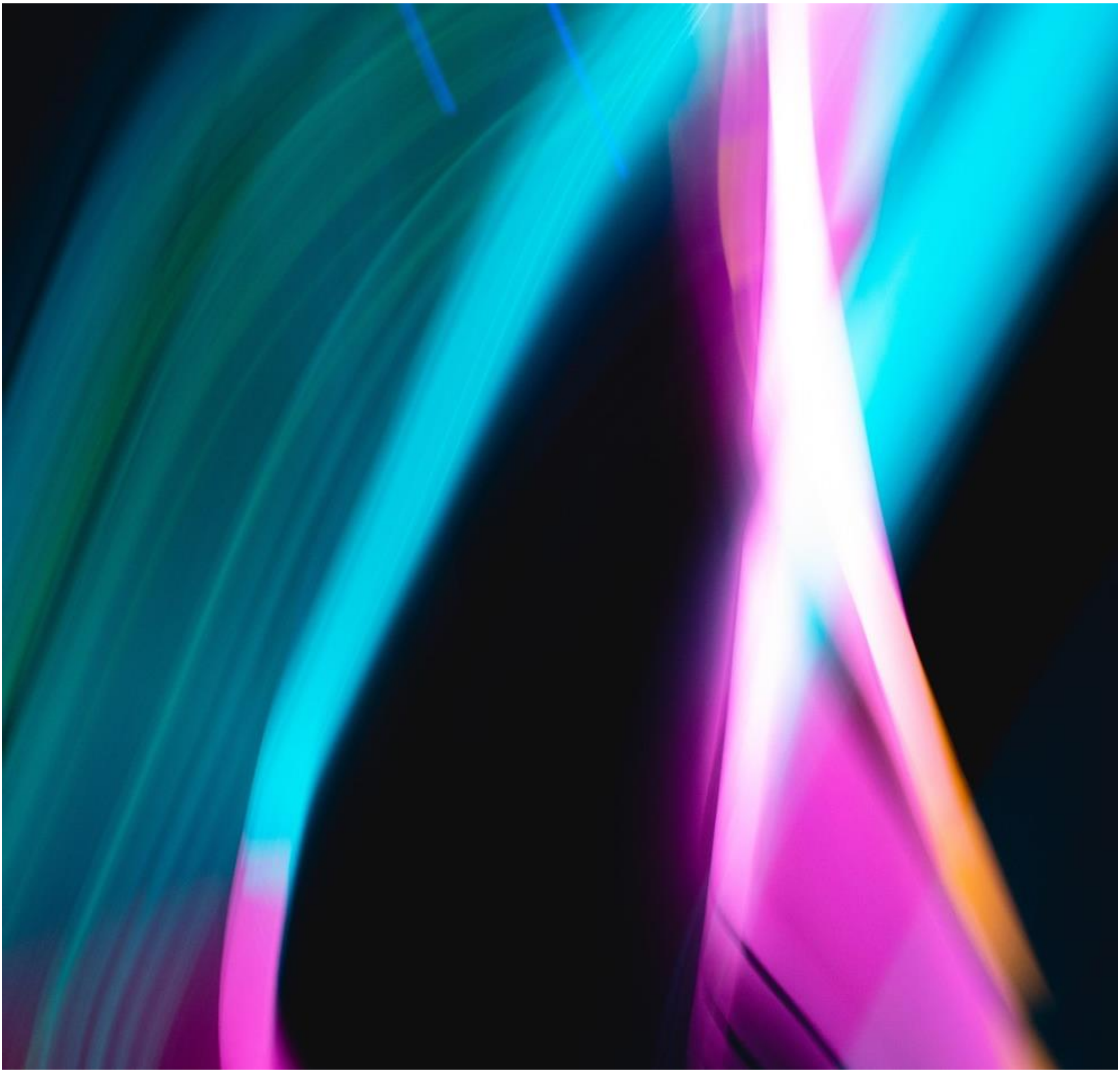
INVESTMENT ENVIRONMENT UPDATE

AUGUST
2022

PATRIZIA ADVISERS



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Prime Super

Investment Environment Update

August saw a moderate reversal of July's risk asset rally, with ongoing inflationary pressures, rising concerns over the supply of Russian gas to Europe and hawkish signalling from the US Federal Reserve all weighing on investor sentiment. Risks of an emerging wage-price spiral have prompted central banks in a number of countries to hike rates at a rapid pace; over the past month the Reserve Bank of Australia (RBA) and Bank of England have lifted rates by 0.5%, while the European Central Bank (ECB) and Bank of Canada hiked by 0.75%; likewise, the US Federal Reserve's next meeting in mid-September is expected to produce a similarly hawkish outcome.

In Australia, unemployment data reached a fresh near-fifty year low and second quarter GDP proved robust, while a recent increase in COVID-19 cases eased as winter drew to a close. However, continued rate tightening has started to weigh on consumer sentiment, while the fall in house prices continues to accelerate. Second quarter Australian GDP was in line with consensus, rising by 0.9% for the three months to 30 June, taking the annual figure to 3.6%. Household consumption was the major tailwind underpinning the strong figure, rising 2.2% quarter-on-quarter, with services spending rising 3.6%. The post COVID-19 economic reopening was reflected in hotels, cafes and restaurant consumption rising 8.8% and recreation increasing 3.6%; albeit both paling in comparison to transport spending, which soared over 37%. Higher consumption was supported by both increased nominal employee compensation (up 2.4%) and a decline in the household saving ratio by 2.4% to 8.7% (compared to a ratio of nearly 20% in September 2021 during the height of delta strain-related lockdowns). That said, rising prices are apparently starting to impact some segments; there was a 1.2% fall in supermarket and specialty store spending. Additionally, while the household saving ratio is now normalising, persistent increases in living expenses may deplete savings further and place greater strain on household finances over time.

Asset Class Returns	August (%)	3 Months (%)	12 Months (%)	3 Years (% p.a.)
Cash	0.15	0.33	0.37	0.36
Australian Fixed Interest	-2.54	-0.76	-11.50	-3.14
Overseas Fixed Interest	-2.72	-1.93	-10.53	-2.66
Australian Equity *	1.18	-2.41	-3.67	5.64
Developed Overseas Equity (unhedged) *	-2.54	-1.11	-9.62	8.21
Developed Overseas Equity (fully hedged) *	-3.57	-4.33	-12.84	8.13
Emerging Markets Equity (unhedged)*	2.21	-2.15	-16.64	2.14

The RBA met market expectations at its early September meeting, lifting the official cash rate by 0.5% for the fourth straight month, taking the target rate to 2.35% - its highest level since February 2015. The RBA's language suggested that it now considers rates to have reached 'normalised' levels. This was reinforced by Governor Lowe's post-meeting commentary, suggesting that hikes may soon revert to 25 basis point increments. While this guidance was interpreted as somewhat dovish and led to a slight downward adjustment in market-implied rate forecasts, the central bank is still expected to tighten rates further; as at early September, nearly 1.0% of further hikes are priced in for the remainder of 2022, with the expected terminal rate expected to exceed 3.5% in early 2023. The RBA has also noted that tightness in the labour market suggests further wage pressures, while it expects CPI to hit 7.75% by the end of 2022, easing to just over 4% by end-2023, and around 3% over 2024 – all above the central bank's target range of 2% to 3%.

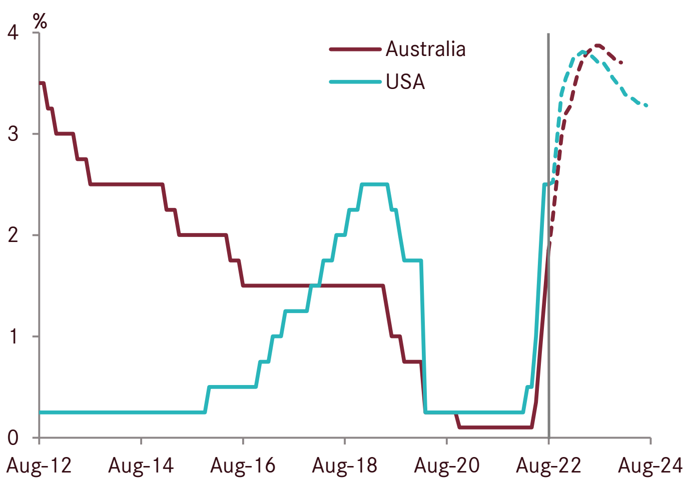
The nation's housing sector continued to decline over August, with all capital cities now recording negative monthly growth, and CoreLogic's national gauge falling by 1.6% for the month - the sharpest fall in 39 years. The largest market of Sydney recorded the largest monthly fall of 2.3%, with prices now down 7.4% since early 2022. Housing finance approvals are also pointing to a further downturn, falling 8.5% for the month.

The latest jobs data reflected continued improvement, with the unemployment rate for July falling 0.1% to a 48-year low of 3.4% amid ongoing low migration and labour shortages as the economy continues its recovery from pandemic-induced lockdowns. This is expected to continue, with RBA forecasts suggesting a rate of 3.25% by the end of 2022. While overall wage price growth has yet to rise significantly in the wake of this tightness, it is evident an increase in employee compensation is gaining momentum; private sector workers who received pay rises during the prior quarter noted a 3.8% increase in remuneration – the highest in a decade.

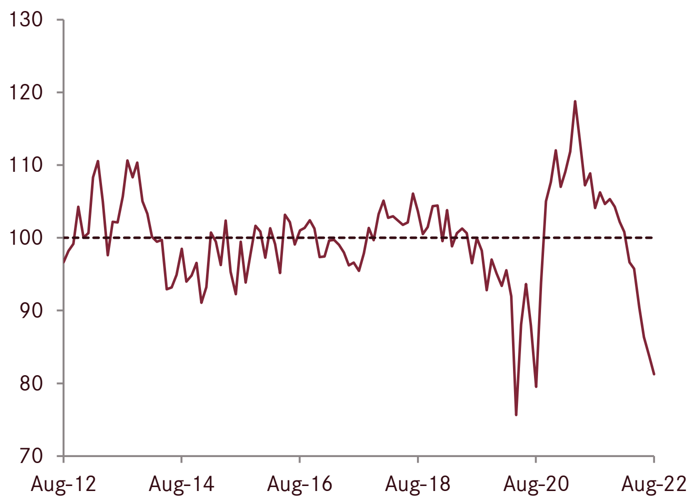
Sentiment data continues to weaken. The Westpac-Melbourne Institute consumer sentiment survey declined further to a reading of 81.2; 23% down from its November 2021 high, and the lowest since August 2020, driven by declines in those with a negative outlook on the economy's prospects and consumer spending on major household items. That said, NAB survey business conditions and confidence readings for July were relatively sanguine, with earlier stimulus and the economic re-opening tempering the perceived impact of cost pressures and tightness in the employment market.

In Europe, the economic impact of the conflict in Ukraine remains front of mind. In early September, Russia indefinitely suspended the flow of gas through the Nord Stream 1 pipeline, ostensibly citing 'technical faults'. The move followed a decision hours earlier by G7 countries to proceed with plans for a price cap on Russian oil exports in an attempt to stymie Russian government revenue. The decision to switch off the pipeline increases fears of further gas supply reductions as winter approaches.

Australia and US Cash Rates



Westpac-Melbourne Institute Consumer Sentiment



Source: Bloomberg

Inflation in the Eurozone remains significantly elevated, with headline CPI rising to a fresh record high of 9.1% in August, driven mainly by soaring energy costs, which have spiked by nearly 40% year-on-year, while food, alcohol and tobacco increased by just over 10% over the same period. Similarly, core inflation surged to an annual rate of 4.3%. In the UK, inflation reached 10.1% year-on-year, with core inflation rising to 6.2%, reflecting the broad-based nature of elevated prices.

The rising inflationary risks in Europe, including the possibility of a de-anchoring of expectations, prompted the ECB to hike rates by a record 0.75% in early September, following the unexpectedly hawkish 0.50% increase in August, taking the policy rate from 0% to an eleven-year high of 0.75%, and signalling further hikes to come. The ECB now anticipates headline inflation to exceed 8% in 2022 and remain above the target to end-2024 at the earliest. Rising inflation has been a key driver behind a continued decline in sentiment indicators, with the IHS/Markit manufacturing PMI readings in contractionary territory across the Euro Area for a second straight month, while the UK also entered the sub-50 range.

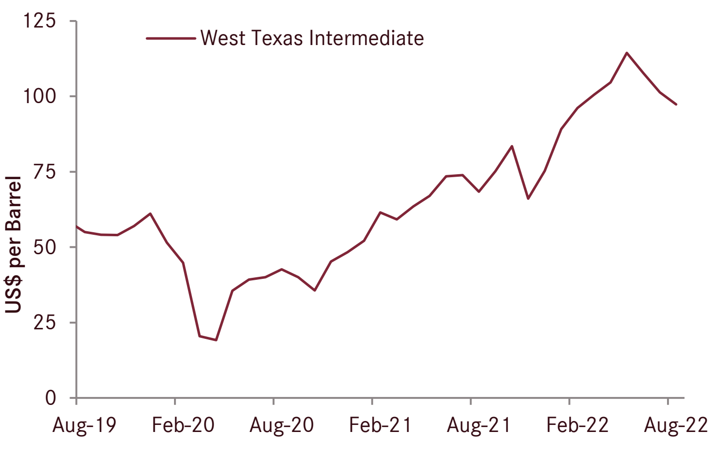
The commencement of a tightening cycle by the ECB to combat surging inflation has led to a significant decline in the value of negative-yielding debt across the Eurozone; by end-August, only EUR543 billion of government bonds in the area were negatively-yielding, the lowest level since 2016, and constituting around 7% of the regional sovereign bond market's worth; by comparison, in late 2020 around 75% of all Eurozone sovereign bonds carried negative yields.

In the US, CPI data for July was a weaker than expected 8.5% year-on-year, with core inflation at 5.9%, and with declines in over one quarter of the measure's primary components. While the print suggested inflation may be peaking, there was a hawkish pivot from the Federal Reserve's Chair Jay Powell at the Jackson Hole symposium in late August in which he cautioned against prematurely loosening settings and stressed the importance of driving down inflation, even if it requires a prolonged period of above-neutral rates. Markets are pricing in a 0.75% increase at the September meeting, with a forecast end-2022 target rate of 3.75% to 4.00%. Meanwhile, US jobs data proved mixed. Private sector data from ADP indicated just over 130,000 new jobs were added in August, well below forecasts, and the unemployment rate edged up 0.2% to 3.7%. However, non-farm payrolls slightly beat consensus to rise by 315,000 for the month.

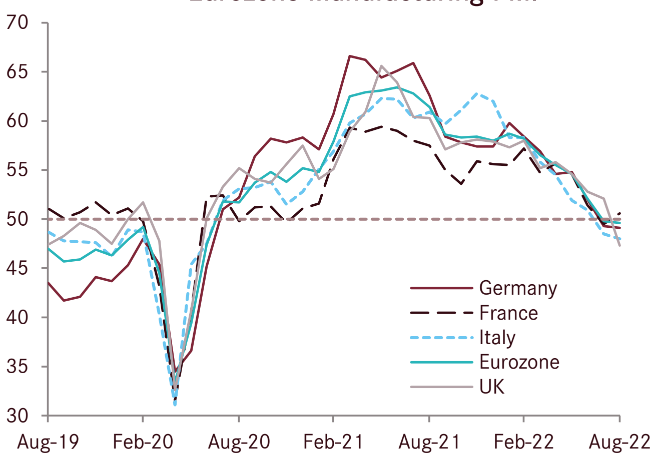
Chinese economic data was weak overall, with COVID-19 outbreaks continuing to wreak havoc, including in Hainan, which is popular with domestic tourists and therefore risks leading to further outbreaks across the country. Annual CPI inflation increased over July to 2.7%, however remains low by global standards, while the local official manufacturing PMI remains contractionary in its outlook. There has also been little progress in resolving 'mortgage strikes' by purchasers of off-the-plan real estate from developers experiencing financial difficulties, leaving the nation's property sector in a precarious position.

The hawkish signalling from Jay Powell at Jackson Hole and threat of a more persistent surge in energy-driven inflation in Europe led to developed overseas equities falling over August, recording a -3.6% return on an AUD-hedged basis. That said, the Australian economy's strong commodities sector offered insulation during the month, with domestic equities returning 1.2%. Higher inflation expectations and central bank rate hikes led to an increase in rates across the yield curve, with Australian and overseas fixed interest returning -2.5% and -2.7% for the month, respectively. Oil prices eased over the month, with the price of West Texas Intermediate falling over 9% for the month, and falling 22% over the past three months. Nonetheless, prices remain above pre-Ukraine conflict levels, and are still up 31% for the year (all in US dollar terms).

Oil Prices (WTI, US$ per Barrel)



Eurozone Manufacturing PMI



Source: Bloomberg, IHS Markit

Index Returns to 31 August 2022

	MONTH (%)	3 MONTHS (%)	FYTD (%)	12 MONTHS (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	1.2	-2.4	7.2	-3.7
S&P/ASX Small Ordinaries Accumulation Index	0.6	-2.6	12.1	-14.7
International Equities				
MSCI World (ex Australia) Index (hedged A$)	-3.6	-4.3	4.1	-12.8
MSCI World (ex Australia) Index (unhedged A$)	-2.5	-1.1	3.7	-9.6
MSCI Emerging Markets Index (unhedged A$)	2.2	-2.1	0.5	-16.6
Property				
S&P/ASX 200 A-REIT Accumulation Index	-3.5	-3.2	8.0	-11.1
FTSE EPRA Nareit Developed ex Aus Rental hedged AUD	-6.0	-7.0	1.7	-15.1
FTSE EPRA Nareit Developed ex Aus Rental unhedged AUD	-4.9	-3.8	1.4	-12.1
Australian Fixed Interest				
Bloomberg AusBond Composite Index	-2.5	-0.8	0.7	-11.5
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	-3.1	-2.2	-0.9	-11.2
Barclay's Global Capital Aggregate Bond Index (hedged A$)	-2.7	-1.9	-0.3	-10.5
Cash				
Bloomberg AusBond Bank Bill Index	0.2	0.3	0.3	0.4
Commodities				
Gold (US$ per ounce)	-2.1	-6.7	-5.6	-5.5
Copper (US$ per metric tonne)	-1.5	-17.4	-5.5	-18.1
WTI Crude Oil (US$ per barrel)	-9.2	-21.9	-15.3	30.7
RBA Index of Commodity Prices (A$)	0.8	-20.3	-6.1	18.1

Australian Dollar versus Foreign Currencies to 31 August 2022

AUSTRALIAN DOLLAR VERSUS	AS AT 31 AUGUST 2022	MONTH (%)	THREE MONTHS (%)	FYTD (%)	12 MONTHS (%)
US Dollar	0.69	-1.8	-4.4	-0.3	-6.2
British Pound Sterling	0.59	2.7	3.5	4.1	10.9
Euro	0.68	-0.4	1.8	3.7	10.1
Japanese Yen	95.03	1.9	3.0	1.7	18.4

Source: Bloomberg

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