Atchison

Market Review - March 2022

Overview

- Global markets made a negative start to Q1 2022 as the shock of Russia's invasion of Ukraine reverberated around the world
- European markets fell in Q1 2022 in the wake of the Russian invasion of Ukraine, markets experiencing a technical correction (-10%)
- Commodity prices soared given Russia is a key producer of several important commodities including oil, gas, and wheat
- Brent crude and Western Texas intermediate oil prices hit highs in the wake of soaring global energy prices
- US headline inflation hit 7.5%, resulting in further tightening by the US Federal Reserve
- Fight against rampant inflation took a decisive turn as the Bank of England (BoE) raised interest rates for the first time in three years
- Elsewhere, Chinese equities were negatively affected by renewed Covid-19 outbreaks, leading to major lockdowns in some major cities
- Bond yields rose sharply (bond prices and yields move in opposite directions), experienced negative returns due to ongoing inflationary pressure
- March 2022 quarter for the US; S&P, Dow Jones, and NASDAQ was the worst period since the first quarter of 2020
- Conversely, Australian markets were buoyed by the increase in commodity prices, miners, oil and gas producers and agricultural names all benefited from higher prices caused by supply concerns
- The Australian stock market managed to produce a positive return for Q1 2022 of +2.2%, driven by strong gains in Energy, Materials and Financials versus the S&P500 of -3.7%
- March 2022 was the worst month in history for the Aussie bond market, down -3.75%
- 2022-23 Australian Budget allows for more spending and lower budget deficits, temporary cut to fuel excise, more spending on infrastructure and defence and assistance to home buyers

Australian Economy

The NAB quarterly business survey showed a fall in confidence in the March quarter (-5 to an index level of 14) and conditions (-5 to an index level of 9) but both are still above average. The war in Ukraine did not have a material impact on the survey (the first half of the survey sample was taken before the invasion and the second half was taken after). Indicators of capacity utilisation, employment and capex all look high. Indicators around price pressures all look elevated (input prices, prices paid, prices received). Firms are still reporting some difficulty around the availability of materials.

Australian retail sales were strong in February, rising by 1.8% because of a big rise in eating out (as Omicron cases were lower in February versus January) but there was also higher spending in other categories like clothing, department stores and household goods which shows that there is still appetite for retail spending despite very strong growth over the past two years

Building approvals surged by 43.5% in February but have been volatile lately because of one-off approvals for large apartment buildings.

Job vacancies were up strongly over the quarter to February (+6.9%) indicating further strength in the jobs market. Private sector credit was 0.6% higher in February but housing finance (ex-refinancing) fell by 3.7% in Australia, while consensus was looking for a rise of 1.5%.

Home prices in capital cities, according to CoreLogic rose by 0.3% in March, with annual growth slowing to 16.3%. Home price growth in the regions was much stronger, up by 1.7% in March or 24.5% on a year ago.

In respect of the recent 2022-23 Australian Budget announcement, this is very much a pre-election Budget with few direct losers (e.g., tax avoiders) and lots of winners ‐ including low- and middle-income taxpayers, welfare recipients, motorists, first home buyers, parents with young children, older super members, apprentices, builders, small business owners, defence industries, transport users, tourism operators, Koalas, etc.

Global Economy

Ukraine risks remain high. The war in Ukraine does not appear to be going well for Russia with reports that up to four times as many Russian soldiers may have died so far as the US lost in Afghanistan over 20 years. This along with the intense economic pressure from the sanctions along with the devastation in Ukraine may force both sides to accept a peace deal which would see a strong bounce in markets (before they go back to worrying about inflation).

US: The shape of the yield curve (i.e., the gap between long term and short-term borrowing rates) has long been used by economists as a guide to whether recession is imminent or not. When long rates are high relative to short rates it's seen as a sign that it's a good time to borrow short and invest in the economy but when long rates are below short rates it's seen as a bad time to borrow and invest. Many are now pointing to a flattening in the US yield curve as measured by a narrowing gap between 10-year bond yields and 2-year bond yields as a sign that the risk of recession is rising in the US.

However, the more traditional measure of the yield curve which looks at 10-year yields less the Fed Funds rate (or the 3-month yield) is steepening, and this indicator has been seen as a more reliable guide to recessions. So far, it says there is no problem.

Apart from the continuing strength in US business conditions PMIs, jobless claims fell to a new post 1969 low and underlying capital goods orders fell slightly but along with shipments remain in a solidly rising trend in February. Against this new home sales fell. The US housing market like that in Australia remains vulnerable to deteriorating affordability and rising mortgage rates although low levels of listings remain a source of support.

UK and Europe: The latest data for February (which would have captured some of the recent moves in commodity prices) showed that Eurozone headline CPI was running at 5.8% over the year to January 2022 and core inflation was 2.7% higher on a year ago. This is the highest pace of annual growth in consumer prices on record (since the data began in 1997 – just before the Eurozone was created).

High inflation is being driven by steep price rises in electricity, gas, other household fuels and petrol. Food prices have also increased. But broad-based inflation pressures are not as prevalent in the Euro area as they are in the US.

Supporting business conditions, PMIs for March were resilient. They fell slightly in Europe and the UK but remain strong and rose in the US, Australia, and Japan. While the war in Ukraine is a threat, so far economic conditions remain strong. Unfortunately, while order backlogs for manufacturers are continuing to fall, input and output price pressures remain very high.

Europe is expected to be the least insulated from higher prices across the advanced countries because of Europe's reliance on Russia's commodity exports. Eurozone consumer confidence fell sharply in March reflecting the impact of the war particularly via higher energy prices.

UK inflation again rose more than expected in February to 6.2% yoy, with core inflation at 5.2% yoy, maintaining pressure on the Bank of England.

Emerging Markets & Asia: The escalation of the conflict between Russia and Ukraine has led to emerging market nations facing higher input costs as commodity prices soar. This is because the two countries are the leading exporters of a variety of commodities including crude oil, gas, wheat, and nickel. High inflation has prompted some central banks,

such as Brazil, Mexico, and South Africa, to raise interest rates. This will increasingly weigh on growth though, which is already showing signs of slowing.

Nonetheless, commodity exporters have outperformed considerably, notably those native to Latin America. Russia's invasion of Ukraine continued to squeeze global supplies of key commodities, with the prices of the region's top exports, whether oil, copper, soybeans, corn, or iron ore, being pushed up. This is generating strong cashflows and rejuvenating the region's economies. Moreover, the jump in commodity exports provided support to local currencies, all while stock valuations remain attractive.

Chinese markets were impacted by the resurgence of Covid-19 cases. Sentiment was further weakened by the sustained regulatory pressure on internet companies. Some losses were pared though, as China's state council signalled efforts to keep its stock market stable and policy support to improve growth. Nonetheless, China finished the month as the second worst performing emerging market, ahead of Egypt. Elsewhere in Asia, India and Indonesia ended the month positive, while Taiwan, Thailand and South Korea all lagged.

In conclusion: In the short-term, concern over the outlook in Europe could see more downside in global shares (especially in Europe). But in the medium-term, the view is that the conflict will be contained in Ukraine and not spread to NATO countries means that there is an expectation shares to be higher in 6-12 months' time. Potentially over 6 12 months' time, non-US shares will outperform in an environment of rising global yields and a more hawkish US Federal Reserve as well as higher concentration of tech shares in the US share market index which could underperform as rates rise.

Currencies

The Aussie Dollar grew stronger against the major currencies over the month and quarter partially offsetting the rebound in global equities for domestic unhedged investors. The AUD/USD rate closed at 74.82 US Cents, a gain over the month of +3.7%. The AUD against the Euro was up +4.3% and against the British pound +5.6% over the month.

Commodities

Commodity prices continued to rise; Brent Oil moved up US $7 to US$108/bbl on continuing geopolitical tensions restricting supply. Iron Ore climbed US$17 to US$153/Mt as markets expect robust restocking demand post COVID19. Interestingly, Gold rose US$32 in March to US$1,942 continuing from a strong gain in February as investors reduced their safe-haven asset exposure.

Table 1: Market Performance – Periods to 31 March 2022

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	6.9	2.2	15.0	10.6	9.2
Australian Shares Small Ords	5.3	4.2	9.7	9.6	9.9
International Shares Ex-Aus (Unhedged)	-0.8	-8.3	12.1	13.5	13.5
International Shares Ex-Aus (Hedged)	3.1	-4.6	12.0	15.7	12.9
Emerging Markets (Hedged)	-5.5	-9.9	-9.8	3.4	6.7
Emerging Markets (Unhedged)	-2.0	-6.1	-9.6	6.6	7.9
Australian Listed Property	1.2	-7.1	17.7	5.2	7.8
International Listed Property (Unhedged)	-4.7	-4.5	7.9	2.3	6.5
Australian Direct Property	0.4	1.3	2.4	3.4	6.8
Australian Fixed Interest	-3.8	-5.9	-5.6	-0.3	1.9
International Fixed Interest (Hedged)	-2.1	-5.0	-4.0	0.8	2.0
Cash (BAUBIL)	0.0	0.0	0.0	0.5	1.0
		Change over the month			
Australian Govt. 10 yr Bond Yield	2.50	+39 bps			
AUD/USD	$0.75	+$0.03			

Australian Shares (S&P/ASX 200 Accumulation Index)

The S&P/ASX 200 returned +6.9% for the month, +2.2% for the quarter and solid +15.0% for the past 12 months. Strong month returns were driven by a rally in IT (+13.2%), Energy stocks (+9.8%) and Financials (+8.5%).

On face value it seems counter-intuitive that equity prices have rebounded so strongly given an increasingly challenging backdrop of the Ukraine war, rising inflation and central banks tightening monetary policy. Nevertheless, the buoyancy in equities may be explained by several factors. Equities provide investors some protection against rising inflation, notably evident in commodities/energy companies and defensive industrial companies that benefit from pass through price mechanisms. Australian equities continue to deliver strong earnings momentum relative to other global equity markets. Earnings revisions remain positive and the ASX 200 is expected to deliver EPS growth of ~10%+ for FY22. The ASX 200 dividend yield is ~4.1% and ranks as the equal highest in the developed world. Australia's dividend yield has been bolstered by high commodity prices with BHP expected to pay more dividends than the 4 big banks in the 12 months to June 2022

The index finished trading at a P/BV of 2.3x and a P/E Ratio of 14.8x and equity yield (dividend) of 4.6%.

The S&P/ASX 200 VIX was at 12.58. A volatility index at relatively high levels generally implies a market expectation of very large changes in the S&P/ASX 200 over the next 30 days, while a relatively low volatility index value generally implies a market expectation of very little change.

Australian Shares Small Cap (S&P/ASX Small Ordinaries Index)

The Small Ords Accumulation Index returned +5.3% higher in March and +4.2% higher over the quarter. Small resource stocks outperformed industrials by an extraordinary +23.6% over the quarter and by over 50% for the 12 months.

Top performing stocks over the month were: Service Stream, Silver LAKE Resources, Beach Energy and NRW Holdings. Stocks that underperformed included City Chic Collective (-38.2%) 4DMedical (-37.0%) and Wisr (-31.02%).

Trailing P/E Ratio was at 14.3x at the end of the month, P/BV is at 2.0x and equity yield (dividend) of 2.6%.

International Shares (MSCI World ex Australia Index, Net AUD and the MSCI World ex Australia Index, Net LCL)

The MSCI World ex Australia Index (Unhedged) -0.8% for March whilst the MSCI World ex Australia Index (Hedged) returned +3.1%.

Uncertainty around the Ukraine/Russia conflict dominated markets however Energy and Utility companies performed strongly as threats of oil and gas supplies being curtailed pushed prices up.

The index finished trading at a P/BV of 3.0x and a P/E Ratio of 18.8x and equity yield (dividend) of 1.7%.

US market: The US S&P500 Index was down -3.7%, the Nasdaq up -8.2% and the Dow Jones -3.2% for the quarter ended March.

US equities declined in Q1, amplified by existing concerns over inflation pressures, particularly food and energy, although US economic data otherwise remained stable. The US unemployment rate dropped from 3.8% in February to 3.6% in March. Wages continue to rise but have not yet matched the rate of headline inflation. The annual US inflation rate, as measured by the consumer price index, hit 7.9% in February.

The US Federal Reserve (Fed) raised interest rates by 0.25%, with calls from within for more aggressive tightening. Further hikes are expected through the rest of 2022.

Energy and utility companies were amongst the strongest performers in relative terms over the month, outperforming a falling market with modest gains. Technology, communication services and consumer discretionary were amongst the weakest sectors.

UK market: UK equities were resilient as investors began to price in the additional inflationary shock of Russia's invasion of Ukraine. Large cap equities tracked by the FTSE 100 index rose +2.8% over the quarter, driven by the oil,

mining, healthcare and banking sectors. Strength in the banks reflected rising interest rate expectations. The Bank of England moved to hike rates ahead of other developed market central banks.

As the quarter progressed, some of the more traditionally defensive sectors advanced up the leader board. Intermittent fears of a global recession, however, drove periodic selloffs in some of these “safer” stocks too. Market volatility rose given the additional uncertainty related to the Russia/Ukraine conflict.

The Bank of England increased its official rate by a combined 50 basis points (bps) with a further two consecutive 25 bps hikes on top of December’s 0.15% increase. Consumer focused areas underperformed, as did traditionally economically sensitive one. Those parts of the market offering high future growth potential also lagged. These factors combined drove a poor performance from UK small and mid-cap equities.

European markets: Eurozone shares fell sharply in the quarter. The region has close economic ties with Ukraine and Russia, particularly when it comes to reliance on Russian oil and gas.

The invasion led to a spike in energy prices and caused some fears about security of supply. Germany suspended the approval of the Nord Stream 2 gas pipeline from Russia. The European Commission announced a plan – RePowerEU – designed to diversify sources of gas and speed up the roll-out of renewable energy. However, in the meantime there are fears that the high energy prices will weigh on both business and consumer demand, hitting economic activity.

Over the quarter, energy was the only sector to register a positive return. The steepest declines came from the consumer discretionary and information technology sectors. Worries over consumer spending led to declines for stocks such as retailers, while the war in Ukraine also exacerbated supply chain disruption, hitting the availability of parts for a wide range of products.

Japan market: After weakness in January and February, the Japanese stock market rose in March to end the first quarter just slightly below its end 2021 level. This was despite the change in outlook for US interest rates, the outbreak of war in Europe and sharply higher energy prices.

From the start of the year, the tone for the equity market was set by the release of minutes from the US Federal Reserve meeting, and the associated change in expectations for US interest rates. This helped to accelerate a change in market dynamics. In Japan, this was especially evident in the outperformance of value-style stocks at the expense of growth. Much of this relative gain in value stocks was concentrated in financial-related sectors including banks and insurance.

Asian markets: Asia ex. Japan equities experienced sharp declines in the first quarter of 2022 amid a volatile and challenging market environment as Russia launched an invasion of neighbouring Ukraine.

Share prices in China were sharply lower in the quarter while shares in Hong Kong and Taiwan also fell. The number of Covid-19 cases in Hong Kong and China spiked to their highest level in more than two years during the quarter despite the Chinese government pursuing one of the world’s strictest virus elimination policies. The city of Shanghai, China’s financial capital with a population of 25 million people, went into a partial lockdown at the end of the quarter in a bid to curb a surge in Omicron Covid-19 cases, prompting fears that other parts of the country could also go into lockdown.

Share prices in South Korea were also sharply lower in the first three months of 2022 as the Covid-19 pandemic continues to affect economic activity in many parts of the Asia-Pacific region. However, despite the index falling sharply, there were pockets of growth such as Indonesia, which achieved solid gains in share prices during the quarter. Thailand, Malaysia, and the Philippines also moved higher, although gains were more muted.

Emerging markets: Emerging market (EM) equities were firmly down in Q1 as geopolitical tensions took centre stage following Russia’s launch of a full-scale invasion of Ukraine. The US and its Western allies responded with a raft of sanctions. Commodity prices moved higher in response to the war, raising concerns over the impact on inflation, policy tightening and the outlook for growth.

Egypt, a major wheat importer, was the weakest market in the MSCI EM index, due in part to a 14% currency devaluation relative to the US dollar. China lagged by a wide margin as daily new cases of Covid-19 spiked, and lockdowns were imposed in several cities, including Shanghai. Regulatory concerns relating to US-listed Chinese stocks also contributed to market volatility. Poland, Hungary, and South Korea also underperformed.

Conversely, the Latin American markets all generated strong gains, led higher by Brazil. Other EM net commodity exporters posted sizeable gains, including Kuwait, Qatar, the UAE, Saudi Arabia, and South Africa. Russia was removed from the MSCI.

Emerging Markets Shares (MSCI Emerging Markets Index, Net AUD)

Emerging market (EM) equities (Unhedged) was down -5.5% in March and down -2.0% on a hedged basis, underperforming other global indices as signs of strong US growth led to a surge in treasury yields.

Emerging markets experienced a challenging and dramatic series of events in the first quarter of 2022 with signs of the global economy tightening and Russia's invasion of Ukraine. Not surprising Russia was one of the worst performing countries in the index. The best performing sectors included Financials, Materials, and Utilities and worst performing sectors were Energy, Consumer Discretionary, and Healthcare.

The index ended trading at a forward P/E Ratio of 12.5x and P/BV of 2.0x and equity yield (dividend) 2.4%.

Australian Listed Property (S&P/ASX 200 A-REIT Accumulation Index)

The S&P/ASX 200 Property Accumulation index returned +1.2% in March, underperforming the S&P/ASX 200, which returned +6.9%. For the past 12 months, AREITs returned +17.7%, outperforming the broader market, which returned +15.0%.

S&P/ASX Industrial AREITs returned +3.1% in March, S&P/ASX Diversified AREITs returned +0.9%, S&P/ASX and S&P/ASX Retail AREITs returned +0.4%. Key outperformers were HMC (+9.6%), CLW (+5.0%) and GPT (+4.9%). Key underperformers were ABP (-5.7%), CMW (-4.4%) and MGR (-3.9%).

At the end of the month the index was trading on a dividend yield of 3.8% with a P/BV 1.2x and a P/E Ratio 8.2x.

International Listed Property (FTSE EPRA/NAREIT Developed ex-Australia Index, AUD)

Globally, REITs returned +5.5% over the month of March in USD terms but -4.7% on an unhedged basis. The best performing regions over the month were US (+8.0%) and Singapore (+7.1%), worst performing region was Japan (-0.3%).

At the end of the month the index was trading on a dividend yield of 3.8% with a P/BV 1.2x and a P/E Ratio 8.2x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted +1.3% return over 3-month period to 31 March 2022. Investors should continue to see upward revaluation of the direct property sector. Capitalisation rates across property sectors continued to trend upwards. Cap rates across office, industrial and retail properties range are 5%, 4% and 5.3% respectively.

Australian Fixed Interest (Bloomberg AusBond Composite Bond Index)

Australian fixed interest returned -3.7% over the month and -5.6%for the year. The Australian government 10-year bond yield increased by 69bps (June 2022 futures) to 2.90% over March. At this point, 10-year bond yields were 56bps above US 10-year yields (2.34%). 3-year single A corporate credit spreads tightened from 0.71% at the end of February to 0.39% at the end of March.

International Fixed Interest (Barclays Global Aggregate TR Bond Index, Hedged to AUD)

International fixed interest returned -2.1% over the month (in AUD), -5.0% over the quarter and -4.0% for the year. The 10-year US government bond yield increased by 51bps to 2.34% over March and by 93bps over the quarter.

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