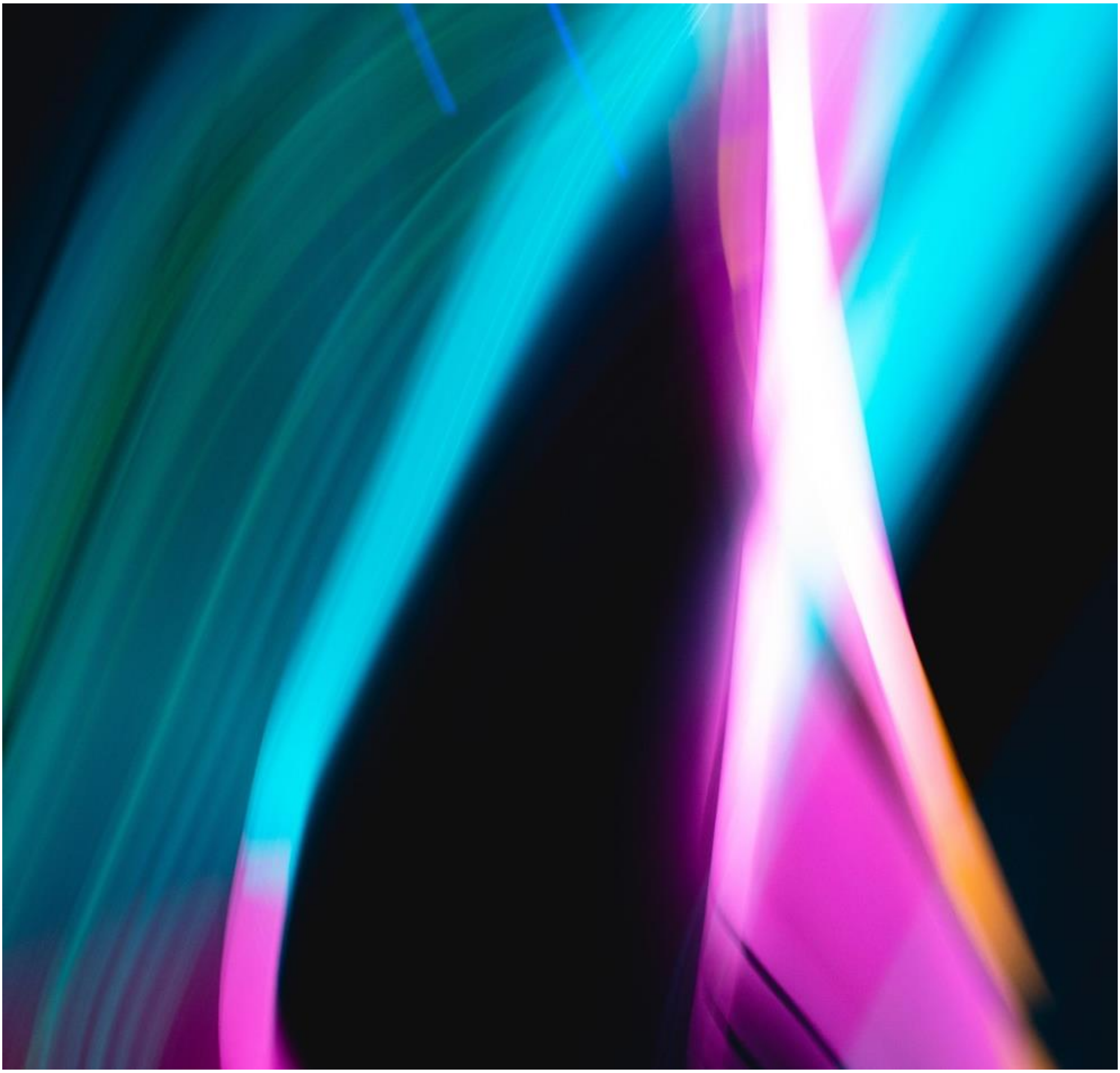
INVESTMENT ENVIRONMENT UPDATE

DECEMBER 2022

PATRIZIA ADVISERS



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Investment Environment Update

2022 drew to a close on a pessimistic note overall, with central banks across a range of developed economies continuing to aggressively tighten policy settings amid persistently high inflation. Chinese authorities' relaxation of COVID restrictions now presents fresh risks of supply chain disruptions amid staff shortages due to illness, while the conflict in Ukraine continued to simmer over the first month of the European winter.

In Australia, the past month was relatively light for economic data, with a better-than-expected November employment print countered by overall weak sentiment as expectations of a looming pause in RBA rate hikes appear to have dissipated for the time being.

Employment data remained robust. November figures beat consensus forecasts, with 64,000 jobs created for the month, while the participation rate returned to an equal all-time high of 66.8%. The unemployment rate held steady at a half-century low of 3.4%, while underemployment edged downward to 5.8%.

With no RBA meeting in January, attention now turns to the February meeting, by which time the fourth quarter inflation print will have been released. After a moderation in expectations of the RBA's terminal rate over November and early December, there was a somewhat hawkish shift at year's end, with market pricing now expecting a higher terminal rate of around 4% by late 2023, suggesting at least another four hikes over the next several months.

Asset Class Returns	December (%)	3 Months (%)	12 Months (%)	3 Years (% p.a.)
Cash	0.25	0.74	1.25	0.55
Australian Fixed Interest	-2.06	0.38	-9.71	-2.87
Overseas Fixed Interest	-1.31	0.64	-12.28	-3.17
Australian Equity *	-3.29	9.13	-1.77	5.51
Developed Overseas Equity (unhedged) *	-5.49	3.95	-12.52	6.22
Developed Overseas Equity (fully hedged) *	-5.19	7.17	-18.06	3.92
Emerging Markets Equity (unhedged) *	-2.63	4.01	-14.33	-1.52

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

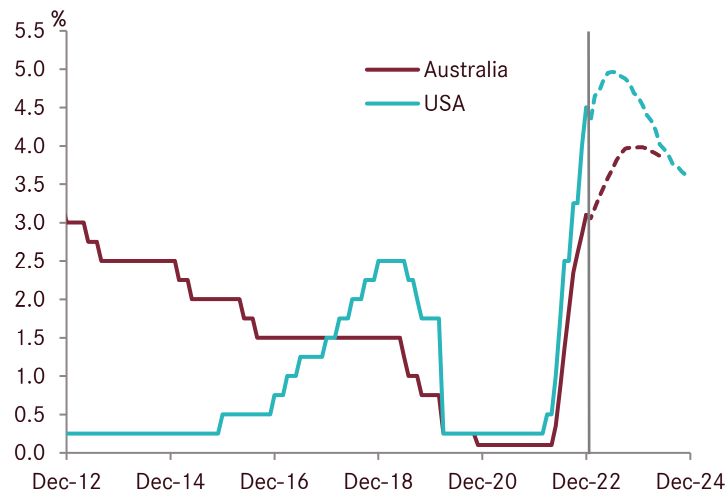
The nation's residential property sector recorded its first negative calendar year for price growth since 2018, with prices across the five mainland capital cities declining by more than 7% over 2022. Sydney – the nation's largest market – has seen house prices fall 13% for the year. After tempering in the spring months, the national rate of decline reaccelerated in December. With the full impact of recent RBA rate hikes yet to filter through to mortgagees and the majority of ultra-low interest pandemic-era fixed rate loans rolling off in 2023, consensus forecasts are for prices to fall further in 2023.

Sentiment indicators remained pessimistic overall. Consumer outlook as recorded by the Westpac-Melbourne Institute survey recorded a 3% increase in November, albeit to a still-low level of 80, which is akin to nadirs reached during the GFC and during the pandemic. Inflation remains the key household concern, with interest rates also weighing on sentiment. Household finances are also well below long-term average levels despite the strong jobs market, with the 'time to buy a major household item' category more than 30% below average. The NAB business survey suggested that the economy continues to gradually slow. Business conditions fell 2 points again in November, albeit taking the overall level to a still very positive +20. Consumer segments as well as business and property eased over the past two months, while capacity utilisation continued to decline from its August peak. Confidence, meanwhile, recorded a four point fall to an overall contractionary reading of -4.

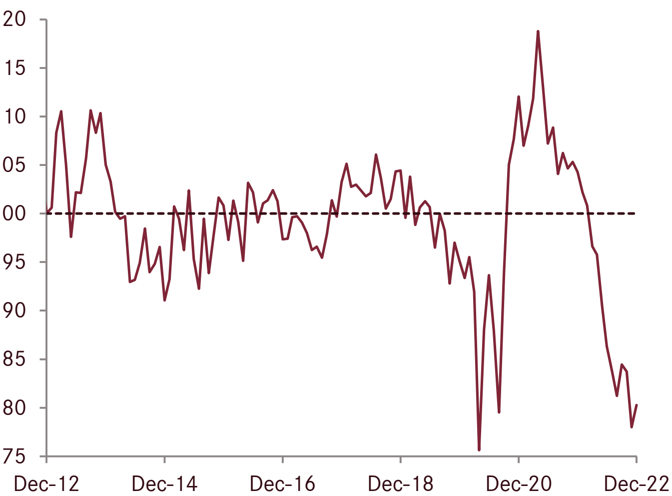
The US Federal Reserve raised rates at its December meeting, lifting the target rate by an as-expected 50 basis points to a fifteen-year high of 4.25% to 4.50%. Officials have indicated that they expect rates to remain elevated over 2023, with no cuts anticipated until 2024 at the earliest. Debate is increasingly turning to when and at what level the Federal Reserve rate will peak, with the 'dot plot' of member expectations suggesting a peak rate of just over 5% in 2023. That said, Chair Powell reiterated post-meeting that decision-making will be data dependent.

In Europe, the ECB also continued to raise interest rates, implementing a 50 basis point increase following two preceding consecutive 75 basis point increases. The main refinancing operations interest rate is now 2.5% - the highest in fourteen years. Tellingly, President Lagarde's post-meeting press conference struck a hawkish tone, noting the need for large, sustained increases to stymie inflation, which the ECB does not expect to return to the medium-term target of 2% at any point in the next three years. Indeed, inflation for November for the Eurozone came in at a revised 10.1% year-on-year, only slightly below the record high achieved the month prior. Energy price increases eased, but nonetheless remain up an enormous 35% for the year to 30 November. Despite the understandable impact of the conflict in Ukraine on energy prices, core inflation – which removes volatile items such as food and energy – remained unchanged at a record high of 5.0%, reflecting the risk of high inflation becoming more entrenched outside supply-side issues. Another sign that inflation is likely to remain more persistent is the continued improvement in jobs data, with the Eurozone's unemployment rate falling to a record low of 6.5%.

Australia and US Cash Rates



Westpac-Melbourne Institute Consumer Sentiment



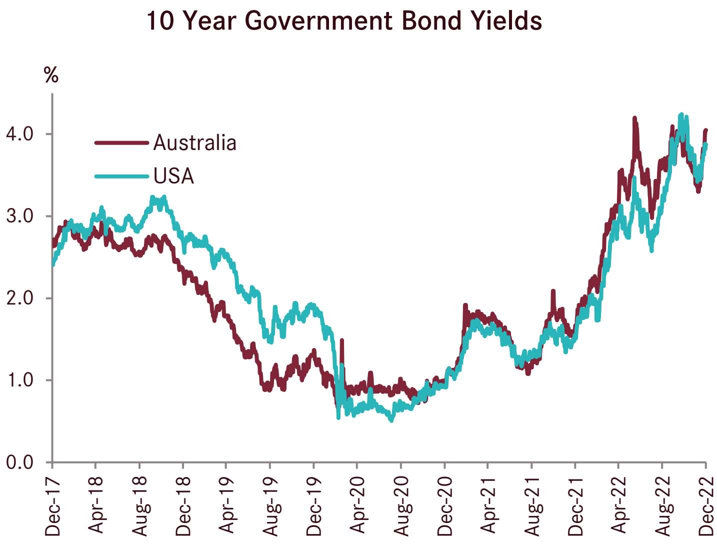
Source: Bloomberg

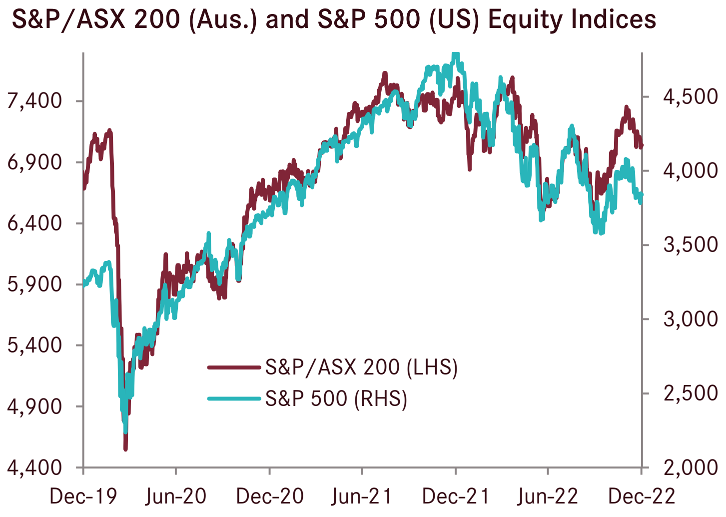
The Bank of England similarly hiked rates at its final meeting in 2022, also slowing the pace of increases to 50 basis points to 3.5% - the highest in fourteen years. The vote was not unanimous, with only 6 voting in favour, while two members voted for no change at all, and one for a more aggressive hike of 75 basis points.

In a major policy shift, the Bank of Japan surprised markets on 20 December by announcing an adjustment to its yield curve control targeting. Expectations had been that no changes would be made to the longstanding strategy for the remainder of Governor Kuroda's tenure, which is set to end in April. The policy tilt – allowing the 10-year bond yield to move 0.5% above or below its 0% target as opposed to the prior 0.25% range – was coupled with an indication that the central bank would materially increase bond buying, suggesting that the decision reflected a calibration of existing policy rather than a tacit withdrawal of stimulus. That said, with inflation in Japan expected to remain at a relatively elevated level above the 2% target rate well into 2023, there may be impetus for further adjustments. The Bank of Japan is the last holdout to normalising policy among major central banks, with all others having embarked on swift tightening over the past year. The decision saw the 10-year Japanese government bond yield rise from 0.25% to nearly 0.50% by the end of December – its highest level since 2015.

In China, Premier Xi flagged that a new phase in its approach to containing the COVID-19 pandemic was commencing. The government abruptly – and uncharacteristically - capitulated to pressure from widespread public dissent against its 'COVID Zero' strategy, which had entailed strict controls on individual movement rather than relying on vaccines produced by western firms. With a revised policy approach that relaxes rigorous lockdowns and mass testing, the country will also re-open to foreign tourists in January. However, by early January it had become apparent that there has been a significant uptick in cases nationally, and the likely impact of millions unwell is expected to impact supply chains and economic output.

December saw the 2022 calendar year draw to a miserable end for both risk and defensive assets. A rally across both equities and fixed interest amid increased expectations of a dovish pivot by central bankers gave way to a sharp downturn as hawkish signalling by the likes of Jay Powell and Christine Lagarde suggested that the battle to contain high inflation remained far from over. With policy settings now expected to be tighter for longer, both equities and fixed interest sold off. Australian and developed overseas equities recorded material negative performance for the month, returning -3.3% and -5.2% (fully AUD hedged), respectively. Local and overseas bonds were similarly poor, recording negative monthly returns that were slightly better at -2.1% and -1.3%, respectively. Both equities and bonds managed to record rare concurrent negative calendar year returns; developed overseas equities were the weakest among major asset classes, returning -18.1% for 2022 on a currency hedged basis; global bonds also posted an exceptionally poor return for the year, returning -12.3%, also fully hedged. The strongest performer over 2022 was cash – after an extended run of poor returns as cash rates were kept at near-zero levels, the pronounced uptick in short-term cash rates amid swift policy tightening led to it being the only major asset class with a positive return, returning around 1.3% for the twelve months to 31 December 2022.





Source: Bloomberg

Index Returns to 31 December 2022

	MONTH (%)	3 MONTHS (%)	FYTD (%)	12 MONTHS (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	-3.3	9.1	9.6	-1.8
S&P/ASX Small Ordinaries Accumulation Index	-3.7	7.5	7.0	-18.4
International Equities				
MSCI World (ex Australia) Index (hedged A$)	-5.2	7.2	1.6	-18.1
MSCI World (ex Australia) Index (unhedged A$)	-5.5	3.9	4.3	-12.5
MSCI Emerging Markets Index (unhedged A$)	-2.6	4.0	-1.6	-14.3
Property				
S&P/ASX 200 A-REIT Accumulation Index	-4.1	11.5	4.0	-20.5
FTSE EPRA Nareit Developed ex Aus Rental hedged AUD	-3.9	4.1	-7.3	-26.3
FTSE EPRA Nareit Developed ex Aus Rental unhedged AUD	-4.2	1.0	-4.6	-21.5
Australian Fixed Interest				
Bloomberg AusBond Composite Index	-2.1	0.4	-0.3	-9.7
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	-2.2	-0.7	-4.9	-13.9
Barclay's Global Capital Aggregate Bond Index (hedged A$)	-1.3	0.6	-3.2	-12.3
Cash				
Bloomberg AusBond Bank Bill Index	0.2	0.7	1.2	1.3
Commodities				
Gold (US$ per ounce)	3.4	8.5	-0.2	0.4
Copper (US$ per metric tonne)	1.6	10.7	1.4	-13.9
WTI Crude Oil (US$ per barrel)	-0.4	1.0	-24.1	4.2
RBA Index of Commodity Prices (A$)	-3.3	-10.4	-10.6	16.6

Australian Dollar versus Foreign Currencies to 31 December 2022

AUSTRALIAN DOLLAR VERSUS	AS AT 31 DECEMBER 2022	MONTH (%)	THREE MONTHS (%)	FYTD (%)	12 MONTHS (%)
US Dollar	0.68	1.3	5.5	-1.4	-6.7
British Pound Sterling	0.56	0.3	-2.1	-0.4	5.0
Euro	0.64	-2.3	-3.2	-3.4	-0.6
Japanese Yen	89.48	-4.2	-3.9	-4.2	6.9

Source: Bloomberg

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