



QUARTERLY ECONOMIC AND MARKET UPDATE

June 2022 Quarter



- / Chartered Accountants
- / Business & Tax Consultants
- / Financial Planners

A history of shaping financial success

P 07 4924 9100 / E kennas@kennas.com / www.kennas.com

5th Floor Capricornia Electricity Centre Cnr Fitzroy & Alma Streets / PO Box 201 / Rockhampton Qld 4700



QUARTER IN REVIEW

QUARTER IN REVIEW

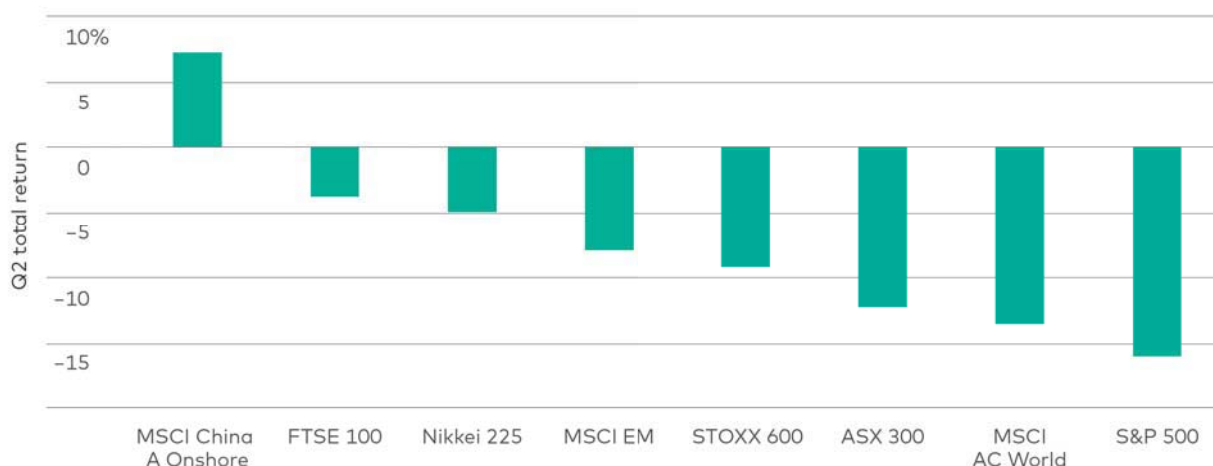
Investors navigated yet another volatile quarter as a deteriorating economic outlook saw risk appetite take a downward turn. Inflation remained a key focus as central banks aggressively hiked rates in efforts to contain it. Equity and bond markets continued to sell off as recession risks emerged, with global equities returning their first negative financial year in a decade (as measured by the MSCI World Index AUD).

Equities were once again led lower by tech stocks and other interest rate-sensitive sectors, while concerns over corporate earnings and slowing economic growth weighed on the broader market. Global equities fell 14% over the quarter, with Australian equities following developed market peers down by 12% (see chart below). European markets remained concerned over energy supply disruptions and

elevated inflation, while China's easing of COVID lockdowns spurred a rebound in Chinese markets from the first quarter's woes. A weaker Australian dollar provided some respite from declines in global equities, dampening losses to 8% for AUD investors.

Bond markets continued to endure the near-term pain of tightening monetary policy as central banks persisted with hiking interest rates. Yields trended upwards as markets weighed the prospects of increasingly hawkish policy against a picture of slowing growth and recession fears. Global bonds fell a further 4.7% and Australian bonds fell 3.8% over the last quarter as yields on U.S. and Australian 10-year government bonds rose by 66 basis points (0.66%) and 83 basis points (0.83%) respectively.

Figure 1. Global equities broadly declined



Notes: Returns are cumulative total returns in local currency.

Source: FactSet, as of 30 June 2022.



ECONOMIC AND MARKET OUTLOOK

A lot has changed since Vanguard published their Vanguard economic and market outlook for 2022: Striking a better balance. At the start of the year, Vanguard expected global economies to continue to recover from the effects of the COVID-19 pandemic, but at a more modest pace than in 2021. While that holds true, the pace of change in macroeconomic fundamentals such as inflation, economic growth, and monetary policy has failed to live up to expectations.

Labour and supply-chain constraints were already fuelling inflation before the year began, but Russia's invasion of Ukraine and China's zero-COVID policy exacerbated the situation. Central banks have been forced to play catchup in the fight against inflation, ratcheting up interest rates more rapidly, and possibly higher than previously expected. But those actions risk cooling economies to the point where they enter recession.

Global economic growth will likely stay positive this year, but some economies are flirting with recession, if not this year, then in 2023. Compared with the start of the year, Vanguard has downgraded its 2022 GDP growth forecasts for all the major regions, increased its inflation forecasts, and become more hawkish about monetary policy.

GREAT BALANCING ACT REQUIRED TO AVOID RECESSION

Australia's status as a commodities exporter has partly insulated it from some of the economic woes elsewhere, but global factors and rising inflation still have an impact. Broad-based and persistent inflation has the Reserve Bank of Australia on course to raise its target rate to at least 2.5% in 2022. A recession isn't likely in Australia unless major developed markets fall into recession first.

In the United States, inflation has reached 40-year highs, eroding consumers' purchasing power and driving the Federal Reserve to aggressively raise interest rates.

Vanguard expect the target federal funds rate landing in the 3.25%–3.75% range by year-end. Vanguard assess the probability of recession at about 25% over the next 12 months and 65% over 24 months. Vanguard believe that a period of high inflation and stagnating growth is more likely than an economic 'soft landing'.

China will fall far short of policymakers' GDP growth target of about 5.5%, given the challenge in achieving all three of their goals: growth, financial stability, and zero-COVID (the latter affects not just China's economy, but the global economy as well). Vanguard believe the actual 2022 GDP growth rate will be 3–4%, far below China's pace for many years. Given China's zero-COVID policy, additional outbreaks resulting in renewed lockdowns could further detract from growth.

In the euro area, headline inflation driven by high energy prices may spike to near 9% in the third quarter. Inflation has become widespread, spurring the European Central Bank on in what it expects will be a "sustained path" of interest rate increases. Europe's dependence on Russian natural gas and the challenges of managing monetary policy for 19 countries put the euro area at a higher risk of recession than the United States in the next 12 months. A complete cut-off from Russian gas would likely lead to rationing and recession.

In the United Kingdom, energy prices will likely drive the headline inflation rate to roughly 10% late in the year. Vanguard expect the Bank of England to raise the bank rate by an additional 1.25 percentage points over the next 12 months. A drop in real wages, combined with diminished consumer and business confidence and tightening financial conditions, could push the United Kingdom into recession.



FOR MORE INFORMATION CONTACT



Brent Giles
Partner / Director

*Certified Financial Planner
Aged Care Specialist
Life Risk Specialist*

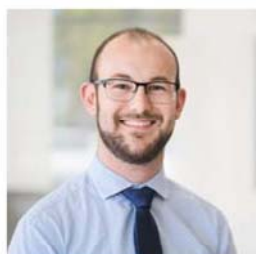
07 4924 9100
brentgiles@kennas.com



Andrew Landsberg
Partner / Director

Financial Planner

07 4924 9100
andrewlandsberg@kennas.com



Jake Duivenvoorden
Financial Planner

Certified Financial Planner

07 4924 9100
jakeduivenvoorden@kennas.com