

Economic and market update

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Key events in December 2022

- Global Shares fell sharply in December to end a miserable year for investors. Wall Street's benchmark S&P 500 index declined by nearly 6% in December while European shares fell by more than 3%. Assertive comments from central banks on the need to raise interest rates as well as recession concerns weighed on global shares.
- Consumer inflation appears to be moderating in the United States with annual inflation at 7.1% in November. However European inflation remains high at 11%. Australia's annual inflation was 6.9% in the year to October.
- Lower global oil prices and shipping costs suggest that global inflation may have peaked, but price pressures are still very evident with rising food costs, residential rents and wages.
- Central banks continue to raise interest rates to reduce inflation. The US and European central banks raised their policy interest rate by 0.5% in December. The Reserve Bank of Australia (RBA) raised the interest rate by 0.25% in December, taking the cash interest rate up to 3.1%.
- Australian shares also made sharp declines in December. All sectors posted negative returns with the sharpest falls were in consumer discretionary (-7%) and information technology (-5.4%) given concerns over profit prospects. Industrials also disappointed with a -4.9% fall given rising interest rates and bond yields. The resources sector was more resilient given rising iron ore prices on China's recovery hopes but still posted a negative -1.4% return.

Asset class summary

Asset class returns in Australian dollars – periods to 31 December 2022

| | 1 month | 3 months | 1 year | 3 years pa | 5 years pa | 10 years pa |
|---------------------------------------|---------|----------|--------|------------|------------|-------------|
| Australian shares | -3.2% | 9.4% | -1.1% | 5.5% | 7.1% | 8.7% |
| Global shares (hedged) | -4.8% | 7.1% | -17.7% | 3.2% | 4.9% | 9.5% |
| Global shares (unhedged) | -5.1% | 4.1% | -12.5% | 5.3% | 8.3% | 12.7% |
| Emerging markets (unhedged) | -2.6% | 4.0% | -14.3% | -1.5% | 1.5% | 5.8% |
| Australian property securities | -4.0% | 11.6% | -20.1% | -0.8% | 3.8% | 8.5% |
| Global property securities (hedged) | -3.8% | 4.0% | -24.2% | -5.6% | -0.4% | 4.6% |
| Global listed infrastructure (hedged) | -2.8% | 6.4% | -4.2% | 1.2% | 4.8% | 8.7% |
| Australian bonds | -2.1% | 0.4% | -9.7% | -2.9% | 0.5% | 2.3% |
| Global bonds (hedged) | -1.3% | 0.6% | -12.3% | -3.2% | -0.2% | 2.3% |
| Global high yield bonds (hedged) | 0.4% | 2.8% | -0.9% | 1.6% | 2.5% | - |
| Australian Inflation-linked bonds | -1.3% | 3.4% | -4.1% | 0.6% | 2.0% | 2.3% |
| Cash | 0.2% | 0.7% | 1.3% | 0.5% | 1.0% | 1.7% |
| AUD/USD | 1.3% | 5.5% | -6.7% | -1.2% | -2.8% | -4.2% |

Past performance is not a reliable indicator of future performance.

Sources: Australian shares - S&P/ASX 200 Total Return Index; Global shares (hedged) - MSCI All Countries World (A\$ hedged, Net); Global shares (unhedged) - MSCI All Countries World in A\$ (Net); Emerging markets - MSCI Emerging Markets in A\$ (Net); Australian property securities - S&P/ASX 300 A-REIT Accumulation Index; Global property securities - FTSE EPRA/NAREIT Developed (A\$ hedged, Net); Global listed infrastructure - FTSE Global Core Infrastructure 50/50 (Hedged \$A); Australian bonds - Bloomberg AusBond Composite 0+ Yr Index; Global bonds (A\$ hedged) - Barclays Global Aggregate (A\$ hedged, Gross); Global high yield bonds (A\$ hedged) - Composite of BCGA US Corp HY BB/B (A\$ hedged) & S&P LSTA BB/B Leveraged Loan Index; Australian inflation-linked bonds - Bloomberg AusBond Inflation Government 0+ Yr Index; Cash - Bloomberg AusBond Bank Bill Index; AUD/USD - WM/Reuters Daily (4 pm GMT).

Key events in global markets over the last three months to December

While the tragic conflict in Ukraine remains troubling, financial markets were becoming more resilient to inflation and interest rate risks in the final quarter of the year. Global shares (hedged) delivered a strong 7.1% return for the three months to December in hedged terms. The sharp revival in the Australian dollar reduced the gain for global shares (unhedged) portfolios to a solid 4.1% return.

Wall Street's benchmark S&P 500 Index delivered a strong 7.4% return, in local currency terms, for the past three months. Inflation appears to have peaked in the United States with annual inflation moderating from 9.1% in June to 7.1% in November. The US central bank also signalled that future interest rate rise will be milder with December's 0.5% increase. Accordingly, investor sentiment has dramatically improved compared to the pessimism of mid-year.

European shares have also recovered despite the Russia-Ukraine conflict, high inflation and rising interest rates. The EURO STOXX 50 Index delivered a very strong 14.2% return, in local currency terms, for the past three months.

Asian share markets have also made strong gains. In the three months to December 2022, in local currency terms, Hong Kong (17.6%) China (12.5%) were boosted by hopes that China's government was ending the 'Zero Covid' lockdowns.

Global bonds (hedged) stabilised after a tough year with a 0.6% quarterly return. Government bond yields have climbed higher this year given inflation pressures.

Global high yield bonds (hedged) made a strong recovery with a 2.8% quarterly return. Investors regained their appetite for yield with optimism that corporate earnings are proving more resilient to inflation and interest rate risks.

Key events in Australia over the last three months to December

Australian shares have also been shaken by global political and inflation concerns this year but managed a very strong 9.4% return for the three months to December. The Utilities sector lead the gains with a very strong 28% return with signs that bond yields were stabilizing. The Resource sector made strong gains (14.7%) given rising iron ore & base metal prices with hopes that China's economic growth could rebound with a less restrictive Covid strategy. The Financial sector delivered a favourable 11% quarterly gain as credit demand remained solid.

Australia's economy appears solid in contrast to the global recession concerns. There have been encouraging results in business surveys and retail spending. Australia's unemployment rate fell to 3.4% in November given solid jobs gains. Yet the inflation acceleration is very concerning with sharp rises in energy and food prices pushing annual inflation to 6.9% in October. This has warranted the RBA raising interest rates from 0.1% in April to 3.1% in December.

Global prospects

The troubling trio of rising inflation, higher interest rates and the war in Ukraine has provided a painful investing climate in 2022. Inflation has risen to multi-decade highs around the world with consumers being squeezed by the higher 'cost of living'. Central banks are rapidly raising interest rates to cool these inflation pressures.

Investors are very worried about whether central banks can safely navigate the challenge of moderating inflation without severely damaging economic activity. As interest rates sharply rise and financial conditions for borrowers become tougher, investors become naturally concerned that a global recession could occur in 2023.

For investors, assessing these considerable inflation and interest rate risks is very challenging. Given the current investment climate is dynamic with multiple positive and negative scenarios possible, investors should maintain a disciplined and diversified strategy to manage these extraordinary risks.

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