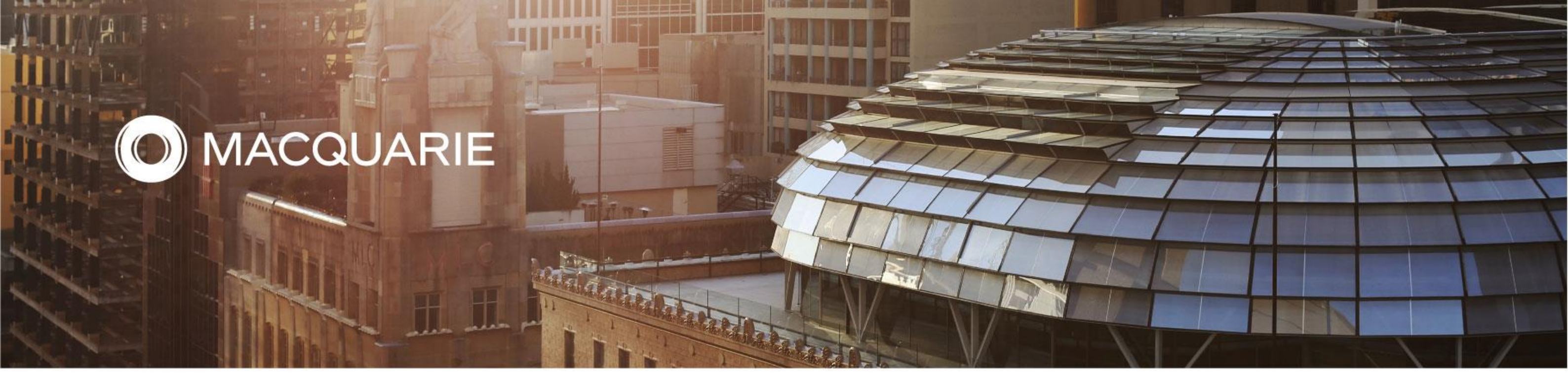
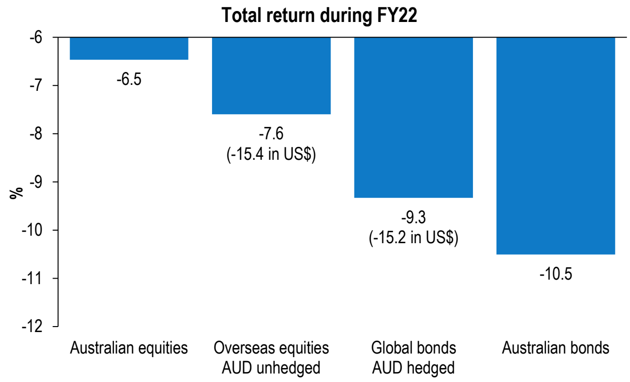


FY22: The year in review

A brutal 2H makes one for the record books

- FY22 witnessed the rare occurrence of both bonds and equities posting large losses, resulting in the worst performance for balanced portfolios since FY09.
- An initially strong first half for the global economy was overshadowed by a surge in inflation, which central banks then scrambled to tame by raising rates earlier and more sharply than initially anticipated. This slowed the global economy in the second half of the financial year but then triggered fears of an impending 'hard landing' or recession.
- Equities, which posted new record highs in early January, subsequently posted heavy losses in the second half of the financial year, driven by valuations compression due to rising interest rates and then by fears of recession.
- Global equities posted an FY22 total return of -15.4% in US$ and -7.6% in A$ with many major indices such as the S&P500 entering 'bear market' territory after falling more than 20% from their peaks in early January.
- The ASX200 index posted a total return of -6.5% over FY22 and fell 16% from its all-time high in August, putting it in 'correction' rather than 'bear market' territory.
- Growth stocks underperformed as they were disproportionately impacted by valuation compression. Energy stocks outperformed due to sharply higher energy commodity prices.
- Rising inflation and central bank hawkishness saw global bond yields jump to multi-year highs, resulting in the worst performance for bonds in decades.
- Commodity prices rose 32% in US$ over FY22 although this was dominated by energy related commodities. Excluding energy, commodity prices rose a more modest 6%.

A bad financial year for major asset classes



Source: Factset, MWM Research, July 2022

Economic backdrop

An initially strong first half…

The global economy started FY22 exceptionally strong, although momentum subsequently slowed as resurgent COVID variants and ensuing lockdowns weighed on the recovery. Nevertheless, the underlying story of the first half of the financial year was one of continued economic growth, albeit at a more normalised pace.

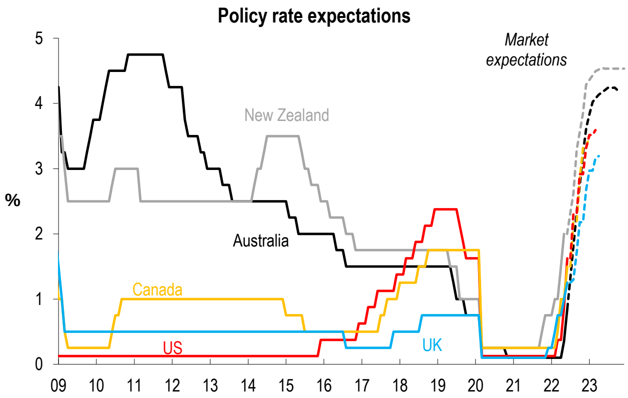
…was overshadowed by a surge in inflation…

However, surging consumer demand combined with pandemic-induced supply side bottlenecks triggered a global supply chain crisis late in CY21. Concurrently, soaring energy prices, particularly in Europe and China, caused an energy crunch. This resulted in the biggest surge in inflation in decades.

…which central banks then scrambled to tame…

The surge in inflation was initially expected to be 'transitory'. However, this proved to be mistaken, with inflation proving to be higher and stickier than previously believed. This saw central banks fall 'behind the curve' and they were forced to raise rates more sharply and earlier than initially anticipated in an attempt to bring inflation under control in the second half of the financial year.

Policy rates set to rise dramatically around the world

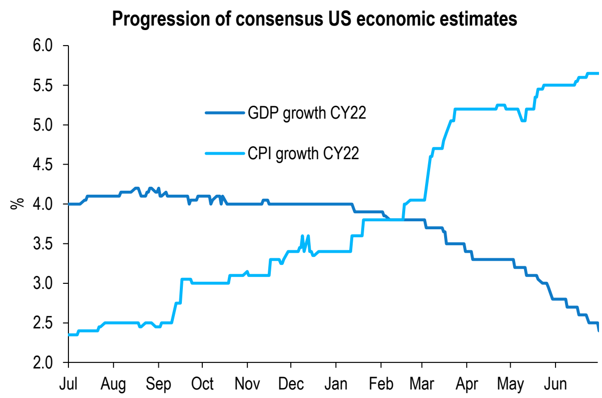


Source: Macquarie Macro Strategy, Bloomberg, July 2022

…slowing the economy…

Sharply rising interest rates, as well as the impact of high inflation, began to slow the economy markedly in the last six months of the financial year. US 1Q22 real GDP contracted for the first time since the pandemic. Consumer confidence plunged as high inflation eroded real incomes. A further hit to the global economy came from the Russian invasion of Ukraine in February, which sparked another sharp rise in energy-related commodity prices and consumer energy bills.

Growth expectations have fallen while inflation expectations have risen



Source: Factset, MWM Research, July 2022

…& raising the risk of recession

Markets became increasingly concerned that central banks would raise rates so sharply to fight inflation that the economy would fall into a 'hard landing' or recession. Underscoring this was repeated statements by US Federal Reserve Chair Jay Powell that the Fed would do whatever it takes to tame inflation. The bond market appeared to be increasingly pricing in this risk, with the yield curve inverting (an event that has historically preceded recessions) in April.

China's economy takes a hit from COVID

The Chinese economy was a laggard as it dealt with the impact of stringent lockdowns stemming from the government's "zero COVID" policy, which resulted in shutdowns of major manufacturing centres. The Chinese authorities responded with various stimulus measures to boost the economy.

Australian economy strong but cracks appear…

The Australian economy performed well over FY22 and maintained momentum towards the end of the financial year. However, the economy was beginning to face a myriad of capacity constraints and inflation began surging albeit less so than overseas.

Cracks began to appear in the previously red-hot housing market as rising mortgage rates, worsening affordability and deteriorating consumer sentiment took a toll. Dwelling prices rose 8.4% over FY22 according to CoreLogic although prices had already begun to fall from their peaks, led by Sydney and Melbourne.

…as the RBA pivots from dovish to hawkish

The RBA abruptly pivoted from saying in October that rates would not go up until 2024 to raising rates by 25 basis points in May (its first rate hike since 2010) and a further 50 basis points in June.

Market backdrop

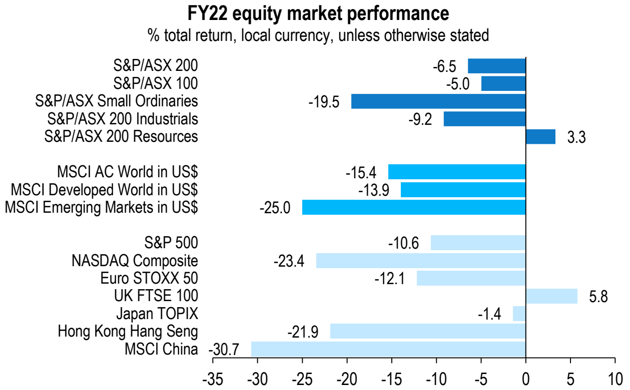
A 'tale of two halves' for equities

Global equities initially rallied for the first six months of the financial year and hit record highs around calendar year end. However, the last six months of the financial year saw equities hit by valuation compression due to sharply rising bond yields followed by concerns that central bank tightening might cause a recession. The S&P500 index at one point fell 24% from its early January all-time high, putting it firmly in 'bear market' territory. Consequently, global equities posted their worst 1H (1st January to 30th June) return since 1970.

Most equity markets post negative returns…

Over FY22 global equities posted a total return of -15.4% in US$ (-7.6% in A$). Most major markets posted double-digit losses with the UK FTSE 100 (due to its exposure to oil stocks) and Japan TOPIX (due to a falling Yen boosting exporters) notable exceptions. However, given the strength of the US$, in common currency terms the S&P 500 was the strongest performing major market (-2.4%% total return in A$). Chinese equities were a major underperformer as the Chinese economy was impacted by COVID lockdowns.

Most equity markets down for the year

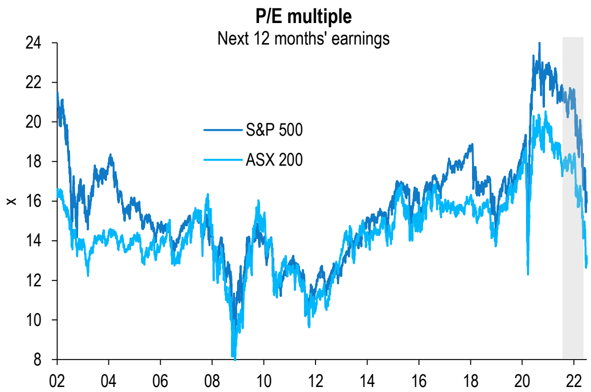


Source: Factset, MWM Research, July 2022

…as valuations come under pressure from rising rates

The overwhelming driver of equity market weakness was falling valuations, which were in turn weighed down by rising bond yields. The S&P500 and ASX200 indices saw their forward P/E multiples fall 26% and 29% respectively over FY22 while earnings rose over the same period. Consequently, US equities are currently trading near their 20-year average P/E while Australian equities are currently trading slightly below.

Big valuation de-rating for equities

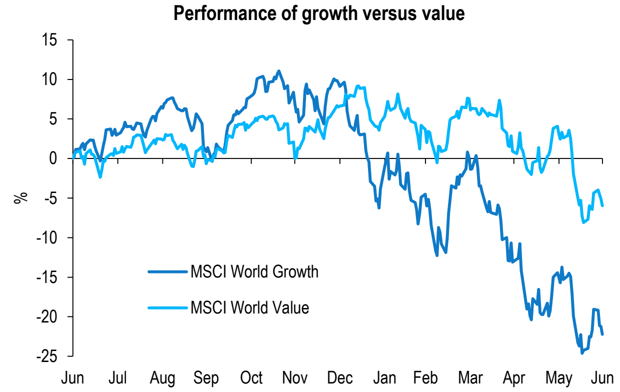


Source: Factset, MWM Research, July 2022

'Growth' stocks a big victim of rising rates

'Growth' stocks trading on relatively high valuations were the main victims of rising interest rates as their expected cash flows extend further into the future, making them more vulnerable to increases in the discount rate used to calculate their present value.

Growth stocks a victim of rising rates

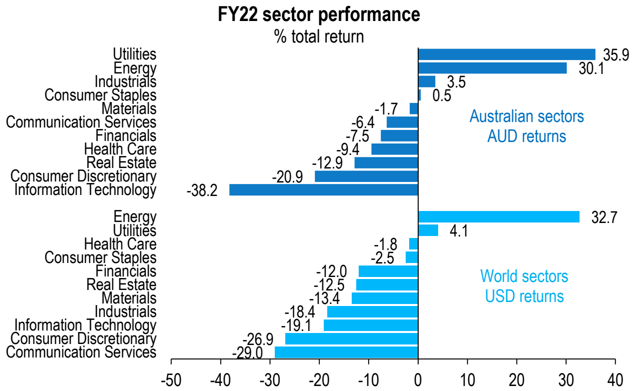


Source: Factset, MWM Research, July 2022

Energy sector the standout

Thematically, defensive sectors generally outperformed cyclical sectors. Energy was the strongest performing sector globally, benefitting from rising energy commodity prices. Utilities also benefitted to a lesser extent from this theme. Information Technology suffered from the de-rating of growth stocks, as did global Communication Services (which contains many growth stocks). Consumer Discretionary underperformed due to an easing of lockdowns (reversing the benefit some stocks gained from lockdowns) and a deteriorating situation for consumption given high inflation and a slowing economy.

Energy the outstanding sector performer



Source: Factset, MWM Research, July 2022

Australian equities fall but outperform peers

The ASX200 index posted a total return of -6.5%, notionally outperforming global equities' -15.4% (US$) return. However, in common currency terms, global equities posted an A$ return of -7.6%, reducing the performance gap substantially. The ASX200 index fell 16% from its all-time high in August, putting it in 'correction' territory rather than the 'bear market' territory of other major global indices.

Australian equities received a boost from resource (particularly energy) stocks (+3.3%) with the ASX200 excluding resources posting a return of -9.2%. Australian small industrials (-24.0%) underperformed heavily given the preponderance of technology/growth stocks in the index.

As was the case overseas, Energy (+30.1%) was one of the strongest performing sectors. However, the strongest performing sector was Utilities (+35.9%) which benefitted from substantial takeover activity among stocks in the sector.

The Information Technology sector (-38.2%) was the worst performing sector with its high valuations falling victim to rising interest rates. Among sub-sectors, gold stocks (-23.8%) struggled with rising costs. Discretionary retailers (-25.5%) suffered as an easing of lockdowns reversed the benefit some of these stocks gained from lockdowns and from a deteriorating backdrop for household consumption given high inflation and a slowing economy.

Best & worst ASX100 performers over FY22

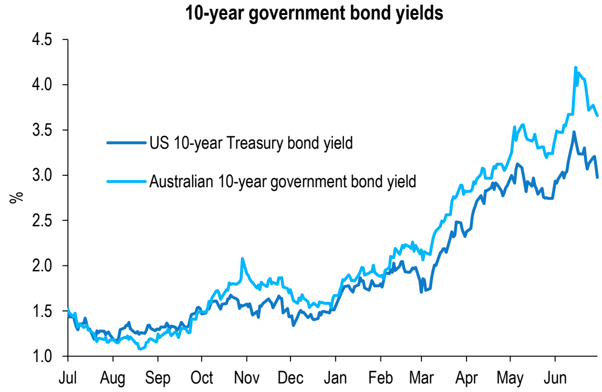
Code	Company name	Sector	Total return
Best performing			
WHC	Whitehaven Coal	Energy	155.8%
AKE	Allkem	Materials	59.4%
PLS	Pilbara Minerals	Materials	57.9%
TAH	Tabcorp Holdings	Consumer Discretionary	54.5%
WDS	Woodside Energy Group	Energy	53.9%
LYC	Lynas Rare Earths	Materials	52.9%
CPU	Computershare	Information Technology	49.4%
IPL	Incitec Pivot	Materials	46.8%
S32	South32	Materials	41.0%
ALX	Atlas Arteria	Industrials	33.5%
Worst performing			
ANN	Ansell	Health Care	-47.4%
EVN	Evolution Mining	Materials	-46.1%
XRO	Xero	Information Technology	-43.9%
DMP	Domino's Pizza Enterprises	Consumer Discretionary	-42.6%
REH	Reece	Industrials	-41.0%
VUK	Virgin Money UK	Financials	-38.6%
FPH	Fisher & Paykel Healthcare Corp.	Health Care	-37.1%
SEK	Seek	Communication Services	-35.8%
NEC	Nine Entertainment Co. Holdings	Communication Services	-34.3%
ARB	ARB Corporation	Consumer Discretionary	-33.4%

Source: Factset, MWM Research, July 2022

Bond yields ratchet up…

Rising inflation and central bank hawkishness saw global bond yields jump to multi-year highs: The U.S. 10-year Treasury yield jumped 150 basis points over FY22 and at one point reached 3.50%, its highest level since April 2011. The U.S. 2-year Treasury yield jumped 275 basis points, resulting in a significant flattening of the yield curve. The Australian 10-year government bond yield jumped 212 basis points over FY22 and at one point reached 4.20%, its highest level since January 2014.

Bond yields rise sharply

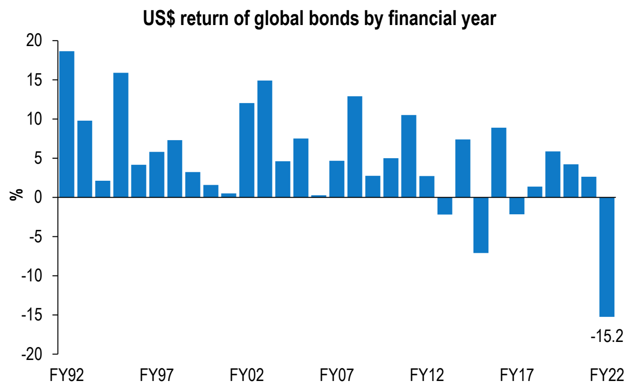


Source: Factset, MWM Research, July 2022

…resulting in a historic bond market rout

The rise in bond yields saw bond indices post their worst returns in decades. The Bloomberg Barclays Global Aggregate bond index posted a US$ total return of -15.2% (-9.3% AUD hedged) while the Bloomberg AusBond Composite bond index posted a total return of -10.5%.

Bond indices post historic losses

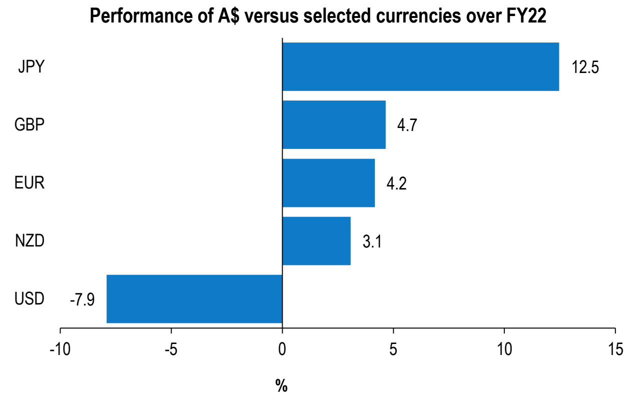


Source: Factset, MWM Research, July 2022

US$ strength the big currency story

The U.S. Dollar strengthened against most major currencies, driven by expectations of a more aggressive U.S. rate hike cycle, which would make U.S. interest bearing assets relatively more attractive. Conversely the other big currency story was the weakness in the Japanese Yen, driven by the Bank of Japan's commitment to low interest rates given Japan's relatively benign inflation backdrop. The Australian Dollar rallied against most major currencies, with the notable exception of the U.S. Dollar, driven by elevated commodity prices.

AUD weakened against USD, strengthened against most other currencies



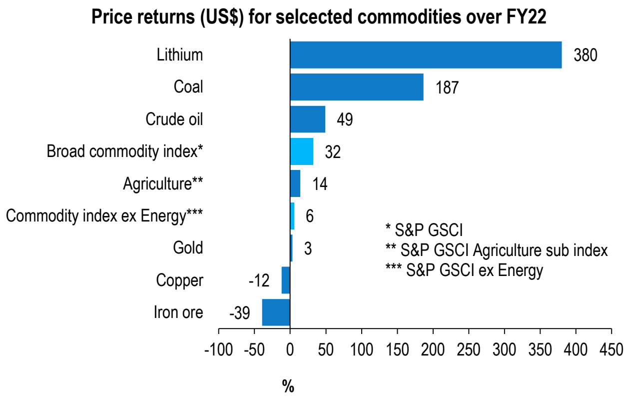
Source: Factset, MWM Research, July 2022

Commodity gains dominated by energy

The broad index of commodity prices rose 32% over FY22 although this was dominated by energy related commodities. Excluding energy, commodity prices rose a more modest 6%.

- **Oil**: The oil price rose sharply, particularly over the last six months of FY22, spiking in late February after Russia invaded Ukraine and Western countries responded with various sanctions against Russian exports.
- **Coal**: Coal rallied strongly throughout FY22 as strengthening demand met supply shortages, exacerbated by Western sanctions on major coal exporter Russia.
- **Iron ore**: Sharp production cuts starting in July to put China on track to meet its "zero growth" target for crude steel production, as well as weakening property construction, triggered the steepest (58%) iron ore price correction in history from July to November. Iron ore staged somewhat of a comeback from November on restocking but nevertheless finished the year sharply lower.
- **Gold**: As a traditionally 'safe-haven' asset, gold spiked late February after the Russian invasion of Ukraine before easing back. Despite rising inflation, over FY22 gold rose only slightly, weighed down by rising interest rates.
- **Industrial metals**: Copper, long considered a bellwether for the economy, fell 12% over FY22, with particularly sharp falls in the last quarter as the global economy slowed and recession risks rose.
- **Lithium**: Lithium rose 380% as it rode the electric vehicle (EV) 'revolution'. Demand for electric vehicles, and by extension for lithium used in electric vehicle batteries, rose substantially and is forecast to continue rising given the global move towards 'decarbonisation'
- **Agriculture**: The prices of key agricultural commodities (such as wheat) spiked sharply in February (but eased back over May and June) after Russia invaded Ukraine given the role of both Russia and Ukraine as major exporters.

Energy dominates commodity performance

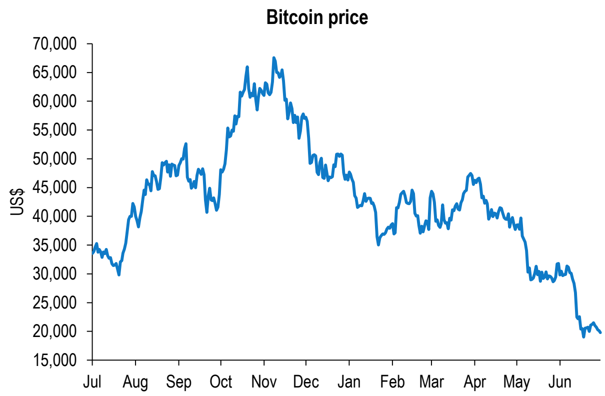


Source: Factset, MWM Research, July 2022

Cryptocurrencies once again in the 'doghouse'

FY22 was an 'annus horribilis' for cryptocurrencies, with most major cryptocurrencies suffering heavy falls, victims of rising interest rates and rising risk aversion. Cryptocurrency markets were rocked by the collapse of a major cryptocurrency – TerraUSD - a 'stablecoin' pegged to the US Dollar but backed by financial algorithms rather than US Dollar assets. Bitcoin, the largest cryptocurrency by market capitalisation and best known, fell 41% (in US$ terms) over FY22 and closed the year down 71% from its peak in early November.

Bitcoin plunges 71% from its November peak

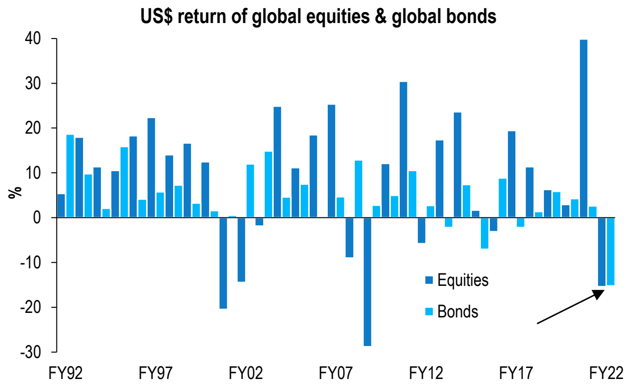


Source: Factset, MWM Research, July 2022

FY22 was an asset allocator's worst nightmare

FY22 witnessed the rare occurrence of both bonds and equities posting double-digit losses, resulting in the worst performance for balanced portfolios since FY09.

Both bonds & equities post sharp losses in FY22



Source: Factset, MWM Research, July 2022

Performance of major asset class indices

	Local currency % return	USD return % return	AUD return % return
Australian Equity Indices			
S&P/ASX 200	-6.5	-13.9	-6.5
International Equity Indices			
MSCI AC World	-11.9	-15.4	-7.6
MSCI Developed World	-10.7	-13.9	-6.0
MSCI Emerging Markets	-19.9	-25.0	-18.1
Country Equity Indices			
S&P 500	-10.6	-10.6	-2.4
NASDAQ Composite	-23.4	-23.4	-16.4
Euro STOXX 50	-12.1	-22.3	-15.7
FTSE 100	5.8	-6.9	1.1
Japan TOPIX	-1.4	-19.3	-12.3
MSCI AC Asia ex Japan	-20.8	-24.8	-17.9
Hong Kong Hang Seng	-21.9	-22.7	-15.6
MSCI China	-30.7	-31.7	-25.4
China Shenzhen SE / CSI 300	-12.4	-15.5	-7.7
Bond Indices			
Bloomberg Barclays Global Aggregate (hedged)	-15.2	-15.2	-9.3
Bloomberg AusBond Composite (0+Y)	-10.5	-18.0	-10.5
Commodities			
S&P GSCI	45.0	45.0	58.4

Source: Factset, MWM Research, July 2022

Macquarie WM Investment Strategy Team

FY22 The Year In Review was finalised on 4 July 2022.

Recommendation definitions (Macquarie Australia/New Zealand)

Outperform – return >3% in excess of benchmark return

Neutral – return within 3% of benchmark return

Underperform – return >3% below benchmark return

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