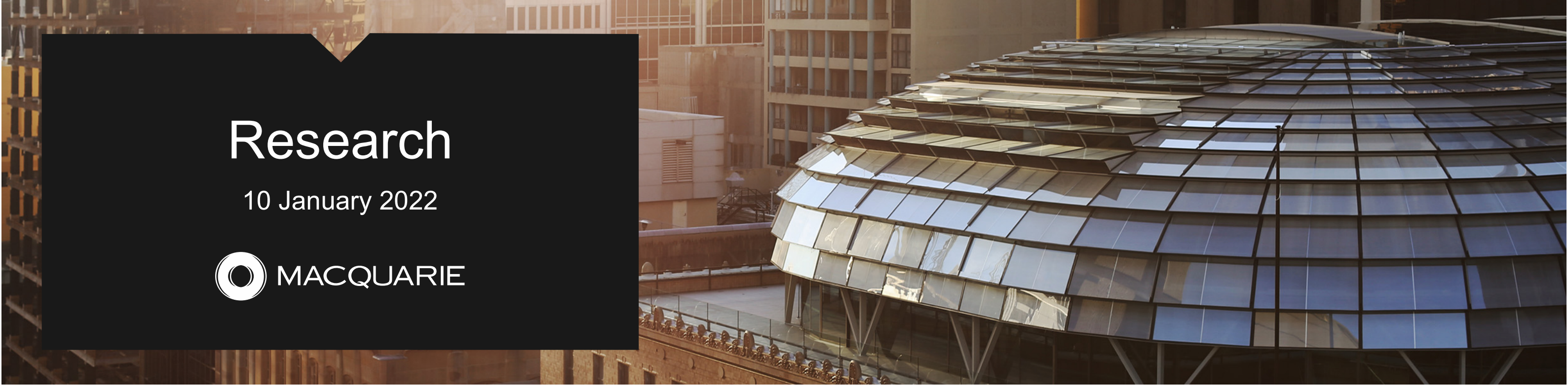


CY21 Market Wrap

Reflation drives another strong year for risk assets, but headwinds begin to emerge

- Global and domestic economies continued to build on their 2020 rebound, despite periodic waves of COVID-19 that drove lockdowns of various intensity and length. 2021 marked the first year in decades where inflation pressures appeared more permanent, driven by supply chain disruptions, a spike in energy and transportation costs and strong goods demand.
- Global equities posted another strong return, with a total return of 19.0% in USD and 26.3% in AUD. This was driven by a strong rebound in earnings with valuations coming under pressure from rising rates. US equities (+28.7% in USD) were the standout performer while Chinese equities (-21.6% in local currency) underperformed heavily as the regulatory push intensified. Australian equities (+17.2% in AUD) posted solid returns but lagged developed world peers.
- Key equity market performance trends included: 1 US outperforming due to relative strength of the US economy, 2 Emerging Markets underperforming due to weak China performance, 3 Outperformance of cyclical sectors and steepening yield curve beneficiaries and, 4 Continued outperformance of structural 'winners' e.g., selected technology stocks.
- Rising inflation, initially assumed to be transitory, proved to be more persistent and prompted some central banks to begin removing monetary stimulus and/or raising interest rates. Rising bond yields saw bonds post their worst calendar year return since 1994, falling 2.9%.
- Commodities prices were generally strong given the positive cyclical backdrop rising demand from reopening economies, while some commodities (e.g., coal) benefitted from supply shortages while other commodities (e.g., lithium) benefitted from rising structural demand from 'decarbonisation'.

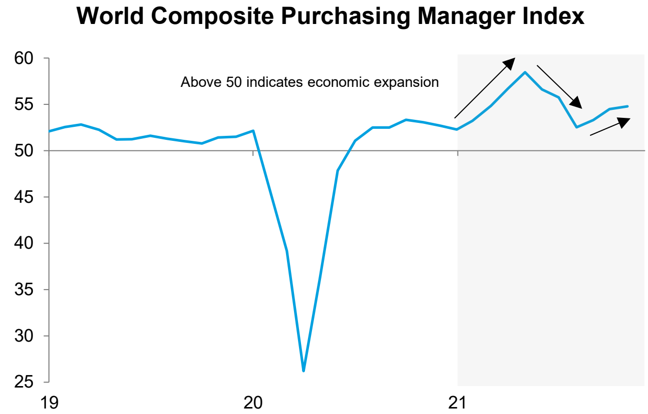
Economic Backdrop

A strong recovery despite multiple COVID outbreaks and a weak China

The global growth backdrop in the first half of the year was exceptionally strong, particularly for the US, as a result of strong fiscal support from the newly inaugurated Biden administration combined with economic reopening. Global GDP rebounded to pre-COVID levels. However, the peak in cyclical momentum was reached around mid-year, with the 'Delta' variant and ensuing lockdowns subsequently weighing on the recovery. Nevertheless, the underlying story over the rest of the year remained one of continued economic growth, albeit at a more normalised pace, supported by elevated savings, recovering labour markets, ongoing fiscal support, easy monetary policy and rising services demand.

China's continued recovery weakened over the year due to property woes, supply bottlenecks, power rationing and sporadic COVID outbreaks as the authorities tightened policy and imposed a regulatory crackdown on various sectors.

Global economic expansion continued through CY21

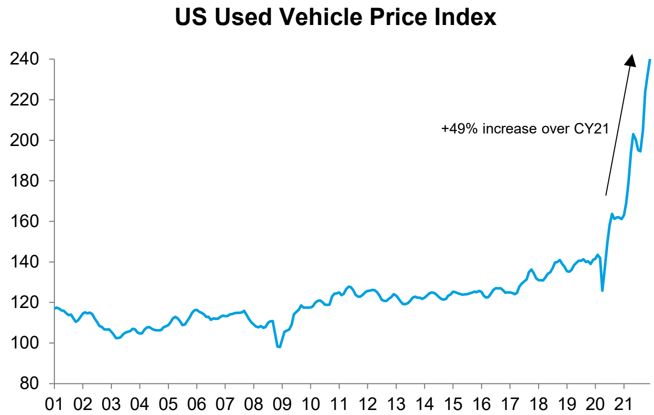


Source: Markit, Factset, MWM Research, January 2022

A supply chain crisis…

The economic recovery saw surging consumer demand (aided by stimulus payments) run into supply chain disruptions that drove a sharp spike in global transportation costs, backlogs and ultimately a rise in prices. An example was the spike in used car prices, as a shortage of semiconductor chips, which had been diverted to increased production of PCs, caused a shortage of new cars, triggering increased demand for used cars.

Used car prices skyrocketed on supply chain problems

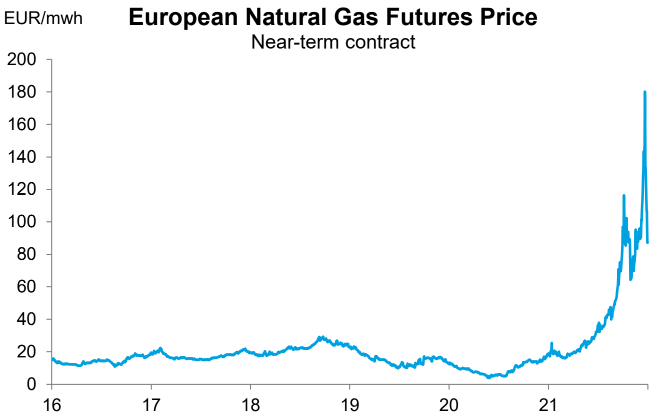


Source: Manheim, MWM Research, January 2022

…and energy price spike…

Soaring energy prices caused an ‘energy crunch’, particularly in Europe and China. The overriding cause was strong demand from as economies reopened and insufficient supply as renewable sources disappointed due to the closure of coal plants, particularly in Europe. However, other shorter-term factors including adverse weather conditions, such as low wind generation in Europe, also played a part, as did lockdowns in coal-producing regions of China.

Energy prices soar, particularly in Europe

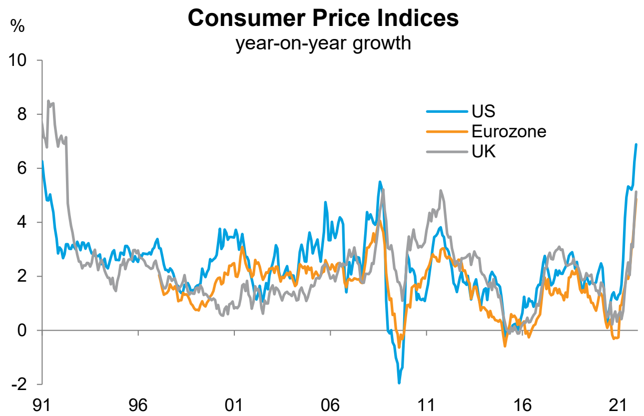


Source: Factset, MWM Research, January 2022

…combined to fuel an inflation surge…

The supply chain crisis and energy price spike combined with strong goods demand to fuel a surge in inflation, as consumer price indices (both headline and core) around the developed world grew by their fastest rate in decades. This prompted much debate about to what extent this inflation spike would be ‘transitory’ or ‘structural’. As the year progressed, inflation appeared to be more persistent than the initial consensus view that it would be transitory.

Inflation at multi-decade highs



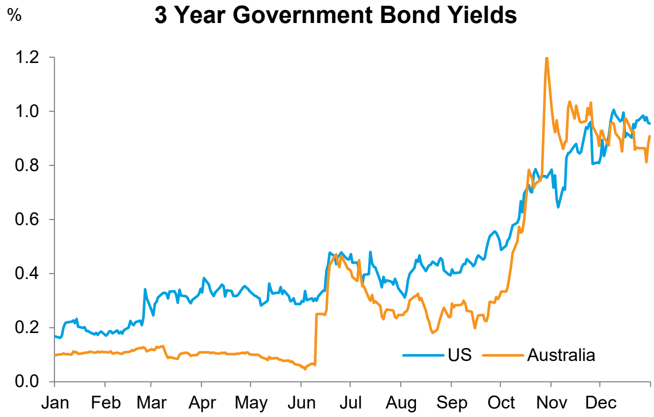
Source: Factset, MWM Research, January 2022

…as the global policy tide began to recede

Rising inflation prompted some central banks to remove monetary stimulus and begin to raise interest rates: The central banks of the UK, Norway and New Zealand (among others) raised their policy rates for the first time since the start of the pandemic. In September the Reserve Bank of Australia announced a ‘tapering’ of its bond buying program, to be completed in early 2022, and in early November abandoned its ‘yield curve control’ program after it chose not to defend the 10bps target for the April 2024 Australian Government bond.

However, most eyes were focused on the timing of the US Federal Reserve’s withdrawal of stimulus. In November, the Fed began ‘tapering’ or reducing its massive purchases of Treasury bonds and mortgage-backed securities and accelerated this process in December. An earlier than expected end of ‘tapering’ as well as rising inflation expectations sent bond yields higher as markets brought forward their expectations of the timing and pace of upcoming rate hikes.

Inflation pushes bond yields higher

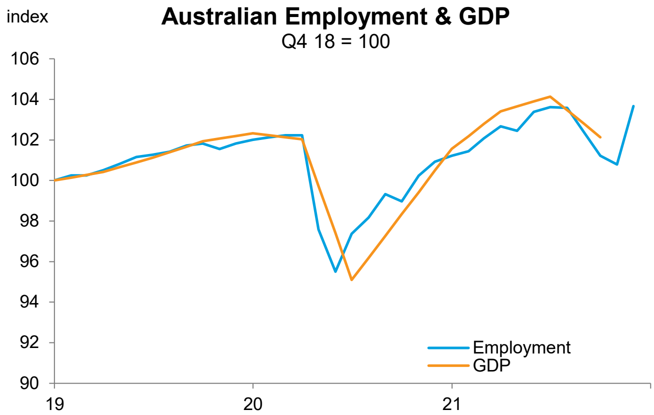


Source: Factset, MWM Research, January 2022

The Australian economy resilient in face of lockdowns…

The Australian economy started the year with strong momentum, building on the stronger than expected recovery that began in 2020. However, Q3 saw the spread of the ‘Delta’ variant of COVID-19 with heavy lockdowns imposed on the two most populous states of New South Wales and Victoria, resulting in a sharp slowdown in economic activity. However, the hit to the economy was less than expected and quickly bounced back with government income support for both households and businesses, ultra-low interest rates (which kept housing price growth elevated) and exceptionally strong commodity exports cushioning the blow.

The economy is bouncing back strongly from lockdowns



Source: Factset, MWM Research, January 2022

…as the housing market runs red hot

The housing market was a bright spot for the Australian economy, with house prices and construction activity rising sharply, supported by government policies (such as the ‘Homebuilder’ grant and other incentives), ultra-low interest rates and shortages of housing stock. Australian dwelling prices rose by 21% over CY21 according to CoreLogic with freestanding houses growing by 24% and apartments growing by 12%. However, momentum began to slow by the end of the year, due to declining affordability as well as macroprudential measures introduced by authorities in order to curb lending.

'Decarbonisation' becomes a key focus

Climate change became an increasing focus for both governments and investors as the COP26 climate summit concluded in Glasgow in November with a deal struck after weeks of intense negotiations. Over 200 nations have committed to the Glasgow Climate Pact which continues to build on the central goal of keeping global temperatures from warming above 1.5 degrees Celsius through 'decarbonisation'. This will involve phasing down the use of fossil fuels, providing a boost to 'green' connected minerals as well as manufacturers of 'green technology' such as wind turbines, solar panels or electric vehicles. Australia committed to net zero emissions by 2050 with a focus on technology to achieve this aim.

Markets Backdrop

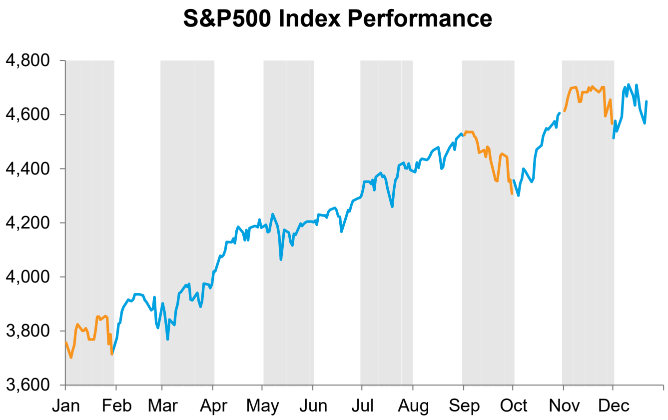
Another strong year for equities, led by the US

Key equity market performance trends included:

- US outperforming due to relative strength of the US economy
- Emerging Markets underperforming due to weak China performance
- Outperformance of cyclical sectors and steepening yield curve beneficiaries
- Continued outperformance of structural 'winners' e.g., selected technology stocks

Global equities posted a strong return (+19.0% in USD) in CY21, driven by rising earnings and offset by minor valuation contraction. The vast majority of developed ex Asia countries posted double-digit (local currency) returns. The US (S&P500 +28.7%) was the standout performer among major equity markets, due in part to the relatively strong performance of the US economy and due in part to the strong performance of major technology companies. The S&P500 index posted 70 closing record highs during 2021, the highest since 1995.

The S&P500 index rose nine months out of twelve

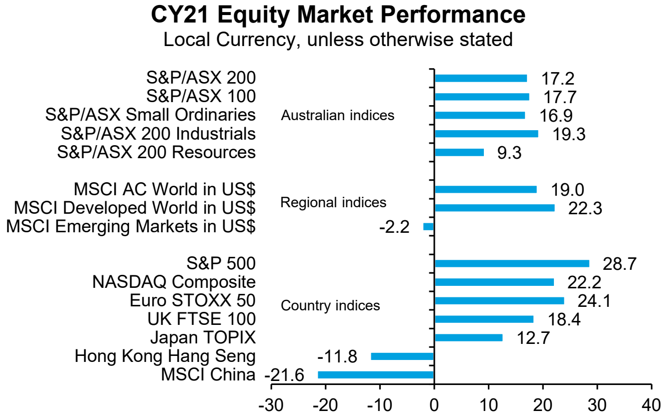


Source: Factset, MWM Research, January 2022

Chinese equities underperform

Chinese equities (-21.6% in local currency) were the notable underperformer, impacted by the Chinese economy's slowdown as well as the Chinese government's regulatory crackdown in various sectors such as technology and education.

A strong year for most equity markets

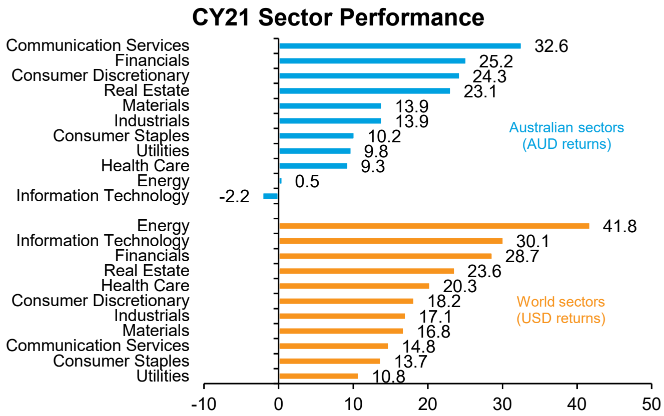


Source: Factset, MWM Research, January 2022

Cyclical sectors outperform

Global sector performance reflected the positive economic backdrop, with cyclical sectors and sectors benefitting from a steepening yield curve (e.g., Energy, Information Technology and Financials) generally outperforming defensive sectors (e.g., Utilities, Consumer Staples and Communication Services). Energy was the best performing sector, benefitting from sharply rising oil, gas and coal prices. Thematically, the MSCI World Value index (22.8% US$ return) slightly outperformed the MSCI World Growth index (21.4% US$ return) disappointing those hoping for a major value rally following years of underperformance.

Cyclical sectors generally outperformed globally



Source: Factset, MWM Research, January 2022

Australian equities post strong returns but lag World

The ASX200 index posted a solid (+17.2%) total return including dividends, hitting new record highs in August. Australian equities underperformed their global counterparts, weighed down by Resources (+9.3%) which underperformed Industrials (+19.3%) although Small Resources (+29.1%) vastly outperformed ASX100 Resources (+7.6%) given large-cap resources were dominated by underperforming iron ore miners.

ASX200 finished the year near its record high

ASX 200 Index Performance

Source: Factset, MWM Research, January 2022

Australian sector trends were not as clear-cut as global trends, although cyclical sectors generally outperformed defensive. Domestically, Information Technology (-2.2%) and Energy (+0.5%) were the worst performing domestic sectors, in direct contrast to global trends. Australian Information Technology was weighed down by the underperformance of sector heavyweight Afterpay (-29.7%) while the Australian energy sector continued to be weighed down by ESG/decarbonisation concerns.

The banks sub-sector (+25.9%) had another good year, benefitting from strong credit demand, better than expected credit quality (due to a red-hot housing market), weak competition for deposits and margin gains as the yield curve steepened. The gold sub-sector (-9.3%) was the worst performing sub-sector, weighed down by a lacklustre gold price.

…as lithium stocks electrify the ASX

The list of strongest performers on the ASX was dominated by resource companies linked to the Electric Vehicle (EV) revolution: The top performers in the ASX100 included lithium producers Pilbara Minerals (PLS), Allkem (AKE) and Mineral Resources (MIN) and rare-earths producer Lynas Rare Earths (LYC).

Best & worst ASX100 performers over CY21

Code	Company name	Sector	Total return
Best performing			
PLS	Pilbara Minerals Limited	Materials	+268%
LYC	Lynas Rare Earths Limited	Materials	+156%
AKE	Allkem Limited	Materials	+133%
WTC	Wisetech Global Ltd.	Information Technology	+91%
REH	Reece Limited	Industrials	+85%
IGO	IGO Limited	Materials	+82%
IEL	IDP Education Ltd.	Consumer Discretionary	+75%
S32	South32 Ltd.	Materials	+67%
RWC	Reliance Worldwide Corp. Ltd.	Industrials	+59%
MIN	Mineral Resources Limited	Materials	+58%
Worst performing			
MFG	Magellan Financial Group Ltd	Financials	-59%
A2M	a2 Milk Company Ltd.	Consumer Staples	-52%
AGL	AGL Energy Limited	Utilities	-44%
AMP	AMP Limited	Financials	-35%
APT	Afterpay Limited	Information Technology	-30%
NST	Northern Star Resources Ltd	Materials	-24%
LLC	Lendlease Group	Real Estate	-17%
EVN	Evolution Mining Limited	Materials	-16%
ORI	Orica Limited	Materials	-8%
ANN	Ansell Limited	Health Care	-7%

Source: Factset, MWM Research, January 2022

Bond returns weak as yields rise…

In contrast to equities, it wasn't a good year for government bonds, with yields rising (hurting the prices of bonds) due to improving economic growth, rising inflation expectations and tightening central bank policies. The US 10-year Treasury yield rose from 0.92% at the start of the year to 1.52% at the end of the year, peaking in March at 1.74%. Global government bonds posted a negative 1.4% US$ hedged return for the year while Australian government bonds' total return was negative 2.9% - the worst calendar year return for bonds since 1994 It was a slightly better year for corporate credit, with the global high yield bond index posting a 2.5% US$ hedged total return due to a tightening in spreads driven by an improving economic backdrop and declining risk aversion. The Australian government 10-year bond yield rose from 0.97% at the start of the year to 1.67% by year end.

Commodity prices rise on positive cyclical backdrop

Oil: The oil price rose to a seven year high on rising demand, particularly from transport, as economies re-opened combined with restrained supply due to better-than-expected discipline from producers.

Iron ore: Sharp production cuts from July to put China on track to meet its “zero growth” target for crude steel production triggered the steepest iron ore price correction in history. The spot index crashed from a peak of more than $230/t in late Q2 to a low of $94/t in mid-September, before rebounding back.

Lithium: Lithium rose 280% 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’.

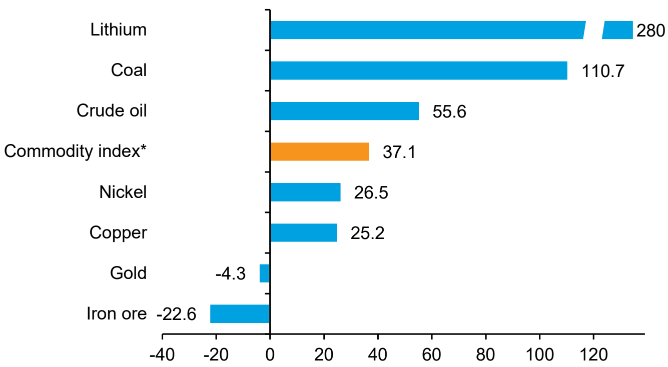
Industrial metals: Industrial metals such as copper and nickel performed strongly, in part due to the cyclical recovery, but also in part due to riding the ‘decarbonisation’ wave in which demand for copper and nickel is forecast to rise substantially.

Coal: Coal rallied strongly as strengthening demand met supply shortages, exacerbated by China's unofficial ban on Australian coal since late last year, compounded by COVID-prompted border closures with Mongolia (a major supplier of coal to China).

Gold: Rising inflation didn't help the gold price, which fell slightly over the year as a cyclical recovery saw this traditionally ‘safe-haven’ asset fall out of favour.

A strong year for most commodities

CY21 Commodity US$ Price Returns



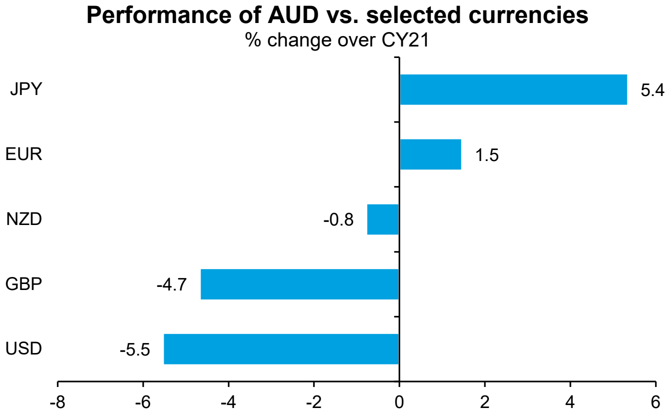
Source: Factset, MWM Research, January 2022

* Goldman Sachs Commodity Index

US$ strengthens, A$ mixed

The US Dollar strengthened against most major currencies, particularly in the second half of the year. The rally was driven by expectations of the US Fed raising interest rates earlier than initially expected, meaning interest rate differentials would be rising in favour of the US Dollar relative to other currencies. The Australian Dollar consequently weakened against the US Dollar although it was mixed against other major currencies.

AUD weakened against USD, mixed against other currencies

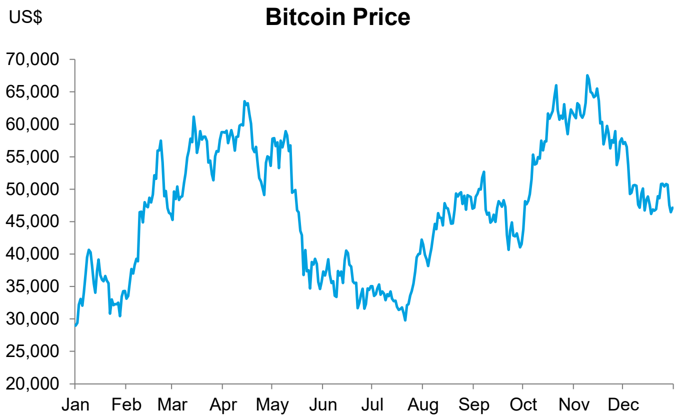


Source: Factset, MWM Research, January 2022

Another strong, albeit volatile, year for Bitcoin

The price of Bitcoin rose 63% in US$ over 2021 albeit with considerable volatility as it experienced two large drawdowns 53% and 32% respectively. The key theme for Bitcoin (& cryptocurrencies generally) was rising institutional acceptance, with highly successful launches of Bitcoin or Bitcoin-related ETFs in the US (the ProShares Bitcoin Strategy ETF (NYSE: BITO)) and Australia (the BetaShares Crypto Innovators ETF (CRYP)). Additionally, in June El Salvador was the first country in the world to accept Bitcoin as legal tender.

Another wild ride for Bitcoin investors



Source: www.coindesk.com, MWM Research, January 2022

AUD returns of major asset classes

	CY21	Q1 21	Q2 21	Q3 21	Q4 21
Australian Equity Indices					
S&P/ASX 200	17.2	4.3	8.3	1.7	2.1
S&P/ASX 100	17.7	4.5	8.5	1.6	2.2
S&P/ASX Small Ordinaries	16.9	2.1	8.5	3.4	2.0
S&P/ASX 200 Industrials	19.3	4.7	8.6	4.5	0.4
S&P/ASX 200 Resources	9.3	2.5	7.1	-9.3	9.7
International Equity Indices					
MSCI AC World	26.3	6.1	9.1	2.9	6.1
MSCI Developed World	29.9	6.4	9.5	4.0	7.2
MSCI Emerging Markets	3.8	3.7	6.6	-4.4	-1.9
Regional Equity Indices					
S&P 500	36.6	7.6	10.1	4.5	10.3
NASDAQ Composite	29.7	4.3	11.3	3.7	7.7
Euro STOXX 50	22.3	7.7	7.8	1.2	4.1
FTSE 100	24.3	7.2	7.5	3.0	4.7
Japan TOPIX	7.0	3.2	0.6	9.0	-5.5
Hong Kong Hang Seng	-6.9	5.6	4.4	-10.7	-5.4
MSCI China	-16.8	0.9	3.8	-14.9	-6.7
International Equity Thematic Indices					
MSCI World Cyclicals	31.0	7.3	9.7	4.0	7.0
MSCI World Defensives	26.8	4.0	8.8	4.1	7.7
MSCI World Value	30.3	11.2	6.4	3.2	6.7
MSCI World Growth	28.8	1.6	12.6	4.8	7.5
Real Estate Equity Indices					
S&P/ASX A-REIT	26.1	-0.5	10.5	4.2	10.1
FTSE EPRA Nareit Global Developed (hedged)	29.8	7.6	9.3	0.0	10.4
Global Bond Indices					
Bloomberg Barclays Global Aggregate (hedged)	-1.5	-2.5	0.9	0.1	0.0
Bloomberg Barclays Global Treasury (hedged)	-2.0	-2.7	0.6	0.0	0.1
Bloomberg Barclays Global Corporates (hedged)	-1.0	-3.3	2.4	0.0	0.0
Bloomberg Barclays Global High Yield (hedged)	2.2	-0.3	2.9	0.1	-0.5
Australian Bond Indices					
Bloomberg AusBond Bank Bill	0.0	0.0	0.0	0.0	0.0
Bloomberg AusBond Composite (0+Y)	-2.9	-3.2	1.5	0.3	-1.5
Commodity indices					
S&P Goldman Sachs Commodity index	49.0	15.0	17.4	9.4	0.9

Source: Factset, MWM Research, January 2022

Note: All returns are in AUD, and unhedged unless otherwise stated

The report was finalised on 10 January 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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