# Monthly Update on the Investment Environment

February 2022

# Market Update

The past month saw continued elevated inflationary pressures globally as the impact of the COVID-19 pandemic continued to ease, with central banks turning increasingly hawkish. While economic data remains broadly positive, it has been overshadowed by the Russian invasion of Ukraine in late February. The mass build-up of Russian troops along Ukraine's border in recent months sadly culminated in a full-scale invasion of the country; an outcome presciently anticipated by US intelligence. What began with Russia's recognition of the independence of two breakaway, Russian-backed, eastern regions of Ukraine quickly turned into an armed invasion of the entire country with the apparent goal to topple the democratically elected Ukrainian leadership and install a Kremlin-friendly puppet.

With direct NATO intervention unlikely owing to the risks of a further escalation in the conflict, the European Union, the US and a number of other nations have united to provide Ukraine with military and humanitarian assistance. Additionally, extreme sanctions unprecedented for a nation of Russia's size have been imposed and are likely to cripple the Russian economy. That said, expected retaliatory measures by Russia are likely to restrict the supply of oil and gas, potentially heightening inflation risks while also curbing global economic growth.

In Australia, the Omicron variant of the COVID-19 virus proved to have a relatively transient impact on the economy, with a sharp fall in cases and deaths over February. Fourth quarter GDP met expectations, offsetting the 1.9% third quarter contraction by rising 3.4%, taking annual growth to 4.2% and total GDP above pre-pandemic levels. Household consumption was the main driver behind the strong recovery. Jobs data again surprised to the upside, with unemployment failing to weaken despite Omicron-related restrictions, while wages increased by an annual 3.0%; the highest pace since mid-2019.

While the RBA made no changes to policy settings at its early March meeting, signaling from Governor Phil Lowe suggested that the RBA would factor in measures other than the Wage Price Index in evaluating wages - a shift likely to reflect higher income growth and strengthen the case for a faster pace of policy tightening; markets are currently pricing in a first hike in the third quarter of 2022.

The US economy continued its run of strong performance. Non-farm payrolls increased by nearly 700,000 jobs over February, while the unemployment rate fell from 4.0% to 3.8% - its lowest level since the pandemic began. US CPI for January, released mid-February, continued to increase, hitting 7.5% year-on-year – its fastest pace in forty years.

The ongoing strong economic data solidified expectations that the US Federal Reserve would hike rates for the first time since 2018 at its meeting on 16 March. Indeed, in recent testimony to Congress, Fed Chair Powell signaled that he would recommend a 0.25% hike at the meeting. While market expectations of the path of rate tightening have eased owing to the geopolitical uncertainty arising from the Russian invasion of Ukraine, market-implied pricing suggests at least six hikes are probable over 2022.

In China, the central bank released its GDP growth target for 2022 - at 5.5%, it is the lowest target in thirty years, with both a local 'zero COVID' approach to the pandemic and easing conditions across the domestic economy both driving the lower target. That said, the target is generally considered ambitious given the challenges the Chinese economy faces.

The ECB made no changes to policy settings, however surprised markets with a hawkish tilt in messaging, avoiding prior commentary of a low chance of rate hikes in 2022. In the UK, the Bank of England hiked rates 0.25% in February amid persistently high inflation and voted to commence reducing its balance sheet.

After paring back most of January's losses over the first three weeks of February, equity markets were rattled by the situation unfolding in Ukraine, driving down developed market equity prices 2.8 % for the month on an Australian dollar hedged basis. The expected imposition of sanctions on Russia bolstered commodity exporters, leading to the Australian dollar's appreciation while also driving down returns for unhedged global developed equity to -5.5%. The expected improvement in commodity demand buoyed domestic equities, which increased 2.1% over February. While benefitting from risk-off sentiment, rising inflation and widening credit spreads provided a headwind for fixed interest returns, with both local and overseas indices posting negative monthly returns.

While considerable uncertainty remains around the duration and outcome of the Ukraine conflict, it is likely to provide a tailwind for commodities as significant segments of the global economy de-couple from reliance on Russian's sizeable commodities sector. The price of brent crude oil reached US$139 per barrel in early March - its highest since 2008. Gold, considered a safe haven asset and an inflation hedge, neared a record high of US$2,070 per troy ounce in early March.

## Table 1: Index Returns to 28 February 2022

| | MONTH (%) | THREE MONTHS (%) | FYTD (%) | ONE YEAR (%) |
|---|---|---|---|---|
| **Australian Equities** | | | | |
| S&P/ASX 300 Accumulation Index | 2.1 | -2.0 | -0.7 | 10.2 |
| S&P/ASX Small Ordinaries Accumulation Index | 0.0 | -7.7 | -4.0 | 5.0 |
| **International Equities** | | | | |
| MSCI World (ex Australia) Index (hedged A$) | -2.8 | -4.0 | 0.2 | 12.3 |
| MSCI World (ex Australia) Index (unhedged A$) | -5.5 | -6.0 | 3.0 | 18.3 |
| MSCI Emerging Markets Index (unhedged A$) | -5.8 | -5.3 | -10.7 | -4.7 |
| **Property** | | | | |
| S&P/ASX 200 A-REIT Accumulation Index | 1.4 | -3.8 | 5.3 | 23.9 |
| **Australian Fixed Interest** | | | | |
| Bloomberg AusBond Composite Index | -1.2 | -2.1 | -3.3 | -1.1 |
| **Global Fixed Interest** | | | | |
| FTSE WGBI ex-Aust (hedged A$) | -1.1 | -3.6 | -2.6 | -2.1 |
| Barclay's Global Capital Aggregate Bond Index (hedged A$) | -1.3 | -3.3 | -2.8 | -2.3 |
| **Cash** | | | | |
| Bloomberg AusBond Bank Bill Index | 0.0 | 0.0 | 0.0 | 0.0 |
| **Commodities** | | | | |
| Gold (US$ per ounce) | 6.4 | 5.8 | 8.3 | 9.6 |
| Copper (US$ per metric tonne) | 4.0 | 4.7 | 5.4 | 8.9 |
| WTI Crude Oil (US$ per barrel) | 8.6 | 44.6 | 30.3 | 55.6 |
| RBA Index of Commodity Prices (A$) | -2.3 | 5.4 | 1.5 | 23.0 |

## Table 2: Australian Dollar versus Foreign Currencies to 28 February 2022

| AUSTRALIAN DOLLAR VERSUS | AS AT 28 FEBRUARY 2022 | MONTH (%) | THREE MONTHS (%) | FYTD (%) | ONE YEAR (%) |
|---|---|---|---|---|---|
| **US Dollar** | 0.73 | 3.0 | 2.3 | -3.3 | -6.3 |
| **British Pound Sterling** | 0.54 | 3.0 | 0.9 | -0.5 | -2.3 |
| **Euro** | 0.65 | 2.8 | 2.6 | 2.1 | 1.3 |
| **Japanese Yen** | 83.58 | 3.0 | 3.8 | 0.3 | 1.3 |