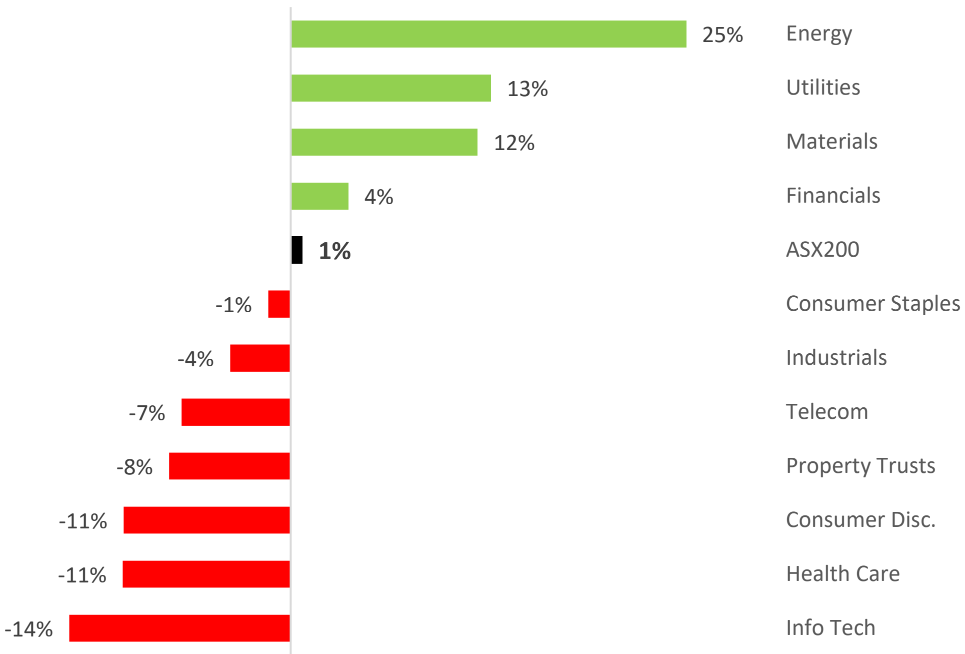
Entrust
WEALTH MANAGEMENT

March Quarter 2022 – Commentary and Outlook

After an incredibly volatile period marked by significant global macro events, the ASX200 emerged from the March quarter with a gain of 0.7%. Most remarkable about this performance was the dispersion of returns across the various sectors. As the below table shows, the Energy, Utilities and Materials sectors delivered strong positive returns offsetting the weak performances of the IT, Health and Consumer Discretionary sectors.



Source: IRESS

The sector dispersion is reflective of the two key macro events that occurred during the period:

1. **The Emergence of Inflation** - In early January, the US recorded annual CPI growth of 7.0%, its highest level in 40 years. Locally, the Reserve Bank of Australia (RBA) had equally been caught by surprise with headline CPI rising to 3.5% over the year to the December quarter. This raises the prospect of interest rates increasing well ahead of the RBA's initial 2024 timeline, with June 2022 the likely start.

   A rising interest rate environment is generally unfavourable for equity markets, as higher interest rates tend to feed into lower equity market valuations. Inflation can also impact on company profitability, subject to a company's ability to pass on increased costs to customers through higher prices.

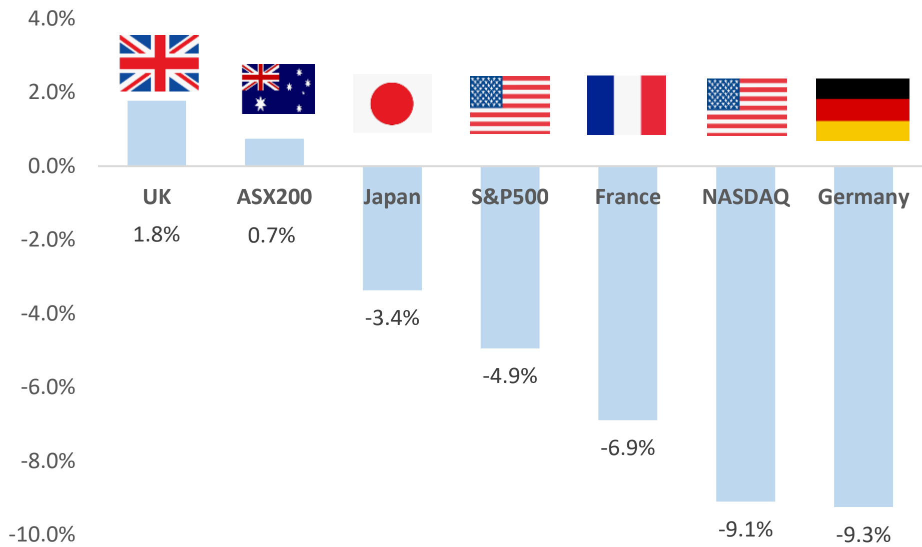
   That being said, some sectors can be beneficiaries of inflation should they have revenue bases with inflation linked increases (e.g. Utilities). Banks can also benefit from a rising interest rate environment due to an increase in the margin they can extract between the rate at which they lend money (e.g. home loans) and that at which they borrow money (e.g. customer deposits). Tempering this to some degree, if interest rates rise too far, to the extent that mortgage stress becomes an issue, this can negatively impact on earnings.

2. **The Russian Invasion of Ukraine** - Further adding to the uncertainty was the invasion by Russia into Ukraine in late February. This has seen a spike in the prices of many commodities for which Russia and Ukraine are major players.

   As a major commodity producing nation, several Australian companies are material beneficiaries of these price spikes, reflected in the strong performance of these sectors in share price terms.

International Markets

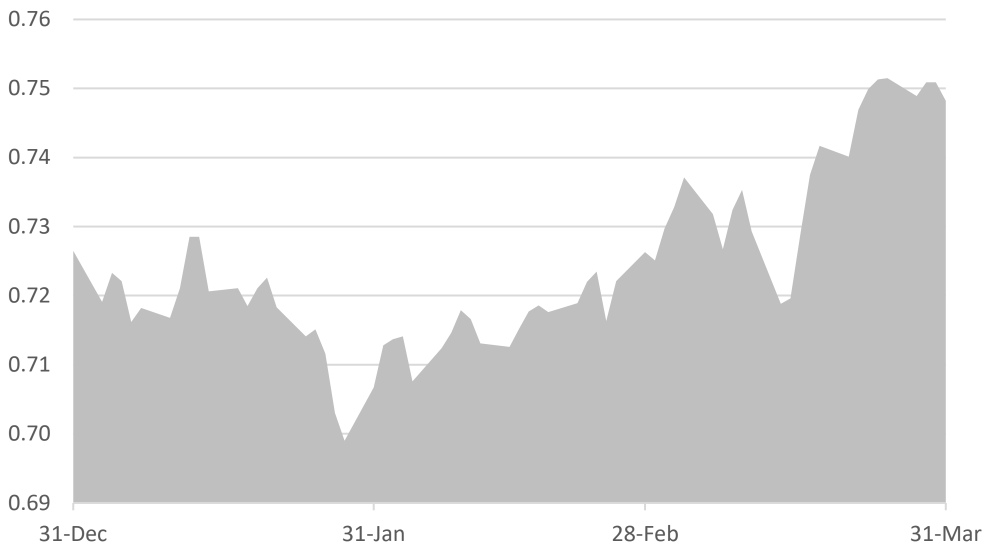
The performance of international share markets over the March quarter is shown below.



In line with the sector discrepancy seen in the Australian market, the UK market (FTSE) has a relatively high weighting toward Energy and Materials companies. The key US markets, the S&P500 and the tech-laden NASDAQ index, finished the March quarter down 4.9% and 9.1% respectively, weighed down by their negligible weightings toward Energy and Materials and much higher weightings toward Technology stocks.

Australian Dollar

The Australian dollar (AUD) strengthened significantly during the period against the US dollar, particularly since Russia's invasion into Ukraine. As a commodity-based currency, at times of strength in commodity prices the AUD has historically performed well.



The other factor to consider here is the path of interest rates in both Australia and the US. In recent days, suggestions that US interest rates may rise faster and further than previously expected has seen a slight reversal in the recent AUD strength.

Outlook

Notwithstanding the major events we have seen during the quarter being negative for global economic growth, equity markets have staged strong recoveries in recent weeks. Weighed against this bounce in equity markets, interest rates are expected to rise materially, leaving the economic outlook somewhat uncertain. This is particularly the case in the US where the economic stimulus delivered over 2020 and 2021 was equivalent to ~40% of GDP. This extraordinary level of stimulus into the economy has seen a surge in inflation with the risk being that this remains stubbornly high for an extended period, potentially requiring interest rate increases above current expectations.

While equity markets, supported by various stimulus measures, have proven very resilient over recent years and they may continue to “muddle through”, we believe that equity market risk lies more to the downside at this time and a slightly more cautious stance is appropriate.

In Australia we see the coming months are likely to be “interesting” from an economic point of view. Inflation has caught the RBA on the back foot so much so that in the next few months we may see our first hike in interest rates since 2010; well before the 2024 expectation that the RBA held until quite recently. Macro events (Russia / Ukraine and COVID lockdowns in China) are having material impacts on supply chains which are likely to feed further into inflation. On top of all of this we have an upcoming Federal election in May.

If you have any queries regarding your reports within, please contact myself and the team.

Kind regards,

Rowan Jones
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