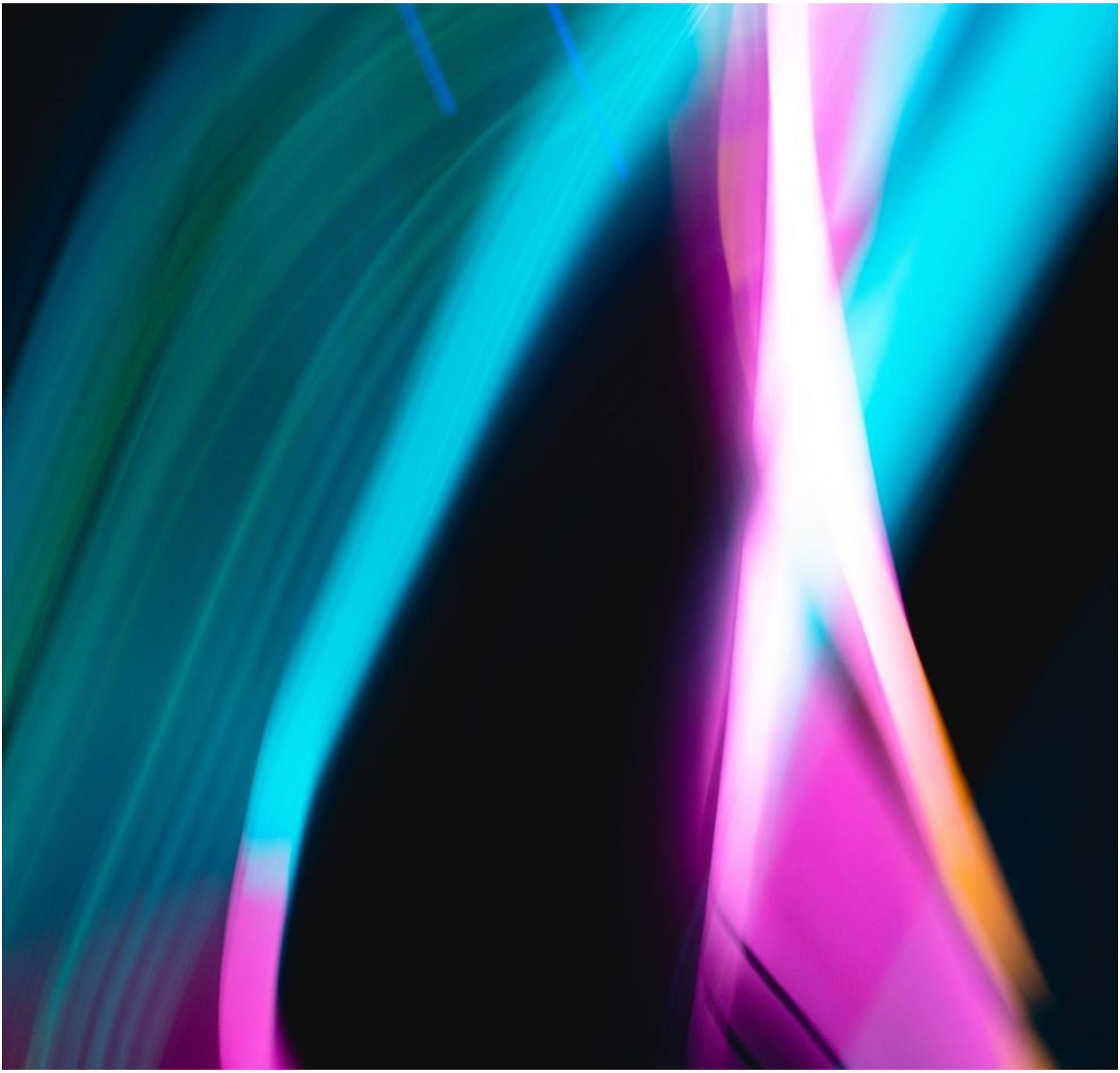
INVESTMENT ENVIRONMENT UPDATE

MARCH
2023

PATRIZIA ADVISERS



PATRIZIA

Prime Super

Investment Environment Update

March proved a mixed one for the global economy. A series of significant liquidity issues caused a handful of banks to collapse in the United States and Europe, however with inflation continuing to ease, market sentiment suggests policy tightening by a number of central banks may be approaching an end, with two central banks of developed economies – the Bank of Canada and the Reserve Bank of Australia - already pausing rate hikes.

The major economic development in March was the sudden collapse of banks on either side of the Atlantic, suggesting the rapid pace of central bank policy tightening over the past year may be starting to cause a degree of stress in the global banking sector. Firstly, the collapse of US-based Silicon Valley Bank was followed quickly by the collapse of another regional American bank, Signature Bank. These collapses were attributable to poor risk management of bank assets, with the banks' investment in long duration US Treasury assets wearing substantial mark-to-market losses as interest rates increased. Meanwhile, in Europe, Credit Suisse's 166-year history came to an end with its negotiated rescue acquisition by fellow Swiss bank, UBS. The collapse followed years of scandals and management troubles, as well as significant depositor withdrawals in late 2022 amid unsubstantiated rumours of looming collapse.

Despite elevated concerns about further bank collapses, by early April it appeared that swift regulatory intervention by American and Swiss authorities had staved off contagion risk for the time being. That said, an unexpected outcome of the absorption of Credit Suisse by UBS was the Swiss regulator's decision to reduce to zero the value of the former's Additional Tier 1 (AT1) securities. A hybrid security, the AT1s rank above equity in the capital structure, and their complete write down while equity holders retained some value of their holdings caused significant investor uncertainty about the risks of similar action should other banks face collapse. A number of regulatory authorities assuaged concerns by assuring investors they would not take the same approach as their Swiss counterparts.

Asset Class Returns	March (%)	3 Months (%)	12 Months (%)	3 Years (% p.a.)
Cash	0.28	0.79	2.04	0.73
Australian Fixed Interest	3.16	4.60	0.35	-2.37
Overseas Fixed Interest	2.11	2.38	-5.48	-2.82
Australian Equity *	-0.24	3.33	-0.57	16.59
Developed Overseas Equity (unhedged) *	3.88	9.20	4.30	12.88
Developed Overseas Equity (fully hedged) *	2.52	7.14	-7.57	15.07
Emerging Markets Equity (unhedged) *	3.74	5.26	0.12	4.64

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

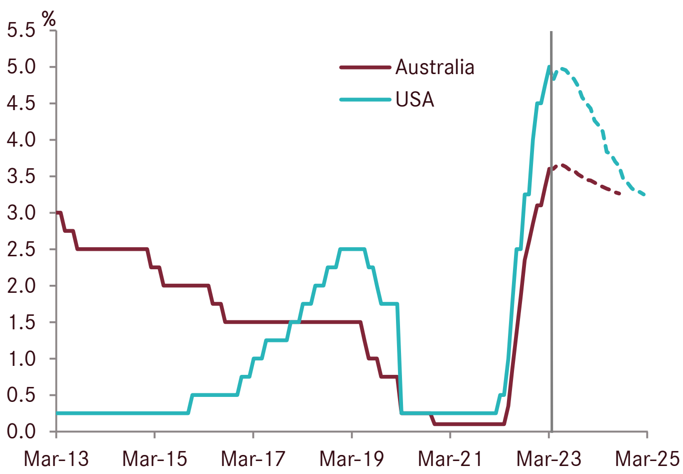
In Australia, February employment data followed indicators from January of a looming improvement due to an above-usual number of workers about to start work – around 65,000 new jobs were added for the month and the unemployment rate moved back down to 3.5% from 3.7%, while underemployment fell 0.4% to 5.8%.

The February monthly consumer price index (CPI) indicator recorded a downside surprise for another month, rising by just 0.2% and bringing the year-on-year rate down from 7.4% to 6.8% - well below the consensus estimate of 7.2%. The deceleration in price growth stands in contrast with the average monthly price increase of 0.9% over the final quarter of 2022, with signs that the slowdown is broad-based across food, transportation and housing. Holiday travel prices, meanwhile, recorded the biggest downside surprise, falling nearly 15% in February after a sharp 7% fall in January. While the monthly inflation reading does not include the full suite of basket components measured in the quarterly gauge, the slowdown in price growth has been a key driver behind the dovish tilt to market rate expectations over March.

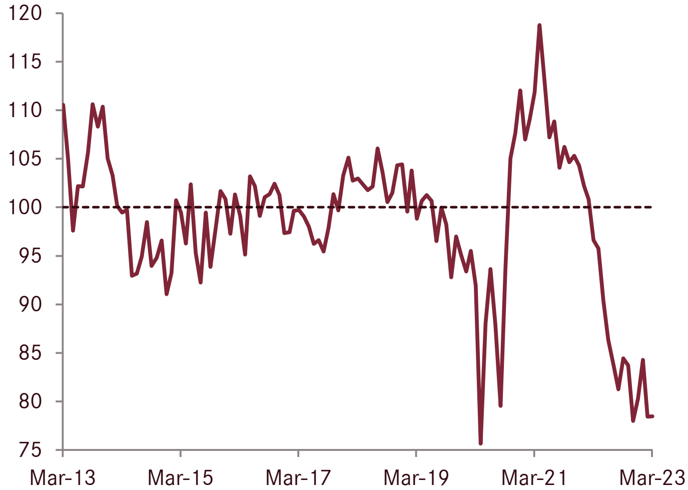
Australian consumer sentiment remains weak. Retail sales met consensus, growing by a subdued 0.2% in February, with increases in clothing, department store and food spending offsetting weakness in other areas. The Westpac-Melbourne Institute index of consumer sentiment, meanwhile, remained steady at a highly pessimistic 78.5, with households rattled by the dual concerns of inflation and interest rates. Homebuying, meanwhile, recorded its weakest reading in 24 years, an outcome somewhat difficult to reconcile with rising optimism about house price increases. Indeed, the RP Data/CoreLogic index posted a monthly return of 0.8% across the eight major capital cities over March – the strongest month since early 2022, and the first positive monthly return in ten months. Low inventory and seasonality are likely factors underpinning prices at a time when loan serviceability and borrowing capacity remain highly constrained relative to a year ago. Business sentiment remains similarly weak, also due to interest rates and inflation – the NAB business confidence survey fell by a hefty 10 points.

The RBA's decision to hold the cash rate steady at 3.60% in early April followed a sharp difference of opinions between cash market traders and many economists. While a number of economists expected the RBA to continue hiking rates, market-implied pricing suggested a pause as probable. Ultimately, it was the market that proved correct, with the RBA noting the lag in transmission of rate increases and a need for additional time to assess the impact of increases thus far. The post-meeting press release cited the effective tightening in financial conditions resulting from banking system problems in the US and Switzerland, while also noting that inflation has likely peaked in Australia. Despite the pause, the RBA did note that it expects some further policy tightening may be needed to drive inflation back to the 2% to 3% target range, with assessment to be undertaken in the coming months. With a pause in hikes anticipated by market consensus, the imminent price impact of the decision saw only a modest rally in both equities and fixed interest.

Australia and US Cash Rates



Westpac-Melbourne Institute Consumer Sentiment



Source: Bloomberg.

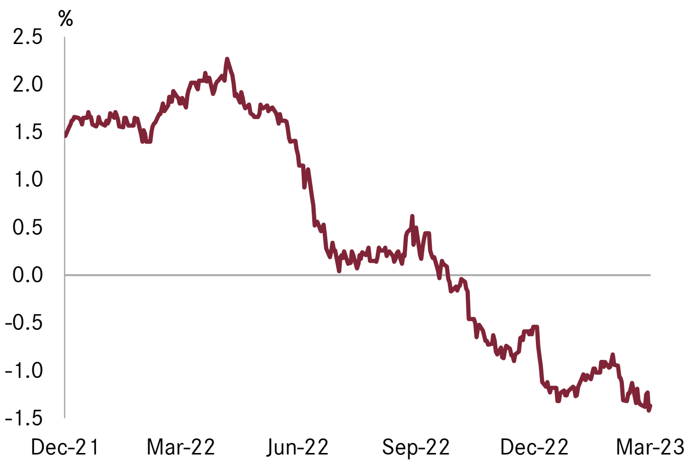
In the US, the Federal Reserve's Open Markets Committee (FOMC) hiked rates 25 basis points to a fresh target range of 4.75% to 5.00% at its mid-March meeting. The move reflected an ongoing commitment by the Fed to contain inflation notwithstanding rising risks within the country's banking sector following the Silicon Valley Bank and Signature Bank failures. Markets are currently evenly split as to whether hikes will pause at the next meeting in early May; that said, directionality in rates in the near term has certainly taken a pronounced downward skew - at least two cuts are priced in as probable by year end, with a target rate of 3.00% to 3.25% considered most likely by the end of 2024. Meanwhile, US inflation data suggests continued easing in price pressures – albeit remaining above the central bank's target rate. Core CPI recorded an upside surprise in February, however the detail revealed this was due to shelter costs, which leading indicators suggest is expected to slow considerably in coming months.

In Europe, the European Central Bank remained resolute in its drive to curb inflation, hiking rates by 50 basis points in March. President Lagarde was adamant in the post-meeting press conference that the central bank and regulators would do whatever is required to avert risks of contagion in the financial system. The Bank of England also raised rates by 25 basis points to 4.25%, though some members voted for a pause in hikes. There was limited concern with the recent surge in inflation – which spiked to a year-on-year 10.4% in February amid the highest food inflation in nearly 50 years - with the central bank expecting a pronounced slowdown in price pressures over the second half of 2023.

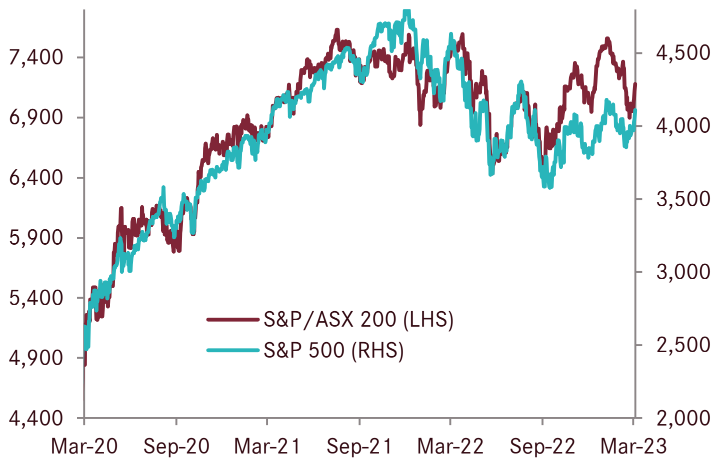
Following the end of its COVID-zero approach, the Chinese economy continues to post positive data. Fixed asset investment recorded an upside surprise, rising 5.5% in the first two months of 2023. The figure was buoyed by residential construction, which materially beat expectations as property sales continued to recover. Retail sales also improved, rising 3.5% in February.

The dovish pivot in the monetary policy outlook over the month proved favourable for fixed interest, with falling yields leading to strong price growth; Australian and overseas fixed interest returned 3.2% and 2.1%, respectively. While Australian equities recorded a minor decline for the month, developed overseas equities also benefitted from expectations of more relaxed policy settings, returning 2.5% on a fully currency hedged basis. The strong positive correlation between fixed interest and equities since the onset of the COVID-19 has continued into 2023 – March quarter returns have been firmly in positive territory across the board. That said, concerns about potential global economic persist and the US Treasury yield curve remains highly inverted – often considered a harbinger of economic contraction.

US Treasury Yield Differential – 3 Month vs 10 Year



S&P/ASX 200 (Aus) and S&P 500 (US) Equity Indices



Source: Bloomberg, St Louis Federal Reserve.

Index Returns to 31 March 2023

	MONTH (%)	3 MONTHS (%)	FYTD (%)	12 MONTHS (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	-0.2	3.3	13.3	-0.6
S&P/ASX Small Ordinaries Accumulation Index	-0.7	1.9	9.0	-13.2
International Equities				
MSCI World (ex Australia) Index (hedged A$)	2.5	7.1	8.9	-7.6
MSCI World (ex Australia) Index (unhedged A$)	3.9	9.2	13.9	4.3
MSCI Emerging Markets Index (unhedged A$)	3.7	5.3	3.5	0.1
Property				
S&P/ASX 200 A-REIT Accumulation Index	-6.8	0.5	4.5	-13.9
FTSE EPRA Nareit Developed ex Aus Rental hedged AUD	-4.0	0.0	-7.3	-23.1
FTSE EPRA Nareit Developed ex Aus Rental unhedged AUD	-2.7	2.2	-2.5	-13.1
Infrastructure				
FTSE Developed Core Infrastructure hedged AUD	2.3	-1.6	-3.0	-10.4
Australian Fixed Interest				
Bloomberg AusBond Composite Index	3.2	4.6	4.3	0.3
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	2.6	2.8	-2.3	-7.0
Barclay's Global Capital Aggregate Bond Index (hedged A$)	2.1	2.4	-0.9	-5.5
Cash				
Bloomberg AusBond Bank Bill Index	0.3	0.8	2.0	2.0
Commodities				
Gold (US$ per ounce)	8.5	9.1	9.0	1.9
Copper (US$ per metric tonne)	0.4	7.4	8.9	-13.3
WTI Crude Oil (US$ per barrel)	-1.8	-5.7	-28.5	-24.5
RBA Index of Commodity Prices (A$)	-1.3	-1.6	-10.0	-3.3

Australian Dollar versus Foreign Currencies to 31 March 2023

AUSTRALIAN DOLLAR VERSUS	AS AT 31 MARCH 2023	MONTH (%)	THREE MONTHS (%)	FYTD (%)	12 MONTHS (%)
US Dollar	0.67	-0.7	-1.2	-2.6	-10.8
British Pound Sterling	0.54	-2.8	-3.9	-4.3	-5.0
Euro	0.62	-3.1	-3.0	-6.3	-8.7
Japanese Yen	89.14	-3.0	-0.4	-4.6	-2.2

Source: Bloomberg