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Economic Snapshot

January 2022

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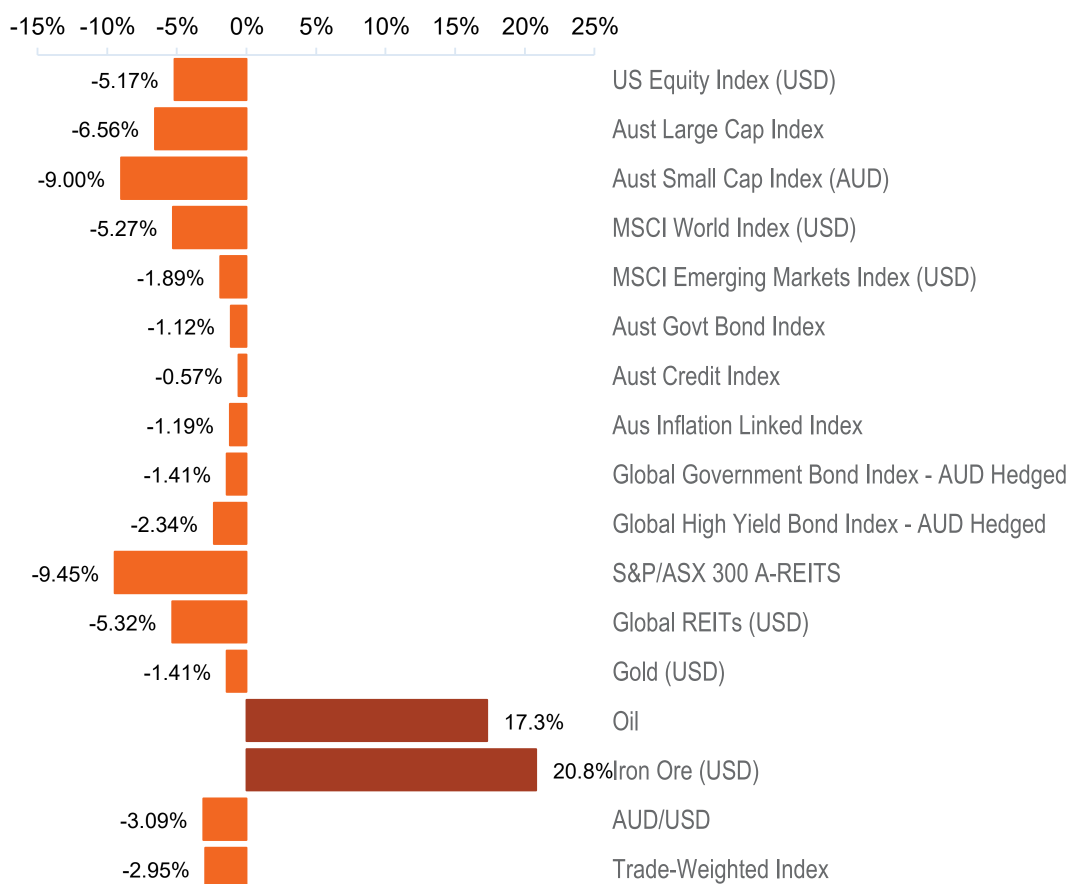
In summary

- The US Federal Reserve announced it will reduce the monthly pace of its net asset purchases (the end of Quantitative Easing) and signalled that it expects to raise interest rates (the start of Quantitative Tightening) shortly. Global bond and equity markets reacted in a volatile fashion, falling sharply on the news.
- The US Dollar bucked the trend as did commodities on the back of heightened geopolitical tensions and higher energy prices.

Selected Market Returns, January 2022



***Sources: Thomson Reuters, Bloomberg*.**

Key Economic Developments

It was a poor start to the year for financial markets with all major financial assets posting negative returns in January. Cash and commodities were the only asset classes to be spared as markets developed a nosebleed after reaching dizzy heights in 2021.

The catalyst triggering the ‘sea of red’ response was the rapid increase in US Treasury yields following the US Federal Reserve’s decision to reduce the monthly pace of its net asset purchases, as well as the Fed’s announcement that tighter monetary policy (higher cash rates) was just around the corner. Whilst these central bank actions were widely anticipated by markets, the sudden realisation that the Fed was on the cusp of ‘lift-off’ mode caught many by surprise, leading to widespread selling and rotation to more defensive pockets of the investable universe.

Among the major developed economies, the US is expected to record GDP growth of around 5.6% in 2021, compared to 5.2% for Europe, 3.8% for Australia and 1.8% for Japan. Even China, which experienced twin shocks in September in the form of the default of Chinese property developer Evergrande and a nationwide energy crisis, is predicted to have expanded by a healthy 8%.

Global bond markets responded to the Federal Reserve’s more ‘aggressive’ tone by rapidly selling bonds, which caused prices to fall heavily and bond yields to rise. Yields on 2-year and 10-year US Treasuries ended the month 45bps and 28bps higher, respectively. This sharp ‘sell off’ of bonds was not just a US phenomenon but mirrored universally across global bond and credit markets.

A consequence of rising real bond yields is that it affects future earnings prospects for companies, which in turn means lower present values and a reduction in the price of shares. Predictably, this is precisely what happened. Growth stocks, which entered the year at all time highs, were impacted most. US stocks fell (-5.2%) with the technology heavy NASDAQ crashing (-9%). Sub sectors of the S&P500 including Consumer Discretionary (-8.2%) and Real Estate (-8.1%), which are extremely sensitive to rising bond yields, were also hit hard by the bond selloff.

The Australian share market also caught the brunt of the volatility with the All Ordinaries down (-6.6%) in January, in what was one of the worst starts to the year for Australian equities in decades. It was not all unwelcome news however, with some sectors of the equity market doing better than others, limiting the damage to a mini correction level only (i.e. less than 10%). Energy (+7.9%) was the top performing sector as surging oil and gas prices supported earnings upgrades in heavyweight energy stocks Santos and Woodside. The big miners, BHP and RIO, also benefitted from abnormally large price moves in the iron ore price, which incidentally was up an incredible +20.8%. In stark contrast to the strong performing Energy and Materials sectors this month, Information Technology (-10.1%), Heath Care (-7.0%) and Real Estate (-5.6%), in combination with other sectors, drove the market lower.

Whilst it was a bumpy ride for markets in January, Australia’s economy continues to hum along in the background. Household balance sheets are still reasonably strong. General confidence is slowly returning, as is general consumption. Labour statistics look promising, and people are finding jobs and returning to work. Wage growth is starting to move in the right direction. Inflation is noticeably on the march but still manageable, and all signs point to a moderation over the coming months as supply and demand forces start to harmonise.

Looking ahead, while economic growth will slow later this year courtesy of rising rates, stronger demand from households and businesses and a rotation from demand for goods to services, should keep the economic recovery alive for a while longer. If recovery continues as expected, it would be a net positive for corporate earnings and equity prices over the next 6-12 months. That said, we expect further volatility this year as markets grapple with the uncertainty posed by higher interest rates, learning to live with the virus, a slowing China, upcoming elections and rising geopolitical risks.

Major Market Indicators

	31-Jan-22	31-Dec-21	30-Nov-21	Qtr change	1 year change
Interest Rates (at close of period)					
Aus 90 day Bank Bills	0.07%	0.06%	0.04%	+3.0	+6.0
Aus 10yr Bond	1.88%	1.61%	1.81%	+16.0	+83.0
US 90 day T Bill	0.24%	0.06%	0.05%	+19.0	+18.0
US 10 yr Bond	1.78%	1.50%	1.44%	+22.6	+68.8
Currency (against the AUD)					
US Dollar	0.705	0.727	0.709	-6.20%	-8.17%
British Pound	0.523	0.538	0.536	-4.50%	-6.29%
Euro	0.628	0.641	0.632	-2.91%	-0.59%
Japanese Yen	81.38	83.63	80.70	-5.08%	1.62%
Trade-Weighted Index	59.30	61.10	60.20	-6.02%	-5.87%
Equity Markets					
Australian All Ordinaries	-6.6%	2.7%	-0.3%	-4.4%	9.7%
MSCI Australia Value (AUD)	-3.4%	4.1%	-2.6%	-2.0%	13.4%
MSCI Australia Growth (AUD)	-10.0%	0.6%	1.9%	-7.7%	4.6%
S&P 500 (USD)	-5.2%	4.5%	-0.7%	-1.6%	23.3%
MSCI US Value (USD)	-2.4%	6.9%	-2.7%	1.4%	25.5%
MSCI US Growth (USD)	-8.9%	1.2%	0.6%	-7.3%	15.8%
MSCI World (USD)	-5.3%	4.3%	-2.2%	-3.3%	17.0%
Nikkei (YEN)	-6.2%	3.6%	-3.7%	-6.4%	-0.8%
CSI 300 (CNY)	-7.6%	2.2%	-1.6%	-7.0%	-13.2%
FTSE 100 (GBP)	1.1%	4.8%	-2.2%	3.6%	20.7%
DAX (EUR)	-2.6%	5.2%	-3.8%	-1.4%	15.2%
Euro 100 (EUR)	-3.1%	4.8%	-3.1%	-1.5%	24.1%
MSCI Emerging Markets (USD)	-1.9%	1.9%	-4.1%	-4.1%	-6.9%
Commodities					
Iron Ore (USD)	20.8%	16.1%	-6.6%	31.0%	-7.2%
Crude Oil WTI U$/BBL	17.3%	13.6%	-20.8%	5.5%	69.0%
Gold Bullion $/t oz	-1.4%	2.4%	0.2%	1.1%	-3.3%

Source: Quilla, Thomson Reuters Datastream

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