



2022 year in review

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“The global economy is still threatened by high inflation, rising interest rates and the conflict in Ukraine. Global share markets delivered sharp negative returns in 2022 given these prominent risks. The possibility that a global recession occurs in the coming year suggests investors could remain cautious.”

Global economy and shares are threatened by conflict, high inflation and rising interest rates.

Global economic activity started the year with promise. Vaccines were becoming more readily available, allowing employees to return to workplaces and even cafes and restaurants began re-opening. Extraordinarily low interest rates set by central banks as well as significant government budget support measures had allowed global economic activity to make a strong recovery in early 2022.

However, storm clouds were developing given rising inflation. With the global economic recovery came both stronger demand but also acute disruptions in supply chains such as a shortage of computer chips and transport ships. This acceleration in inflation was evidenced by consumer inflation being above 5% in Europe and above 7% in the United States in January 2022.

Russia's devastating invasion of Ukraine on 24 February then dramatically intensified the inflation threat by pushing up key commodity prices. Russia accounts for circa 16% of global natural gas production, 15% of fertilizer, 12% of crude oil and 11% of wheat production¹. Ukraine is also a major supplier of wheat with 10% of global trade. So, the world was contemplating lower supplies of these key commodities from both Russia and Ukraine. These key commodity prices increased circa 30% by April 2022 following Russia's invasion.

Consumer inflation then surged to multi decade highs. US inflation hit a peak of 9.1% in June while European inflation climbed to a peak of 11.5% in October. Everything on the consumer's shopping list was going up in price. Inflation had become the key economic and social concern across the globe in 2022. Alarming annual inflation readings have also been seen in Britain (10.7%), Egypt (22%), Turkey (64%) and Argentina (92%) as illustrative of this price squeeze on the global consumer.

In response to this inflation surge, both government and corporate bond yields rapidly increased as investors contemplated a climate of high and persistent inflation. Central banks then began a rapid sequence of raising their cash interest rates to cool these inflation pressures. US interest rates increased by more than 4% in 2022 while Europe raised interest rates by 2%. The Reserve Bank of Australia (RBA) raised the cash interest rate by 3% with the cash rate now standing at 3.1%.

For global economic activity in 2022, there was both relapses and resilience. Europe's economy was showing more promising signs as business and consumer confidence improved at the start of 2022. However, this confidence was shattered by Russia's invasion of Ukraine. The devastating loss of lives and the traumatic flight westwards to safety by Ukrainian women and children had a dramatic negative impact. European businesses and consumers ended the year very worried about persistent high inflation and the consequent recession risk with the Russia – Ukraine conflict on their doorstep.

The US economy proved more resilient with robust jobs growth in 2022. The US unemployment rate ended the year at a very low 3.5% given the acute shortage of American workers. Wages growth accelerated to a 5% annual pace in response to this strong labour demand. Yet even these higher wages did not fully compensate for US consumer inflation being above 7%. There are also warning signs of a potential recession in 2023 given that consumer spending and housing construction is starting to struggle with the sharp surge in mortgage interest rates.

China's sharp economic slowdown and the financial woes of their property developers also made the headlines. China's economy has recorded subdued industrial production and weak retail sales given the

¹ Estimates for Russia's share of global commodity production in 2021. JP Morgan, Global Data Watch, 4 March and 18 March 2022.

combination of falling house prices and the government’s “Zero-COVID” strategy. China’s government had been imposing harsh lockdowns with virus outbreaks which cut both production and spending. This had also materially contributed to problems in global supply chains with extensive delays in obtaining goods from China’s factories and shipping ports. There was a glimmer of economic hope at year end with China’s government removing the ‘Zero-COVID’ lockdown strategy.

A turbulent year for Australia’s economy

Australia’s economy started the year on a strong note. The benefits of high vaccination rates, low interest rates and resilient businesses and consumers had seen the Australian economy make a rapid recovery. Robust jobs growth had allowed the unemployment rate to fall to 3.5% in November 2022, the lowest since 1974.

However, Australia is also confronting the challenge of high inflation and rising interest rates. Australia’s consumer inflation was running at 7.3% in the year to November 2022. Leading this inflation surge was higher annual prices for housing construction (+17.9%), petrol (+16.6%), holiday travel (+12.8%), bread (+12%), food (+10.9%) fruit & vegetables (+9.5%) as well as meat & seafood (8.1%). This high inflation rate represents a significant loss of purchasing power for consumers.

The RBA rapidly raised the interest rate from 0.1% in April to 3.1% in December 2022. Further interest rate rises in 2023 have been signalled by the RBA to reduce inflation. This suggests a very challenging climate for borrowers and investors in the coming year. Australia’s housing market has also hit reverse gear with falling prices and construction. There are also concerning signs that consumers are becoming more cautious with milder readings for retail spending recently.

A disappointing year for investment returns

Asset class returns in Australian dollars –to 31 December 2022

Asset class	Returns			
	1 yr	3 yrs (pa)	5 yrs (pa)	10 yrs (pa)
Cash	1.3%	0.5%	1.0%	1.7%
Australian bonds	-9.7%	-2.9%	0.5%	2.3%
Global bonds (hedged)	-12.3%	-3.2%	-0.2%	2.3%
Global listed infrastructure (hedged)	-4.2%	1.2%	4.8%	8.7%
Global property securities (hedged)	-24.2%	-5.6%	-0.4%	4.6%
Australian shares	-1.1%	5.5%	7.1%	8.7%
Global shares (unhedged)	-12.5%	5.3%	8.3%	12.7%
Global shares (hedged)	-17.7%	3.2%	4.9%	9.5%
Emerging markets (unhedged)	-14.3%	-1.5%	1.5%	5.8%

Past performance is not a reliable indicator of future performance.

Sources: FactSet, MLC Asset Management Services Limited. Benchmark data: Bloomberg AusBond Bank Bill Index (cash), Bloomberg AusBond Composite 0+ Yr Index (Aust bonds), Bloomberg Barclays Global Aggregate Index Hedged to \$A (global bonds), FTSE Global Core Infrastructure 50/50 Index Hedged to \$A, FTSE EPRA/NAREIT Developed Index (net) hedged to \$A (global property securities), S&P/ASX300 Total Return Index (Aust shares), MSCI All Country World Indices hedged to \$A and unhedged (net) (global shares), and MSCI Emerging Markets Index (net) unhedged to \$A (emerging markets).

2022 will come to be known as a memorable but miserable year for investors. The calendar year began with a political shock with Russia’s brutal and reckless invasion of Ukraine. This conflict caused a surge in energy and food prices which drove global inflation to multi-decade highs. Bond markets and central banks furiously reacted to this high inflation by pushing yields higher. Share prices dramatically fell in response given the impact of rising yields and prospect of weaker corporate profits. The year ended with consumers and investors worrying that a global recession is again looming for a second time after the Pandemic began in March 2020.

Global share investors had a disappointing year with a market return of -17.7% for hedged Australian dollar (AUD) and -12.5% for unhedged portfolios. The primary drivers of this very weak performance are high inflation and increasing interest rates which are threatening corporate profit prospects.

US share prices made new record highs in early January 2022 given low interest rates and the robust +45% annual gain in corporate profits in 2021. Strong business surveys and job gains also provided encouragement that the US economic recovery was improving. There were similar sharp gains for European shares at the start of 2022 given this optimism on global growth and that the virus threat was gradually diminishing.

Yet the inflation storm clouds rained on these share gains. Global share prices slumped in response to accelerating commodity prices, rising interest rates and wage pressures which were squeezing profit margins. Investors became alarmed that central banks would need to continue increasing interest rates to slow demand. Russia's invasion of Ukraine also damaged sentiment by casting a shadow over European national security.

The slide in global share markets has been particularly dramatic for technology companies. Tesla and Facebook/Meta fell nearly 65% while Amazon and Netflix were down by circa 50% in 2022. The US technology focused Nasdaq 100 recorded a -32.5% negative return for 2022. The only 'safe havens' for global share investors were the energy sector (MSCI +42.7%), healthcare (+0.6%) and consumer staples (+0.2%).

Emerging markets such as China (-20.7% return) and Taiwan (-22%) also struggled in 2022. Continuing tensions over Taiwan's independence from mainland China is an issue that is likely to trouble investors over coming years.

Australian shares as measured by the ASX 200 were more resilient but still declined by -1.1% for the year. The sharpest annual falls were in the Information Technology (-33.7%) and Consumer Discretionary (-20.4%) sectors as investors cut their growth expectations. Australian Real Estate Investment Trust (REITS) were also weak with a -20.5% return given the impact of rising interest rates and doubt over future demand. Yet there were some bright spots amidst the gloom with the Energy (+49%) sector on fire given the surge in natural gas and oil prices. Resources (+22.3%) benefitted from gains in select metal prices and a weaker Australian dollar.

Bond investors had a brutal year with sharp negative returns given rising inflation and alarm that central banks will continue to rapidly raise interest rates over coming years. The Australia fixed interest market return came in at -9.7% while the benchmark global bonds (hedged) return was -12.3%.

Global property securities also suffered with a -24.2% return in 2022. The sharp rise in interest rates and bond yield as well as worries about a potential global recession looming served to caution investors.

Essentially 2022 proved to be a year where cash was the prudent measure for safety with a small positive return. By contrast, Crypto currencies proved their lack of worth as "virtual money" with a disastrous performance in 2022. The two largest crypto currencies in Bitcoin and Ethereum suffered falls of more than 60% in US Dollar terms. Given episodes of spectacular bankruptcies (e.g., FTX) and "stable coins" that were more volatile than a volcano (e.g., Luna), crypto was shown to be a gamble for the reckless in 2022.

Prospects for the coming year

The troubling trio of rising inflation, higher interest rates and the war in Ukraine provided a painful investing climate in 2022. Inflation rose to multi-decade highs around the world with consumers being squeezed by the higher 'cost of living'. Central banks are rapidly raising interest rates to cool these inflation pressures.

Investors are very worried about whether central banks can safely navigate the challenge of moderating inflation without severely damaging economic activity. As interest rates sharply rose and financial conditions for borrowers become tougher, investors become naturally concerned that a global recession could occur in 2023.

There are some hopeful signs on global inflation pressures at the end of 2022. Lower global oil prices and shipping costs suggest that global inflation may have peaked. However, price pressures are still very evident with rising food costs, residential rents, and wages. Thus, the inflation threat remains on the radar for 2023.

For investors, assessing these considerable inflation and interest rate risks for the new year is very challenging. Given the current investment climate is dynamic with multiple positive and negative scenarios possible, investors should maintain a disciplined and diversified strategy to manage these extraordinary risks.

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