PATRIZIA

Monthly Update on the Investment Environment

January 2022

Prime Super

Market Update

2022 commenced in much the same way as 2021 ended for the global economy - while the COVID-19 pandemic continues to cause a significant health impact across the world, the relatively mild effects of Omicron did little to dampen the ongoing global economic recovery, with a number of developed market central banks striking a more hawkish tone amid surging inflation and strong jobs data. Nonetheless, the recovery is not without its risks, including fresh strains of the COVID-19 virus and escalating geopolitical tensions in Europe amid a potential Russian invasion of Ukraine.

The IMF downgraded its 2022 outlook for global growth in January, cutting forecast GDP growth from its October 2021 forecast of 4.9% down to 4.4%. The most significant downgrade in growth was for the US, which was cut from 5.2% to 4.0%, and largely due to lower-than-expected fiscal stimulus and an expected central bank tightening. The IMF also flagged that a hastened pace of policy tightening would likely trigger further reductions in its growth forecasts.

January saw a significant outbreak of COVID-19 cases in Australia, with the Omicron strain spreading across most states, and daily new cases peaking at 150,000 in mid-January. Despite the case surge, social distancing restrictions have been easing and the local economy remains in solid shape. The fourth quarter inflation print smashed forecasts, with the headline rate rising to an annual 3.5%, while the unemployment rate also beat forecasts, falling 0.4% to a thirteen-year low of 4.2%. The nation's housing bull market continued into the new year, with prices rising 0.8% across the major capital cities in January, with annual growth for homes an exceptional 24%.

The strong Australian economic data releases prompted the RBA to announce an end to its quantitative easing program at its early February meeting, with markets also expecting a swift pace of tightening in 2022, pricing in five rate hikes. This contrasts with the RBA's guidance, which noted that it remains too early to confirm if inflation is 'sustainably' within its target range, albeit acknowledging that there may be conditions under which a single rate hike by end-2022 would be 'plausible'.

The US economy continued to post robust data, with the expected pace of policy tightening increasing further. Fourth quarter GDP beat forecasts comfortably, growing at 6.9% over 2021. Employment data was generally above consensus, with non-farm payrolls rising by 467,000 over January. Inflation continued to rise to levels last seen in the early 1980s; the annual headline rate over 2021 coming in at 6.9%. The jobs and inflation data led the US Federal Reserve to make a hawkish pivot, deciding to reduce asset purchases at a hastened pace, with the program set to end in March and a rate hike considered all but certain at that month's meeting. The Fed's tilt led to markets pricing in at least six hikes as probable over 2022.

After taking an accommodative stance in recent months, the ECB started to make hawkish overtures over the month, with President Lagarde refusing to rule out raising interest rates in 2022, noting the changing economic climate and the fact inflation was nearing the ECB's target level. The Bank of England, meanwhile, met expectations by hiking rates for a second straight month, raising the official cash rate 25 basis points to 0.5%, although the vote was 5-4, with the minority in favour of hiking rates by a more hawkish 0.5%.

Tensions between Russia and NATO over Ukraine remain elevated, with indications suggesting a near-term armed invasion of eastern Ukraine by Russian forces is a genuine possibility. While negotiations and posturing between Russia and NATO continue, energy prices continued to spiral upwards.

Unlike its counterparts in Europe and the US, the People's Bank of China took a dovish turn, cutting the Medium Term Lending Facility rate on loans to financial institutions by 10 basis points, and increasing liquidity of its financial system through repurchase agreements. These dovish policies were echoed by President Xi at the World Economic Forum, warning of serious negative spillovers from rising rates globally.

Rising inflationary pressures and expectations of a hastened pace of policy tightening had a negative impact on risk assets over the month. Australian equities fell nearly 6.5% in January, while fully hedged developed overseas equities fell by over 5%. Growth stocks, the valuations of which are more susceptible to rising base rates, were particularly hit, with technology stocks in particular experiencing significant falls – the Nasdaq Composite index fell 9% during the month.

Rising rates led to a flattening curve as front-end yields spiked, generating negative fixed interest index returns both in Australia and globally. Longer-dated yields also increased, with Australian 10-year government bond yields rising to over 2% in early February; their highest level since early 2019. Similarly, US Treasury 10-year yields passed the 2% barrier for the first time since mid-2019. While credit spreads widened amid the prospect of higher borrowing costs as base rates rise, they remain tight by historical levels.

Table 1: Index Returns to 31 January 2022

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	-6.5	-4.5	-2.7	9.6
S&P/ASX Small Ordinaries Accumulation Index	-9.0	-8.0	-4.0	6.7
International Equities				
MSCI World (ex Australia) Index (hedged A$)	-5.1	-2.8	3.0	18.6
MSCI World (ex Australia) Index (unhedged A$)	-2.2	3.1	9.0	27.3
MSCI Emerging Markets Index (unhedged A$)	1.2	2.2	-5.2	1.0
Property				
S&P/ASX 200 A-REIT Accumulation Index	-9.5	-0.8	3.8	19.0
Australian Fixed Interest				
Bloomberg AusBond Composite Index	-1.0	1.1	-2.2	-3.5
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	-1.5	-1.3	-1.5	-3.1
Barclay's Global Capital Aggregate Bond Index (hedged A$)	-1.6	-1.3	-1.6	-2.6
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.0	0.0	0.0
Commodities				
Gold (US$ per ounce)	-0.6	1.5	1.8	-3.7
Copper (US$ per metric tonne)	-2.2	0.1	1.4	21.0
WTI Crude Oil (US$ per barrel)	14.5	5.5	20.0	68.9
RBA Index of Commodity Prices (A$)	3.6	17.6	6.8	30.9

Table 2: Australian Dollar versus Foreign Currencies to 31 January 2022

AUSTRALIAN DOLLAR VERSUS	AS AT 31 JANUARY 2022	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.70	-3.1	-6.2	-6.2	-8.2
British Pound Sterling	0.53	-2.2	-4.2	-3.4	-6.0
Euro	0.63	-1.7	-3.2	-0.7	-0.5
Japanese Yen	81.18	-3.0	-5.2	-2.6	1.1