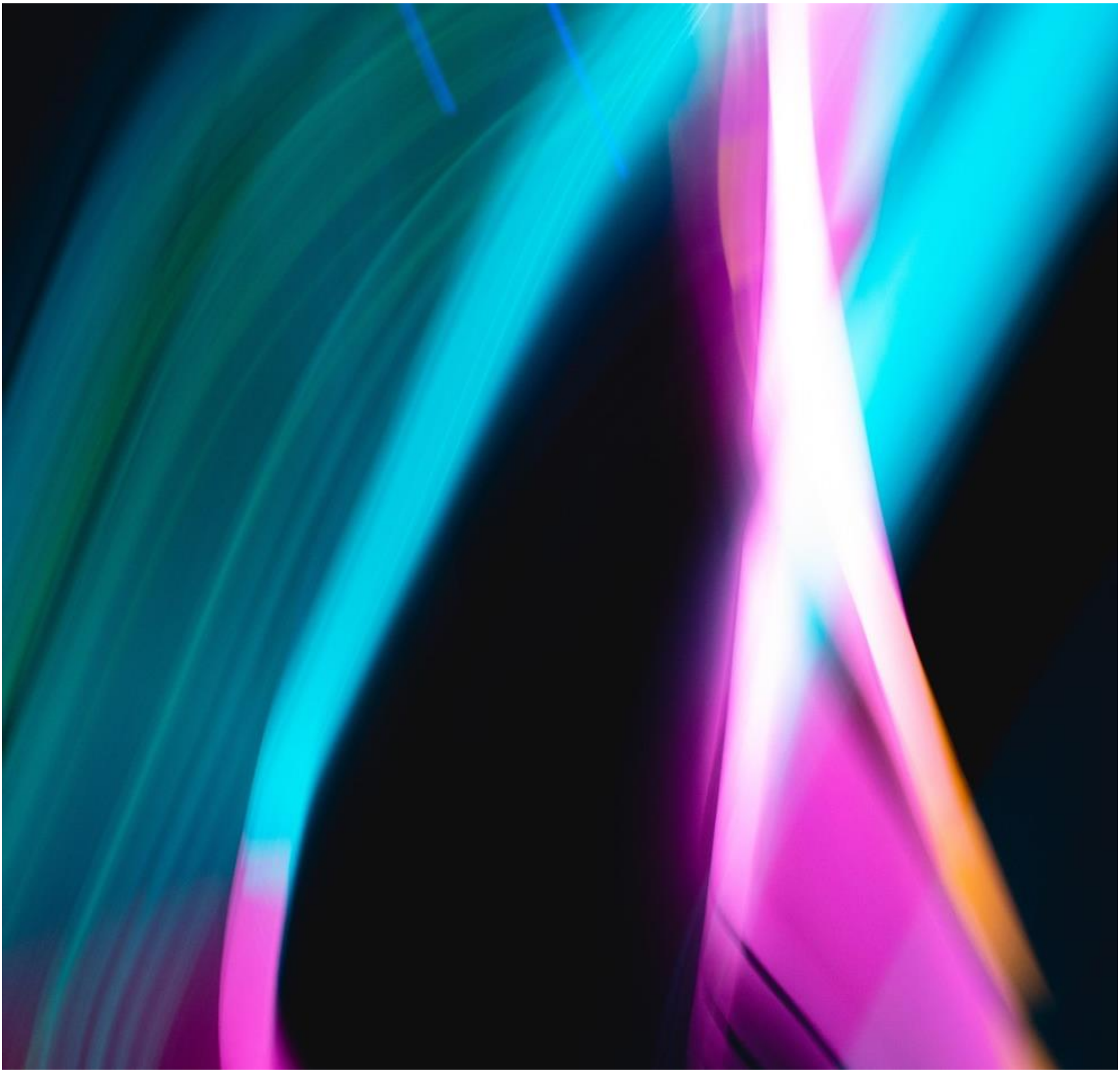
INVESTMENT ENVIRONMENT UPDATE

JULY
2022

PATRIZIA ADVISERS



PATRIZIA

Prime Super

Investment Environment Update

The past month saw continuing policy tightening by central bank rate hikes across much of the developed world - including, for the first time in over a decade, the European Central Bank - as inflationary pressures continued to persist amid energy and food shortages due to the conflict in Ukraine, as well as ongoing global supply chain disruptions. The impact of these headwinds on global growth prompted the International Monetary Fund (IMF) to downgrade its global GDP forecast for 2022 in July, cutting expected growth by 0.4% to 3.2%. It also expects higher inflation, upping its global forecast from 7.4% to 8.3%. While attracting fewer headlines of late, the COVID-19 pandemic remains ongoing, with global daily confirmed deaths starting to trend upward over July. That said, deaths remain at their lowest levels since March 2020.

Australian economic data releases over the month followed the trend of preceding months, with high inflation and strong jobs data. The unemployment rate recorded a positive surprise, falling to just 3.5% in June; a 48-year low and 0.4% down on the prior month. The data suggests an increasingly tight labour market is likely to place increased pressure on wage growth. That said, Australia's second quarter headline CPI came in slightly below consensus at a still-elevated 6.1%, with housing costs the largest contributor, due mostly to lower supply of inputs and labour. The Reserve Bank of Australia (RBA) forecasts the annual rate to exceed 7% per annum by year-end as the 2021 data drops out of the annual level, although the slight undershoot suggests inflation may be less rampant in the medium term than prior expectations. Meanwhile, the trimmed mean figure was an annual rate of 4.9%.

Asset Class Returns	July (%)	3 Months (%)	12 Months (%)	3 Years (% p.a.)
Cash	0.12	0.21	0.22	0.33
Australian Fixed Interest	3.36	0.93	-9.10	-1.81
Overseas Fixed Interest	2.49	0.61	-8.23	-1.04
Australian Equity *	5.95	-6.21	-2.31	4.43
Developed Overseas Equity (unhedged) *	6.40	0.62	-4.39	9.24
Developed Overseas Equity (fully hedged) *	7.96	-0.98	-7.18	8.70
Emerging Markets Equity (unhedged)*	-1.70	-4.74	-15.82	0.48

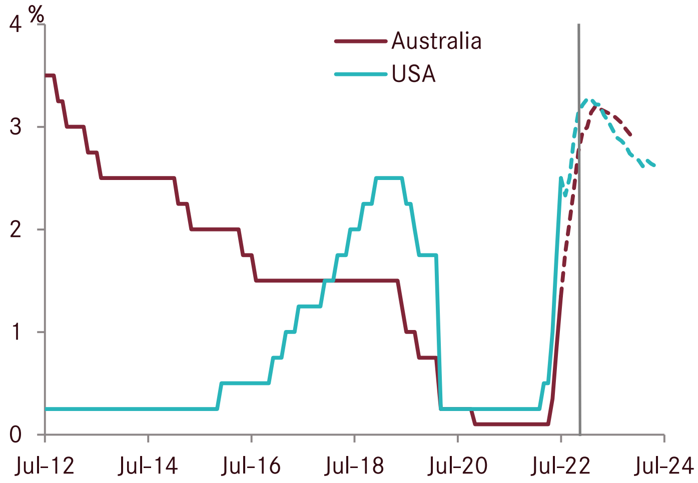
As widely anticipated, the RBA lifted the official cash rate by 50 basis points to 1.85% - a six-year high - at its early August meeting. Governor Lowe's statement noted that the RBA is not on a 'pre-set path', which was construed as a dovish tilt, leading to market expectations for September reducing the probability of a 0.5% hike. The forecast terminal rate eased as July drew to a close, with the cash rate expected to reach around 3.25% in early 2023.

The 1.75% increase in the cash rate over just four meetings and its associated increase in variable mortgage rates has already had a material impact on the nation's housing sector, with prices falling at their sharpest rate since the global financial crisis. Prices in the largest city, Sydney, fell by 2.2% in June alone; the largest single month fall in 32-years. With over 1% of rate hikes expected by year-end, this trend is likely to accelerate.

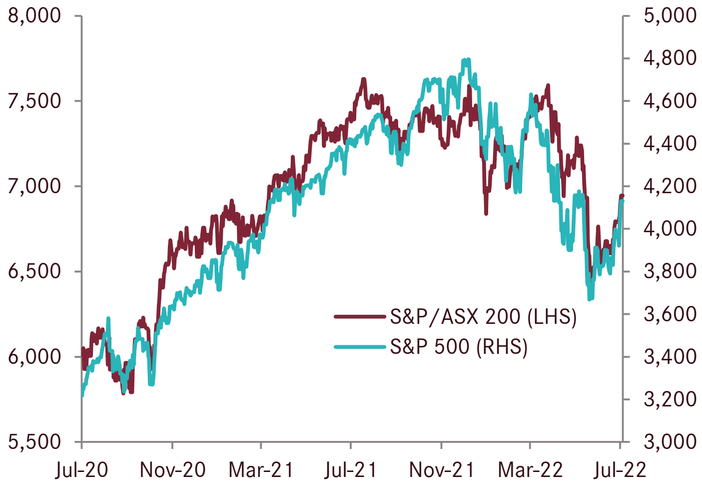
The latest US GDP data revealed that the US economy entered a 'technical recession', contracting 0.9% over the second quarter compared to a consensus forecast of 0.3%. The decline follows a 1.6% fall over the first quarter, and was attributable to a range of factors, such as reduced investment, lower government spending and decreases in inventories. US inflation, meanwhile, continued to surge, increasing to 9.1% year-on-year to 30 June; the highest level in over 40 years. Energy prices remain the main drivers behind the increase, while the cost of food and shelter also increased by multi-decade highs.

The elevated June CPI print prompted market pricing to consider a 100 basis point hike a realistic possibility at the US Federal Reserve's late July meeting. However, the central bank met consensus and hiked its target rate by 75 basis points for a second straight meeting, lifting it to a range of 2.25% to 2.50%. The Fed's outlook was more sanguine than prior guidance, with Chair Powell expressing more optimism that inflation would be contained without triggering a sharp recession. Additionally, the central bank abandoned forward guidance around rates, suggesting a more flexible approach given uncertainty in outlook and the need to strike a delicate balance in policy stance. While market-implied pricing suggests another 100 basis points of hikes are probable over the remaining three meetings of 2022, rates are now expected to moderate in 2023, with two rate cuts priced in by the middle of the year.

Australia and US Cash Rates



ASX 200, S&P 500 Indices



Source: Bloomberg

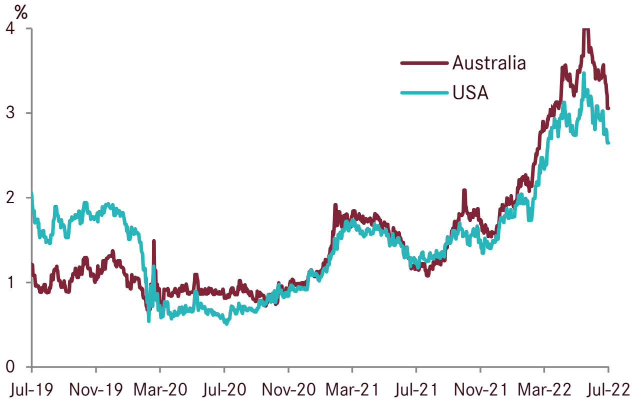
In Europe, the ECB proved more hawkish than consensus, raising its key rates by 0.50% instead of the forecast 0.25%. Concerns around inflation, particularly relating to the uncertainty of gas supplies from Russia in the coming months, prompted the lift in rates, with its key refinancing rate rising from -0.50% to zero. Consensus suggests a further 0.5% hike at its next meeting in September, however the ECB signalled an optimistic outlook given the robust labour market; June unemployment for the Eurozone was steady at 6.6%; the lowest ever for the region. That said, concerns around inflationary pressures and potential recession have weighted on sentiment, with Eurozone purchasing managers' index (PMI) readings continuing to decline to the 50 point mark delineating between a contractionary and expansionary outlook. Meanwhile, the UK is bracing for recession, with the Bank of England hiking rates 0.5% to 1.75% in early August in an attempt to stymie inflation now expected to peak at over 13% in late 2022.

There was political turmoil in Italy, with Prime Minister Mario Draghi resigning following the boycott of a confidence vote by partners in his broad-based national unity government. Draghi's resignation prompted the dissolution of Italian parliament, with snap elections to be held in late September. Polling suggests growing support for far-right, Eurosceptic candidates and the possibility of a populist, anti-EU coalition forming government.

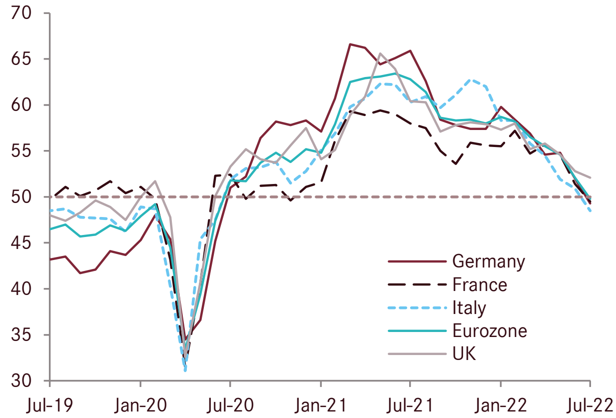
Chinese second quarter GDP data proved disappointing, with 0.4% quarterly growth the second-weakest print in three decades, and well below consensus forecasts of 1.2%. The extended pandemic-induced lockdown in Shanghai was a key factor; likewise, the ongoing weakness in the property sector while regulators seek to temper panic amid a mortgage payment boycott on unfinished dwellings by purchasers unhappy with rising borrowing costs. As a result, the country is expected to fall short of its 5.5% per annum growth target this year – and this was the lowest target in thirty years. Geopolitical tensions also came to the fore at the start of August, with US House Speaker Nancy Pelosi becoming the most senior-ranking US politician in decades to visit Taiwan - a move considered inflammatory by the Chinese government. In response, China announced military exercises around the island, including missile tests.

July ended on an optimistic note for risk assets, with the ostensibly softer tone from Fed Chair Powell suggesting a reduced risk of policy overtightening in the near-term, driving up equities values and reducing both bond yields as well as credit spreads on corporate bonds in a marked reversal of the prior month's performance. Australian equities increased just under 6% for the month, while hedged developed overseas equities returned 8%. That said, annual returns for both classes remain in negative territory. Emerging market equities continued to struggle amid geopolitical and inflationary concerns, however, returning -1.7% for the month, taking the year-on-year return to -15.8%; Turning to bonds, the US Treasury curve remains inverted, with the 10-year yield around 30 basis points below the 2-year yield at month-end; an inversion reflects expected economic downturn. Having reached nearly 600 basis points at end-June, US high yield credit spreads narrowed on the dovish signalling from Powell, falling a full percentage point to around 480 basis points by end-July. As with equities, the strong July return performance for fixed interest failed to lift year-on-year returns into positive territory; indeed, returns for both local and overseas fixed interest sit at -9% and -5%, respectively.

Australia and US 10 Year Bond Yields



Eurozone Manufacturing PMI



Source: Bloomberg, IHS Markit

Index Returns to 31 July 2022

	MONTH (%)	3 MONTHS (%)	FYTD (%)	12 MONTHS (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	6.0	-6.2	6.0	-2.3
S&P/ASX Small Ordinaries Accumulation Index	11.4	-9.9	11.4	-10.9
International Equities				
MSCI World (ex Australia) Index (hedged A$)	8.0	-1.0	8.0	-7.2
MSCI World (ex Australia) Index (unhedged A$)	6.4	0.6	6.4	-4.4
MSCI Emerging Markets Index (unhedged A$)	-1.7	-4.7	-1.7	-15.8
Property				
S&P/ASX 200 A-REIT Accumulation Index	11.9	-8.4	11.9	-2.1
Australian Fixed Interest				
Bloomberg AusBond Composite Index	3.4	0.9	3.4	-9.1
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	2.3	0.2	2.3	-8.6
Barclay's Global Capital Aggregate Bond Index (hedged A$)	2.5	0.6	2.5	-8.2
Cash				
Bloomberg AusBond Bank Bill Index	0.1	0.2	0.1	0.2
Commodities				
Gold (US$ per ounce)	-3.5	-8.3	-3.5	-4.0
Copper (US$ per metric tonne)	-4.1	-19.0	-4.1	-18.6
WTI Crude Oil (US$ per barrel)	-6.8	-5.8	-6.8	33.4
RBA Index of Commodity Prices (A$)	-7.6	-10.3	-7.6	14.4

Australian Dollar versus Foreign Currencies to 31 July 2022

AUSTRALIAN DOLLAR VERSUS	AS AT 31 JULY 2022	MONTH (%)	THREE MONTHS (%)	FYTD (%)	12 MONTHS (%)
US Dollar	0.70	1.5	-1.8	1.5	-5.1
British Pound Sterling	0.57	1.3	1.3	1.3	8.5
Euro	0.68	4.0	1.6	4.0	10.4
Japanese Yen	93.26	-0.2	1.3	-0.2	15.6

Source: Bloomberg