PATRIZIA

Monthly Update on the Investment Environment

May 2022

Prime Super

Market Update

The dominant themes over the month continued to be soaring inflationary pressures, rising interest rates and, in Australia, the result of the federal election. While the global economy continued to post positive data overall, the risks associated with the inflationary pressures and the ongoing conflict in Ukraine suggest that tail risks remain elevated in the near term.

The Australian federal election held on 21 May brought about a seismic shift in the Australian political landscape. The Australian Labor Party, led by Anthony Albanese, secured a majority government, bringing an end to the Coalition Government's nine-year tenure. The defeat was particularly crushing for the Liberal Party as it lost many seats historically considered to be Liberal Party strongholds. However, the headline result was not the only prominent election result – there was a notable swing away from both major parties towards both the Australian Greens and the 'teal' independent candidates. This result reflects that Australians went to the polls wanting more pressing action on climate change, integrity in federal politics and the treatment of women.

The Australian labour market continues to tighten, marked by a 0.1% fall in the unemployment rate to 3.9% in April. Hours worked also increased in April and the underemployment rate fell. Wages recorded a 2.4% year-on-year increase to the end of March. With wage inflation well below the first quarter CPI print of 5.1%, many Australians are experiencing negative real wage growth.

A rate hike from the RBA at its early June meeting was entirely expected, however the central bank surprised markets by implementing a 0.5% hike, rather than the 0.25% increase that was more widely anticipated. The RBA has been slower to act than many other developed market central banks, previously citing that the inflationary pressures have not been as strong domestically as overseas. However, in the corresponding statement to its June rate hike, the RBA noted that inflation is now higher than the central bank had previously anticipated. The impact of higher borrowing rates is already being felt in Australian housing markets, as Sydney, Melbourne and Canberra all recorded falls in dwelling prices in May.

In the US, inflation moderated slightly in April, coming in at an annual rate of 8.3%, down from 8.5% in March. The US labour market continues to show signs of strength, with non-farm payrolls coming in well above expectations, and the unemployment rate remaining steady at 3.6%. However, there are signs that inflation is starting to impact consumers. The savings rate has fallen back to pre-pandemic levels, as the pandemic-related fiscal support has been exhausted and prices are increasing. American retailers such as Walmart and Target have both recently reported significant falls in profit as consumers defer spending on durables (such as electronics and furniture) in favour of everyday essentials. The US Federal Reserve is expected to implement 0.5% rate hikes at both its mid-June and end-July meetings to rein in inflation.

After two arduous months, the strict lockdowns in Shanghai finally lifted at the end of May and were accompanied by significant fanfare from state-owned media, as President Xi hopes to inspire consumer confidence and generate a strong economic recovery. The end of the lockdown supported a rebound in the price of iron ore in early June as there is expected to be a resurgence in Chinese demand for Australian exports.

The economic implications of Russia's invasion of Ukraine continue to be immense across Europe. Inflation in the eurozone in May came in above consensus at 8.1%. While energy inflation of 39% is a significant driver of the overall inflation print, data released this month revealed that industrial producer prices in the EU rose 37% in the year to April, illustrating that inflationary pressures are quickly broadening beyond just the energy price inflation. Commentary from the European Central Bank suggests the central bank could begin raising rates as early as July. In the UK, Prime Minister Boris Johnson's leadership was weakened as he only narrowly survived a no-confidence motion in early June.

Strong inflation prints and hawkish central banks created headwinds for both risk and defensive asset classes over the month. Australian equities fell by 2.8% while developed overseas equity faced a more modest decline of 0.2% on a fully hedged basis. The more significant sell-off in Australian equities can be attributed to the RBA initiating its monetary policy tightening at the start of the month. Australian 10-year government bond yields increased by 0.3% to 3.4% over May, while the US equivalent fell by a modest 0.1% to 2.8%. As a result, Australian fixed interest returned -0.9% for the month, while overseas fixed interest faced a more modest decline of 0.2% on a fully hedged basis.

Table 1: Index Returns to 31 May 2022

	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	-2.8	3.1	2.4	4.7
S&P/ASX Small Ordinaries Accumulation Index	-7.0	-3.6	-7.4	-4.6
International Equities				
MSCI World (ex Australia) Index (hedged A$)	-0.2	-5.0	-4.8	-2.5
MSCI World (ex Australia) Index (unhedged A$)	-0.8	-4.8	-2.0	2.6
MSCI Emerging Markets Index (unhedged A$)	-0.5	-6.2	-16.2	-13.5
Property				
S&P/ASX 200 A-REIT Accumulation Index	-8.7	-7.1	-2.1	3.3
Australian Fixed Interest				
Bloomberg AusBond Composite Index	-0.9	-6.0	-9.2	-8.5
Global Fixed Interest				
FTSE WGBI ex-Aust (hedged A$)	-0.7	-5.7	-8.1	-7.6
Barclay's Global Capital Aggregate Bond Index (hedged A$)	-0.2	-5.1	-7.8	-7.4
Cash				
Bloomberg AusBond Bank Bill Index	0.0	0.0	0.0	0.0
Commodities				
Gold (US$ per ounce)	-3.8	-3.7	4.3	-3.2
Copper (US$ per metric tonne)	-3.3	-4.4	0.8	-7.9
WTI Crude Oil (US$ per barrel)	9.5	19.8	56.1	72.9
RBA Index of Commodity Prices (A$)	1.0	5.2	24.0	33.7

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

AUSTRALIAN DOLLAR VERSUS	AS AT 31 MAY 2022	MONTH (%)	THREE MONTHS (%)	FYTD (%)	ONE YEAR (%)
US Dollar	0.72	0.9	-1.1	-4.4	-7.3
British Pound Sterling	0.57	0.6	5.2	4.7	4.5
Euro	0.67	-0.6	3.7	5.8	5.8
Japanese Yen	92.28	0.2	10.4	10.8	9.0