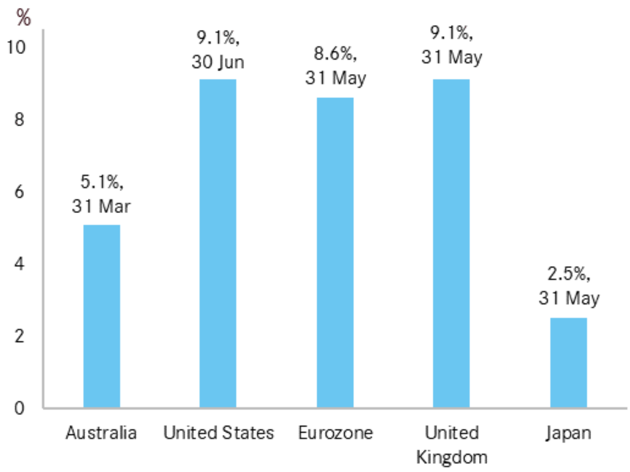
The US Federal Reserve's Open Markets Committee (FOMC) continues to remain in focus for investment markets globally. The FOMC maintained a hawkish outlook at its mid-June meeting, raising its overnight cash rate by 0.75% to a target range of 1.5-1.75%, the biggest single hike since 1994. Inflation remains stubbornly high in the US – the June print showed headline inflation at 9.1% year-on-year, while core inflation was recorded at 5.9%, a slight reduction from the May print of 6.0%. Continued high energy prices on the back of the ongoing conflict in Ukraine and the rebound in consumer demand following the end of most COVID-19 restrictions have been the key drivers of higher inflation. However, the tight labour market is also playing a role – non-farm payrolls rose by 372,000 in June while the unemployment rate remained steady at 3.6%. The Federal Reserve's dot plot indicates that the target range for the overnight cash rate could be as high 3.25-3.5% by the end of the year.

In mid-June, the European Central Bank (ECB) committed to a 0.25% rate hike in July, its first in more than a decade, and it also expects to raise its cash rate by 0.5% at its September meeting. This would bring an end to its negative interest rate policy approach that has been in place for eight years. The ECB also announced that it would cease net asset purchases on 1 July. The ongoing conflict in Ukraine has had particularly acute impacts on European inflation – year-on-year headline inflation in June rose to 8.6%, up from 8.1% in May. European energy prices are up an eye-watering 42% in the year ending in June, due to the trade disruption caused by the EU's sanctions on Russia. Further disruption to energy supplies could arise, depending on Russia's approach to the reopening of the Nord Stream 1 gas pipeline following a maintenance shutdown.

Australia and US Cash Rates



Headline Inflation Rates, Most Recent Available



Source: Bloomberg

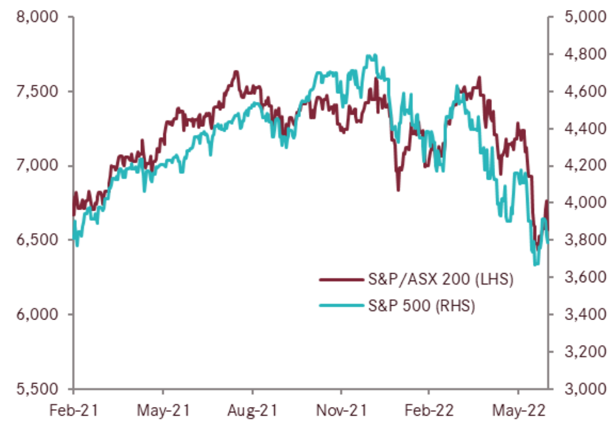
The political turmoil in the UK intensified in early July. Despite narrowly surviving a vote of no confidence in June, Prime Minister Boris Johnson was forced to resign in early July, following a number of scandals, including his handling of sexual assault allegations against a Member of Parliament and the hosting of parties at 10 Downing Street at the height of COVID-19 lockdowns. Johnson will remain Prime Minister until the Conservative Party elects its next leader, a process which could take up to two months. The UK also continues to grapple with soaring inflationary pressures. Headline inflation reached a forty-year high of 9.1% in May, driven by higher imported energy and food prices. The Bank of England raised its cash rate by 0.25% at its mid-June meeting to 1.25%. The central bank expects that inflation has not yet peaked; its current forecasts suggest headline inflation could reach as high as 11% in the second half of 2022.

China's economic growth in the year to the end of June is expected to be just 1.1%, down from the 4.8% year-on-year figure at the end of May. The country's 'COVID-zero' approach, specifically the severe lockdown in Shanghai from late March to the end of May, is the main driver of the low GDP print. At the time of writing, new COVID restrictions were being implemented in some Chinese cities in an effort to combat highly transmissible Omicron variants. While the Chinese Communist Party (CCP) has continued to implement broad-based fiscal and monetary support in the wake of the significant fallout from the COVID-zero approach, significantly higher growth will be required in the second half of 2022 for the country to achieve its 5.5% growth target for the calendar year, a year considered important by the CCP given its 22nd National Congress is being held in November 2022.

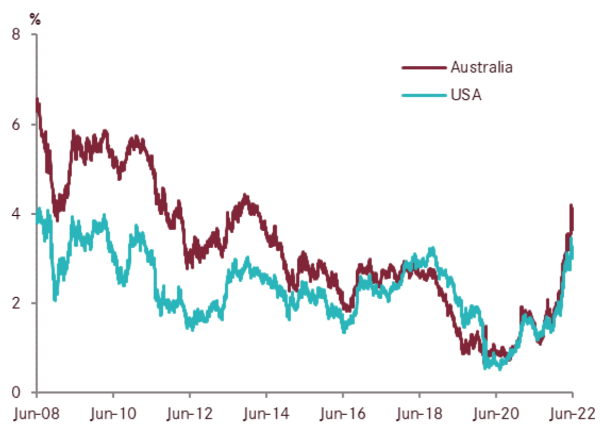
After a flatter month in May, global equity markets recommenced a downward trajectory in June. The Fed's mid-June 0.75% rate hike sent markets tumbling mid-month, fearing a hawkish Fed determined to see lower levels of demand. On a fully hedged basis, developed overseas equity fell by 8.1% over the month of June. The broad depreciation of the Australian dollar over the month caused the unhedged return to fall by a lesser 4.6%. The larger than anticipated 0.50% rate hike from the RBA in early June and weaker commodity prices rattled Australian equity markets, causing the ASX 300 to fall by 9% over the month. On a year-to-date basis, fully hedged developed overseas equity finished the financial year down 19.4%, while Australian equity was down 10.4%.

Tightening central bank policy has seen bond yields continue to march higher, causing poor fixed interest returns over the month. The 10-year US Treasury yield rose from 2.9% to as high as 3.5% in mid-June, before ending the month at 3.0%. Meanwhile, the 10-year Australian Government bond yield rose from 3.4% to 3.7% over the course of the month. Correspondingly, Australian and overseas fixed interest markets were down by 1.5% and 1.6% over the month, respectively.

ASX 200, S&P 500 Indices



10-Year Government Bond Yields



Source: Bloomberg

Index Returns to 30 June 2022

	MONTH (%)	3 MONTHS (%)	FYTD (%)	12 MONTHS (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	-9.0	-12.2	-6.8	-6.8
S&P/ASX Small Ordinaries Accumulation Index	-13.1	-20.4	-19.5	-19.5
International Equities				
MSCI World (ex Australia) Index (hedged A$)	-8.1	-15.1	-12.5	-12.5
MSCI World (ex Australia) Index (unhedged A$)	-4.6	-8.4	-6.5	-6.5
MSCI Emerging Markets Index (unhedged A$)	-2.6	-3.3	-18.4	-18.4
Property				
S&P/ASX 200 A-REIT Accumulation Index	-10.3	-17.7	-12.3	-12.3
Australian Fixed Interest				
Bloomberg AusBond Composite Index	-1.5	-3.8	-10.5	-12.3
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	-1.3	-4.9	-9.3	-9.3
Barclay's Global Capital Aggregate Bond Index (hedged A$)	-1.6	-4.7	-9.3	-9.3
Cash				
Bloomberg AusBond Bank Bill Index	0.1	0.1	0.1	0.1
Commodities				
Gold (US$ per ounce)	-1.2	-6.4	3.1	3.1
Copper (US$ per metric tonne)	-12.6	-20.4	-11.9	-11.9
WTI Crude Oil (US$ per barrel)	-7.8	5.5	43.9	43.9
RBA Index of Commodity Prices (A$)	-1.5	0.9	26.1	26.1

Australian Dollar versus Foreign Currencies to 30 June 2022

AUSTRALIAN DOLLAR VERSUS	AS AT 30 JUNE 2022	MONTH (%)	THREE MONTHS (%)	FYTD (%)	12 MONTHS (%)
US Dollar	0.69	-4.1	-8.4	-8.4	-8.4
British Pound Sterling	0.57	-0.5	-0.7	4.2	4.2
Euro	0.66	-1.8	-2.5	3.9	3.9
Japanese Yen	93.42	1.2	2.5	12.1	12.1

Source: Bloomberg

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