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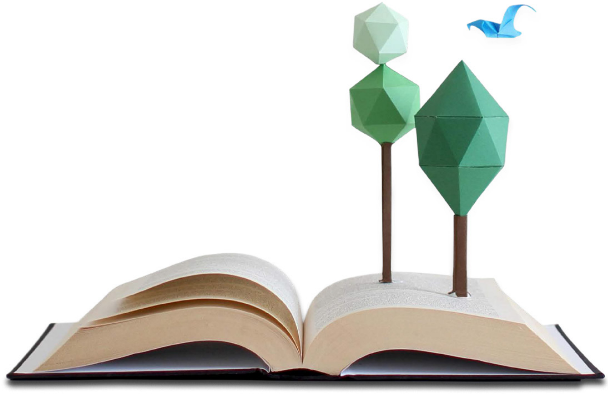
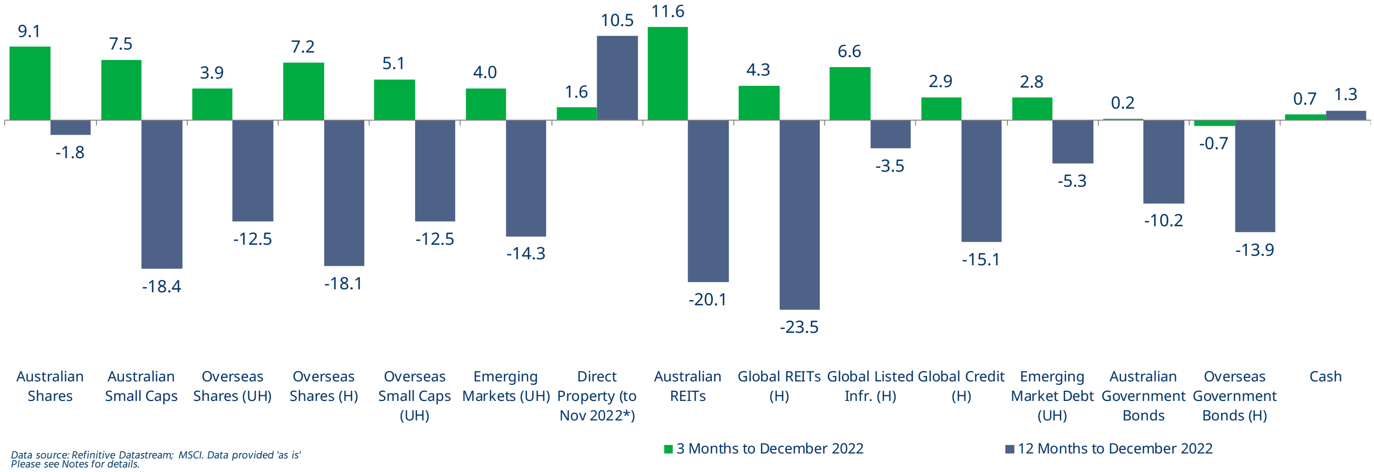
Q4 2022

Market and economic conditions



Selected market indicators commentary

Asset class returns as at December quarter 2022



Data source: Refinitiv Datastream; MSCI. Data provided 'as is'
Please see Notes for details.

The fourth quarter of 2022 began with two strong consecutive months in October and November followed by a selloff in December. Investor optimism seemed to return in October and November following better than expected inflation readings, however, in December sentiment reversed as Central Banks reiterated their commitment to monetary tightening, which clawed back some of the gains established earlier in the quarter.

Hedged Developed Market Overseas Shares returned 7.2% over the quarter as earnings proved to be resilient so far and some signs of declining inflation emerged. Unhedged Overseas shares gains were modest in comparison at 3.9% given the decline of the USD in Q4. Australian Shares also posted strong gains of 9.1% over Q4 given the defensive composition of the index, with large relative weights in materials and financials helping the index outperform its global counterparts. Emerging market equities gains were slightly more subdued at 4.0%, most of the gains coming from Chinese equities in November and December following an easing of COVID restrictions.

Hedged Overseas Government Bonds were relatively muted over the quarter, returning -0.7% as major developed bonds yields increased slightly. Fixed income investors positioned for continued monetary tightening following hawkish guidance from all major central banks. Over the quarter inflation expectations for the US rose, as measured by the 10-year inflation breakeven rate which grew from 2.15% to 2.30%.

Australian shares outperformed hedged overseas shares over the quarter with the ASX 300 gaining 9.1%. The S&P/ASX 50 was the best performing Australian index, gaining 9.7%. The strongest performing sector was Utilities (28.0%) followed by Materials (14.7%), whilst the worst performing sectors were Consumer Staples (1.7%) and IT (1.9%). BHP was the top contributor (21.7%), whilst CSL was the largest negative contributor (1.3%).

Significant Developments

- During its December 2022 meeting, the Reserve Bank of Australia (RBA) decided to increase the current target cash rate by 25 basis points to 3.10% per annum and the interest rate on exchange settlement balances from 2.75% to 3.00%. Inflation in Australia is too high, at 6.9% over the year to October. Global factors explain much of this high inflation, but strong domestic demand relative to the ability of the economy to meet that demand is also playing a role. A further increase in inflation is expected, with inflation forecast to peak at around 8% over the year to the December quarter. Inflation is then expected to decline in 2023. The Bank's central forecast is for CPI inflation to decline over the next couple of years to be a little above 3% over 2024. The Australian economy is continuing to grow solidly. Economic growth is expected to moderate over the year ahead as the global economy slows, the bounce-back in spending on services runs its course, and growth in household consumption slows due to tighter financial conditions. The Bank's central forecast is for growth of around 1.5% in 2023 and 2024. The labour market remains tight and many firms are having difficulty hiring workers. The unemployment rate declined to 3.4% in October. Employment growth has also slowed as spare capacity in the labour market is absorbed. Wages growth is continuing to pick up from the low rates of recent years and a further pick-up is expected due to the tight labour market and higher inflation. The Board recognises that monetary policy operates with a lag and that the full effect of the increase in interest rates is yet to be felt in mortgage payments. Household spending is expected to slow over the period ahead although the timing and extent of this slowdown is uncertain. Another source of uncertainty is the outlook for the global economy, which has deteriorated. The path to achieving the needed decline in inflation and achieving a soft landing for the economy remains a narrow one. The Board expects to increase interest rates further over the period ahead, but it is not on a pre-set course. It is closely monitoring the global economy, household spending and wage and price-setting behaviour. The size and timing of future interest rate increases will continue to be determined by the incoming data and the Board's assessment of the outlook for inflation and the labour market.
- Australian seasonally adjusted employment increased by 64,000 in November, above expectations for an increase of 19,000 and above the prior month's increase of 32,200. The unemployment rate remained the same in November at 3.4%, in line with expectations of 3.4%. The participation rate increased to 66.8%, above expectations of 66.6%. Part time jobs increased by 29,800 and full time jobs increased by 34,200.
- The CoreLogic House price index indicated Australian residential house prices declined by -1.1% MoM to November. Australian building approvals decreased by -9.0% month-on-month to November, compared to the decrease of -5.6% (revised) for October.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 48.4 in December, below consensus for 48.5 and below the 49 recorded in November. The two manufacturing industries that reported growth in December were, Primary Metals; and Petroleum & Coal Products. There were 13 industries that recorded contraction in December compared to November. The ISM Services Index recorded 49.6 in December, below consensus for 55 and below the 56.5 recorded in November. Of the 11 services industries, the top performers were Retail Trade; and Health Care & Social Assistance. There were six industries that reported a decrease in the month of December.
- US Non-Farm Payrolls increased by 223,000 in December, below the 263,000 increase recorded for November. The unemployment rate decreased to 3.5% over December, below expectations of 3.7%.
- US GDP third estimate for Q3 2022 is 3.2% quarter on quarter (QoQ) annualised, above expectations of 2.9%.
- US headline consumer price index (CPI) increased to 0.1% MoM and increased to 7.1% YoY in December.
- The Caixin Manufacturing PMI in China recorded 49 in December, below expectations of 49.1, as COVID-19 containment continues to dampen output at the end of 2022.
- Chinese GDP increased 3.9% YoY for Q3 2022, above expectations for 3.3%. Seasonally adjusted GDP increased 3.9% QoQ for Q2 2022, above expectations for 2.8%.
- The preliminary estimate of the European Core CPI recorded 5.2% over the year to December, above expectations of 5.1%. The unemployment rate increased over the month at 8% in December.
- The Eurozone composite PMI increased to 48.8 in December, above expectations for 47.9.
- The final estimate recorded for Q3 2022 Eurozone seasonally adjusted GDP is 0.3% QoQ and 2.3% YoY.

Australian Equities

Australian shares were positive over Q4 2022 as the S&P/ASX 300 Index returned 9.1% for the period. The S&P/ASX 50 Accumulation Index was the strongest performer for the quarter returning 9.7%, while the S&P/ASX Mid 50 Accumulation was the weakest performer, returning 7.2%.

The best performing sectors were Utilities (28.0%) and Materials (14.7%), while the weakest performing sectors were Consumer Staples (1.7%) and IT (1.9%). The largest positive contributors to the return of the index were BHP, Rio Tinto and CBA with absolute returns of 21.7%, 28.0% and 13.1% respectively. On the other hand, the most significant detractors from performance were CSL, Woolworths and NAB with absolute returns of 1.3%, -1.2% and 5.5% respectively.

Global Equities

The broad MSCI World ex Australia Accumulation Index increased 3.9% in unhedged terms and 7.2% in hedged terms over the quarter, as the AUD strengthened against the USD. The strongest performing sectors were Energy (13.5%) and Industrials (11.8%), while Consumer Discretionary (-7.6%) and Communication Services (-4.8%) were the worst performers. Other global shares indices produced positive results as the MSCI Small Caps Total Return Index returned 5.1% and the MSCI Emerging Markets Accumulation Index returned 4.0% over the quarter.

Over the December quarter, the S&P 500 Composite Index (7.6%) and the Dow Jones Industrial Average increased (16.0%) while the NASDAQ decreased (-1.0%), all in USD terms. European markets experienced positive returns, as the FTSE 100 (United Kingdom) (8.7%), the CAC 40 (France) (12.6%) and the DAX 30 (Germany) (14.9%) increased, all in local currency terms. Equity returns were similarly positive across Asia as the S&P BSE 500 (India) (4.1%), SSE Composite (China) (2.1%), Hang Seng (Hong Kong) (15.0%) and TOPIX (Japan) (3.3%) increased, all in local currency terms.

Real Assets

Domestic listed property experienced strong positive performance over the quarter and returned 11.6%. Global REIT's returned 4.3% (in AUD hedged terms) over the December quarter. The Australian unlisted property sector (NAV) increased 1.6% over the quarter and the FTSE Global Core Infrastructure 50/50 Index returned 6.6% for the quarter in hedged AUD terms.

Fixed Interest

Global sovereign bonds produced mixed returns over the December quarter as ten-year bond yields increased in the US (3bps to 3.83%), Germany (46bps to 2.56%) and Japan (17bps to 0.41%), while decreasing in the UK (-51bps to 3.67%). Two-year bond yields increased in the US (28bps to 4.54%), Germany (98bps to 2.68%) and Japan (8bps to 0.03%), while similarly decreasing in the UK (-57bps to 3.71%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index returned 0.6% and the FTSE World Government Bond (ex-Australia) Index decreased by 0.7% over the December quarter, both on a fully hedged basis.

Domestically, the Australian 10-year bond yield (16bps to 4.05%) and five-year bond yield (1bp to 3.70%) increased, while the two-year bond yield (-9bps to 3.42%) decreased. The Bloomberg Ausbond indices returned broadly positive results over the quarter, with the Bloomberg Ausbond Inflation Index producing the highest quarterly return, returning 3.7%, and the weakest being the Bloomberg Semi-Government Index, returning 0.1%.

Currency Markets

The Australian Dollar (AUD) depreciated against most major developed market currencies over the December quarter. Despite the AUD depreciating against the Pound Sterling (-2.1%), the Japanese Yen (-3.9%) and the Euro (-3.2%), it appreciated against the USD (5.5%). On a trade-weighted basis, the local currency depreciated by 0.2% over the quarter.

Commodities

The S&P GSCI Commodity Total Return Index decreased by 1.9% over the quarter. Gold prices finished the quarter at US$1,815.64 per ounce, increasing by 8.5%. Meanwhile, Iron Ore prices increased by 19.9% to US$117.5 per metric tonne over the period and Oil decreased by 3.7% to US$84.92 per barrel.

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Chart Constituents

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Net Index: Total Return (Net Dividends Reinvested).*
- *Total Return: Total Return Index with Gross Dividends.*
- *Where a lag exists, the performance period start and end dates are shifted accordingly.*

Asset class	Benchmark	Data type
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
Overseas Shares (UH)	MSCI World ex Australia	Net Index
Overseas Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
Overseas Small Caps (UH)	MSCI World Small Cap	Total Return
Emerging Markets (UH)	MSCI Emerging Markets	Net Index
Direct Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian REITs	S&P/ASX 300: Industry Group: A-REIT	Total Return
Global REITs (H)	FTSE EPRA/NAREIT Developed Hedged	Total Return
Global Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Total Return
Global Credit (H)	Bloomberg Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
Overseas Government Bonds (H)	FTSE WGBI Non Australia	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

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- For higher volatility investments, losses on realisation may be high because their value may fall suddenly and substantially.
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