MarketSay"

The Russian invasion of Ukraine saw a significant spike in energy prices and renewed volatility in global equity markets. Intraday volatility rose to extraordinary levels. The swift and wide-ranging economic sanctions introduced against Russia produced a sustained rally in energy and a broad array of commodities.

Policy Watch: Bonds rallied as market participants positioned for a slower pace of global interest rate tightening given the geopolitical uncertainty and the risks of the Ukraine conflict spreading into neighbouring countries. Inflation is now likely to be higher in coming months on the back of the lift in energy and other commodities, but central banks are likely to look through this increase somewhat. Once things in Europe de-escalate, the focus will shift back to the high inflation prints and the need to move policy to a more appropriate setting. The US is likely to raise rates by 25 basis points at its next meeting in mid-March while the ECB will continue to resist moving.

Inflation Watch: While inflation prints are undoubtedly affected by temporary supply chain disruptions and speculative demand for energy, there is a clear concern that structural inflation is increasing and policy remains too stimulatory. Wages are beginning to increase in many jurisdictions and will likely put pressure on companies to pass on higher prices through 2022.

Risk Budget: Volatility measures spiked and yields on long bonds fell in the back half of February. With so much uncertainty surrounding the future path of markets, we retained our current broad risk stance while taking some selective opportunities to adjust our portfolio holdings.

Call to Action: The coordinated response from the global community to the Russian invasion has been surprising and widespread. We believe that while markets are likely to be volatile, any sign of a cease fire should trigger a relief rally in equities and a subsequent fall in energy prices. A more cautious tightening cycle by central banks will also support equity markets to recover some of the ground they have lost in 2022. However, rallies are likely to be short lived and investors will need to be nimble to make the most of opportunities. 2022 will not be a year to set and forget. We continue to look for no regret decisions, focussing on markets and stocks which have been heavily oversold and off a cushion of valuation support.

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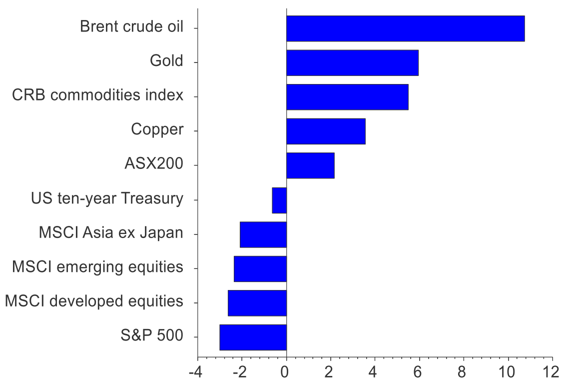
February Review

February was driven largely by Geopolitical tensions, with a Russian invasion of Ukraine pushing investors to de-risk in a very volatile environment. The S&P500 dropped 3%. Large cap technology struggled again with the Nasdaq 100 4.5% lower. The ASX200 remained resilient (+2.1%), largely on the back of a positive corporate reporting season. Commodity prices saw strong gains, particularly in Gold which lifted US$115 to US$1,910/oz. Brent Oil also rose to US $110/bbl as markets reacted to the impacts of sanctions on Russia – a large oil and gas exporter.

Chart 1: February Asset Class Performance
Percentage Change (total return in local currency)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

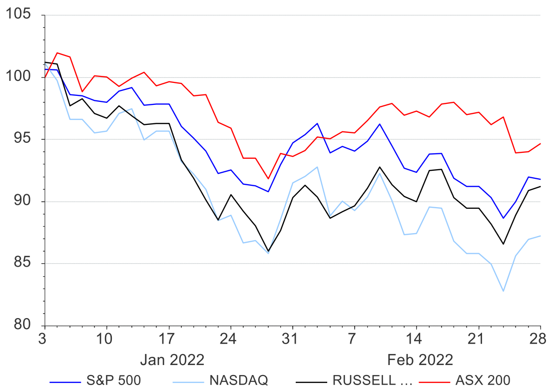
In a rising energy and commodity price environment the Energy (+8.6%) and Materials (5.2%) Sectors outperformed the broader ASX market, while Consumer Staples (5.6%) also saw investor support. IT names again struggled (-6.6%), as did Consumer Discretionary (-5%) on a more cautious outlook. Energy has been the best performing sector on the ASX year to date, up 16% versus the 3% fall from the S&P/ASX200.

By month end almost all ASX companies had reported results for the December half. Overall, results were positive with the median company beat consensus at the NPAT line by +0.7%. While this is a slight decrease on the previous two halves, the environment has arguably been tougher. Outlook commentary was dominated by cost pressures and labour market tightness.

The US Energy Sector (-7%) was the best performing sector in the S&P500 in February, while loses in Real Estate (-4.9%) and Technology (--4.9%) continued after a poor January.

Year-to-date the S&P500 is down 8%, the Nasdaq Composite down 12%, underperforming MSCI World (-7% in $US terms). Emerging Markets (-4.8%) and large capitalisation European stocks (Stoxx 50, -4.3%) are outperforming year to date.

Chart 2: US and Australian Equity Markets YTD Relative Performance (100 = 1 Jan 2021)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

In the early part of February, the focus on Central Banks remained, however a growing Russian military presence on the border with Ukraine and subsequent invasion soon took centre stage. From an economic perspective, Russia is a now a small part of global trade, however it remains a significant oil and gas exporter, especially to Europe.

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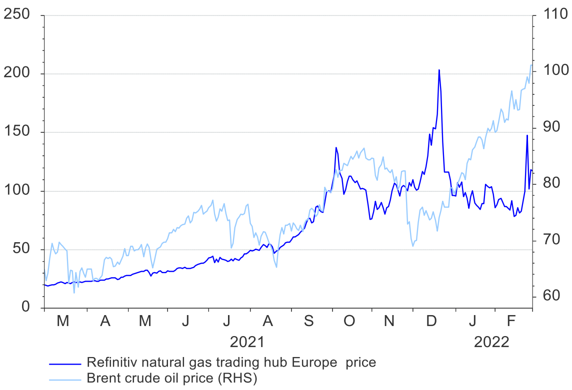
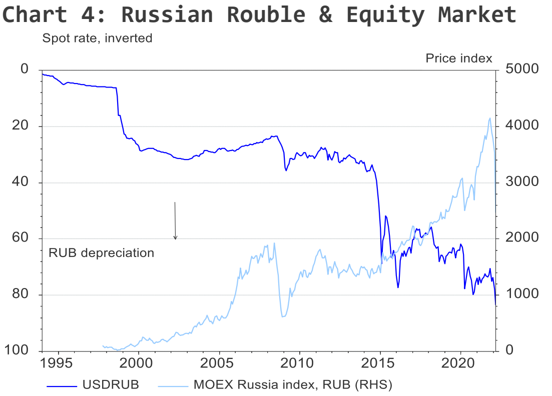
Chart 3: Brent Oil & Natural Gas (USD)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

The ramp up of economic sanctions by the members of the EU, US, Canada, Japan and other nations had an immediate impact on the value of the Russian currency which declined over 30% against the USD and the Russian equity market has lost 50% of its market capitalisation. Of most significance was the removal of Russian financial institutions from the SWIFT global payments network, significantly impacting the movement of capital in and out of Russia and making the job of defending the value of the Rouble close to impossible – the Russian Central Bank attempted to do so by raising interest rates from 9.25% to 20%.

Chart 4: Russian Rouble & Equity Market



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

With the risk-off tone gaining momentum towards the end of February US 10-year yields moderated their strong upward trend, moving up slightly by 5bp to 1.84%, after lifting 27bps in January.

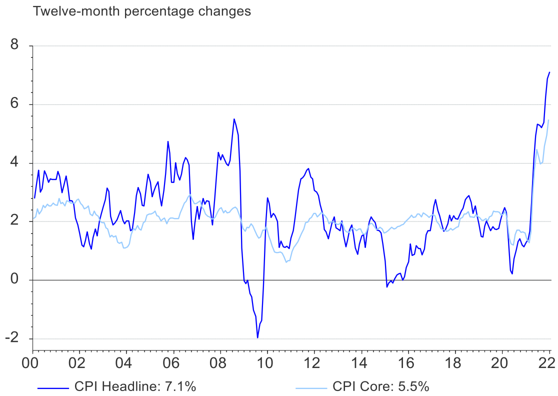
Australian 10-year yields surged 25bps across February to 2.13%, as the market continued to price in tightening monetary policy from the RBA.

Chart 5: US and AU 10 Yr Bond Yields

Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Economic news took a back-seat during the month, but earlier in February US CPI printed above market expectations at both the headline and core measures for January. While the numbers were just .1% above expectations, Headline CPI rose at 7.5%, the largest gain since 1982. This was enough for equities to sell off and for the market to price over six 25bp rate hikes for 2022.

Chart 6: US Inflation (CPI)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

US employers added more jobs than forecast last month despite significant disruptions from Omicron, with nonfarm payrolls increasing by 467,000 versus 125,000 expected; average hourly earnings also jumped to 0.7% (versus 0.5% expected). Previously numbers were also revised higher. With the US labour market remaining strong, investors interpreted this number as giving the Federal Reserve further confidence to hike rates in March.

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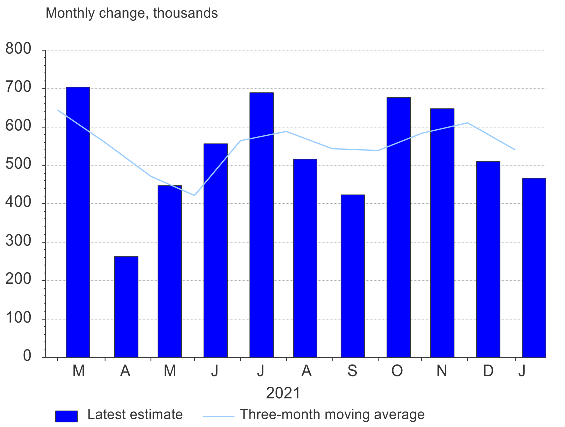
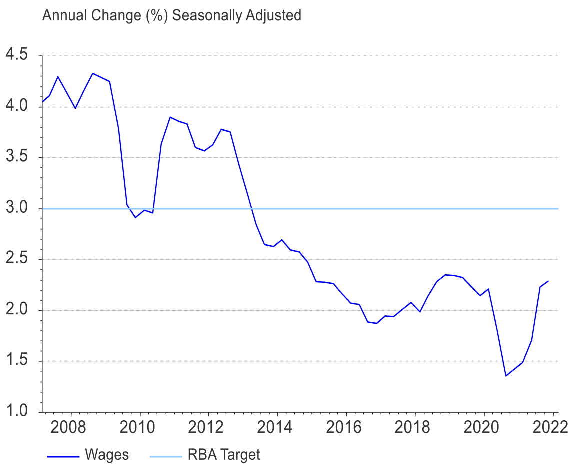
Chart 7: US Non-Farm Payrolls



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Domestically, the economic highlight and key indicator for the Reserve Bank of Australia, Private Sector wage data showed 0.7 per cent growth in the December quarter and 2.3 per cent annual rise. This was in line with RBA expectations and did little to interest rate expectations.

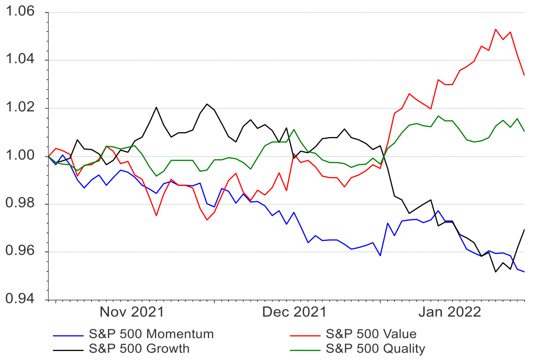
Chart 8: AU Private Sector Wages



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

The rotation to value continued for much of February, however as bond yields started to reverse late in the month this trend also reversed with Growth making a late comeback. Momentum continues to underperform, while Quality is trending sideways.

Chart 9: S&P500 Equity Factor Relative Performance (3 months)

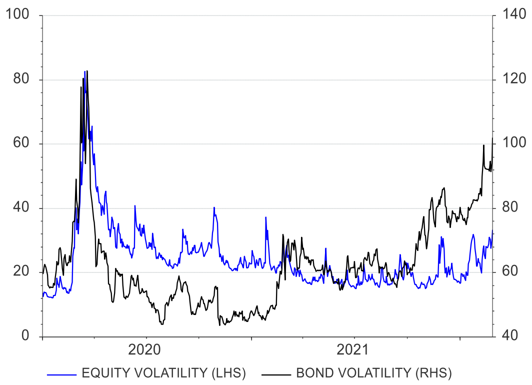


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Risk

Equity volatility continued its rise through February. The 7% intra-day range in the NASDAQ and 1.7% range for the DXY USD index on Thursday 24 February was the most volatile day in stocks and (G10) FX since March 2020.

Chart 10: US equity & bond Volatility (MOVE)

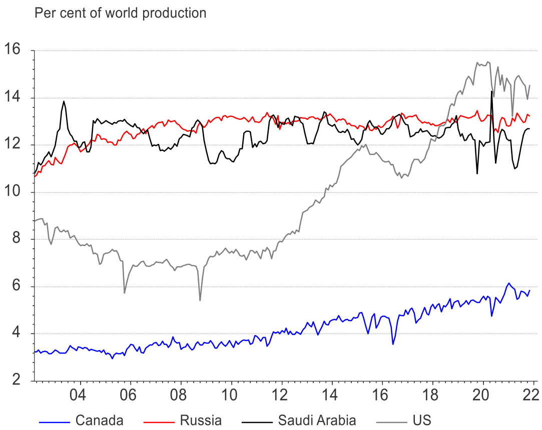


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Outlook

The ongoing Russia/Ukraine conflict is likely to dominate news headlines and market sentiment in the short-term. We believe that a de-escalation of this conflict, with a ceasefire or peace agreement may cause a relief rally in equity markets. An escalation of the conflict, that drags NATO into direct conflict with Russia would be a devasting humanitarian outcome and likely very damaging to equity markets. While we believe is an unlikely outcome, it is certainly a risk to highlight.

Chart 11: Top Oil Producing Nations



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

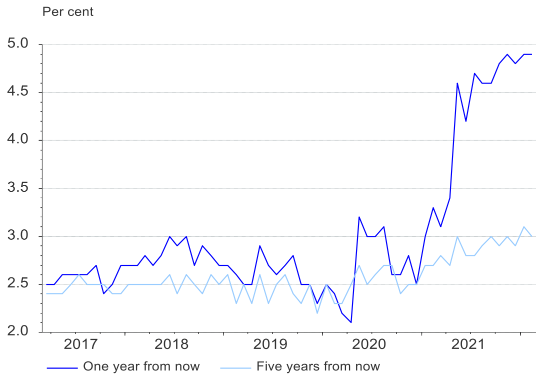
Russia makes up less than 2% of global goods and services trade, so the impact of a weakened Russian economy is unlikely to provide a significant drag on global growth. Russia remains however one of the top 3 oil producing nations in the world with approximately 13% share of world production, dwarfed by OPEC nations combined with over 40%, but nonetheless significant. There are exemptions for energy being worked out and alternative buyers for Russian oil (which is reportedly being offered at a discount), buyers may have difficulty transporting and paying for it.

European consumers and businesses are likely to be most impacted in the near term with higher power and input costs. The longer term impact of this might be a move away from the reliance on Russia as a energy provider, as well as accelerating the move away from fossil fuels to renewable sources of energy.

Russia's isolation, economic sanctions and removal from SWIFT may also cause some impact on financial systems and money markets with Russia amassing significant foreign currency reserves which it now can no longer utilise.

Should the spotlight on the conflict in Ukraine move, we believe the market will again focus on inflation and how central banks respond. While the recent spike in energy prices is likely to lead to higher inflation expectations and resultant inflation data in the coming months and therefore reinforce the need for higher interest rates. However, should a conflict continue in Ukraine we believe that global growth may moderate quicker than expected, leading to a more cautious and gradual increase for rates.

Chart 12: US, Uni of Michigan Inflation Expectations



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

While economies should continue to recovery from the Covid effected 2021, the path will not be a straight line. Living with Covid and readjusting to working in the office are likely to see quite different activity levels across the year. The pattern of household expenditure is likely to shift towards experiences such as restaurants and tourism and away from online goods purchases. While this backdrop should be supportive for risk assets in general, valuation multiples will continue to be challenging in a rising interest rate environment. Alternative and non-correlated assets will continue to be critical tool to smooth out volatility. Some markets, such as China equities, which have lagged the recovery so far are likely to offer investors greater value in 2022.

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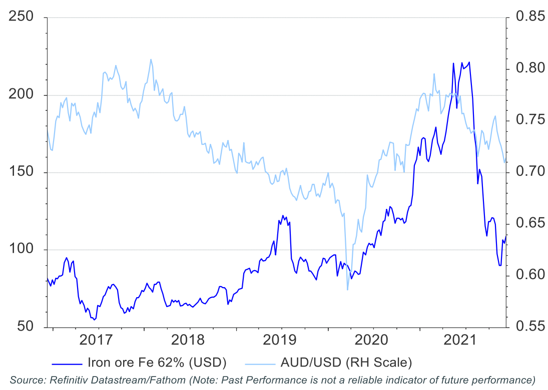
Chart 13: AUD & Iron Ore Price



The Australian Dollar has benefited from the strong demand for energy and commodities and has risen above 73 cents at the end of February. We are less constructive on energy prices over the short term and China has expressed a desire to push iron ore prices lower. Against this backdrop, we feel the currency will struggle to gain much traction from here.

James Wright and Luke Hansen
Sayers Capital Solutions Group

4 March 2022

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