GPS WEALTH

The path to normal will be bumpy.

GPS Wealth Monthly Market Update

Pandemic trauma marked the end of 2021, with Omicron the latest version of COVID sweeping throughout the world. However, beginning in December, investors began to discount the latest wave as more infectious but less deadly and possibly the very thing needed to end the pandemic. Although this would be ideal for herd immunity globally, the low vaccination rates in some countries will ensure that more mutations will occur and consequently economic and market volatility will likely persist in light of new, however, hopefully less virulent strains. Bond markets globally moved rapidly to factor in higher interest rates on the back of persistently higher inflation readings – particularly in the US. In December, the US Federal Reserve announced a doubling of the rate of reduction of money printing per month, essentially ending its quantitative easing programme in March 2022, two months earlier than expected. Projections are now for four interest rate increases in 2022. The central bank signalled one rise in September last year. Things have changed quickly indeed. In the post-meeting statement, the term “transitory”, which had been used to describe the increase in inflation, was removed. Inflation over the year to November was 6.8%. While the US bond market posted a modest gain of 0.3% for the quarter, performance for the year was negative -2.3%.

In Australia the spread of the Omicron variant has been swift and case numbers extremely large. Despite the rapid spread, there is a sense that the economic disruption will be short-lived, even if the healthcare system is currently overwhelmed. Whilst the appetite for lockdowns is virtually non-existent, precautionary behaviour has led to supply disruptions. Interestingly, employment data demonstrates how quickly the economy rebounded. Hours worked and total employment recovered, the unemployment rate fell to 4.6% and underemployment returned to levels where accelerating wage pressures have been observed. Wage growth may begin to level out as immigration is expected to return gradually this year.

In Europe inflation has also increased from 1.3% in March 2021 to 4.9% in November, however the economic recovery has been slower. Although the European Central Bank has argued for a more cautious approach in withdrawing stimulus it has indicated it will end its Pandemic Emergency Purchase Programme by March 2022. In Germany a coalition government was finally formed. Investors

Emmanuel Calligeris
Chairman of the Investment Committee

will monitor fiscal policy be closely as the coalition agreement contains an ambitious agenda for long term investment spending to modernise the economy in areas such as digital infrastructure and energy transition. While this suggests some openness to adjusting its self-imposed fiscal rules, debt discipline remains the primary principle. The European bond markets sold off in December registering a fall of 3.5% for the year.

After a relatively strong export-led recovery in the first half of 2021, China's economy lost momentum in the second half. It grew by 4.9% in the third quarter and decelerated further to 4.0% in the fourth quarter. For the full year, GDP grew 8.1% from 2020. Beijing's regulatory crackdown on the tech and education sectors and the near implosion of one of China's largest property developers – Evergrande – also weighed on the economy as investors worried about financial contagion through the Chinese property markets. China has tried to rekindle growth by lowering interest rates and easing bank-reserve restrictions, as well as easing some curbs on mortgage lending. More decisive growth-supporting efforts are expected. A marginal easing of property policy seems to be underway as the PBoC calls for banks to stabilize mortgage and property-related lending however more needs to be done in order to ease the severe liquidity constraint facing the overall property sector. We don't think the government will stimulate the housing sector as in the past, but conditions are getting ripe to support growth with the easing of stagflation concerns. In addition, the new monetary facility to support decarbonization launched recently can function as a key channel for the PBoC to inject more credit to the real economy.

Global equity markets delivered their third consecutive year of double-digit gains in 2021, with the MSCI World Index returning +21% for the calendar year. The US led global share markets higher in 2021, with the S&P500 recording one of its best years on record with a +29% return, setting fresh record highs throughout the year. The tech heavy NASDAQ index lagged as investors rotated out of riskier names late in the year, as investors started factoring higher interest rates in future. Across the Atlantic the mood was equally buoyant with Europe's Stoxx50 index returning +24%, whilst Japan's Nikkei returned a more modest +7%. At the time of writing global share markets were beginning to sell off in response to some excess valuations, US interest rate policy and political tensions between Russia and the Ukraine.

Similar to global peers, the ASX300 increased 2.7% over the month to be +17.5% higher over the year. The calendar year saw a frenzy of M&A activity as lower interest rates tempted many acquirers to take over companies that looked good on long-term value with 'old economy' companies such as AusNet, Spark Infrastructure, Crown Resorts, Sydney Airport, Z Energy and Australian Pharmaceutical Industries all receiving takeover bids. The Resources sector enjoyed a strong quarter up +9%, primarily driven by the iron ore miners, courtesy of restocking from Chinese steel producers. Base metal and gold miners were also firmer as inflationary expectations continued to increase. The Industrials segment of the market was held back by a poor performance from the Financials sector as the banking sector was sold off on concerns on how earnings are likely to be impacted by a sharp compression in the sectors net interest margins, as record low interest rates and fierce competition in mortgage pricing take their toll. Like moves across the globe, the local Technology sector sold off as investors focused on valuations in the light of a likely rising interest rates. Afterpay, was one of the more prominent victims shedding over -30% of its market value. This was no surprise. The Utilities sector enjoyed a strong quarter with both Origin and AGL rising to reflect expectations for an improvement in electricity prices through 2022. Also buoyant was the Communication Services sector led by Telstra, with the company continuing to benefit from the better prospects for its mobile division and from the company's share buyback. Nine Entertainment continued its strong run with both Stan and Domain continuing to demonstrate very strong revenue growth in the second half of calendar 2021.

Volatility was forecast to increase and it has. It is too early to predict whether the coming tightening cycle will result in a hard landing (recession) where growth assets bear a lot of pain. For now we are witnessing a healthy and overdue correction.

Returns

31st December 2021

ASSET CLASS RETURNS ARE BASED ON

Australian Cash
RBA Bank accepted Bills 90 Days

Australian Bonds
Bloomberg AusBond Composite 0+ Yr TR AUD

International Bonds Hedged
BarCap Global Aggregate TR Hdg AUD

Australian Listed Property
S&P/ASX 200 A-REIT TR

International Property Hedged
FTSE EPRA/NAREIT Dv REITS TR Hdg AUD

Australian Shares
S&P/ASX 200 TR

International Shares
MSCI World Ex Australia NR AUD

Emerging Market Shares
MSCI EM GR AUD

RETURNS TO THE 31ST DECEMBER 2021

	1 Month	3 Months	1 Year	3 Years	5 Years
Australian Cash	0.01	0.01	0.03	0.54	1.06
Australian Bonds	0.09	-1.46	-2.87	2.86	3.36
International Bonds Hedged	-0.44	0.03	-1.53	3.52	3.17
Australian Listed Property	4.88	10.07	26.14	12.87	9.34
International Property Hedged	6.98	12.39	34.54	12.53	7.91
Australian Shares	2.75	2.09	17.23	13.62	9.77
International Shares	1.68	7.19	29.58	20.58	15.08
Emerging Market Shares	-0.65	-1.95	3.44	9.76	9.79

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