Quarterly Economic Wrap

December Quarter 2021

Summary

- The U.S. consumer price index rose 0.5% for the month of December, 7.0% on a year-on-year basis, the fastest rate of increase since June 1982. It is now clear that some elements of inflation globally aren't transitory, while other elements will take significantly longer to dissipate than initially expected.
- The World Bank has lowered its forecasts for China's GDP to 5.1% during 2022.

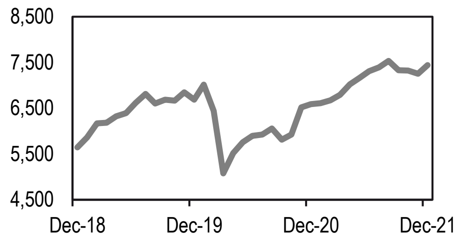
Markets

- Australian micro-cap equities performed very well over the December quarter, but the larger cap part of the equity market continued to struggle against global peers (see Chart 2), while value stocks again unperformed Growth stocks over the quarter (see chart 3). Note that Value stocks did have a very good December relative to Growth stocks.
- Emerging market equities continued to underperform developed markets. Note the difference over the quarter was about 9% (+7% vs -2%). Ongoing fears of the Omicron variant has triggered significant risk-off sentiment amongst investors (see Chart 4).

Key economic news

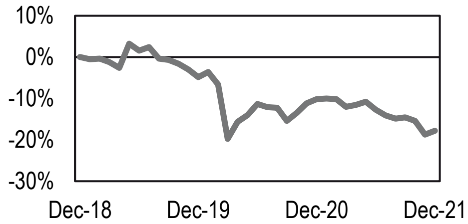
- In Australia, retail sales rose 7.3% month-on-month in November, well above the consensus for a 3.6% rise and following a 4.9% increase in October. That puts retail sales nationally 5.8% above their previous record high in November 2020 and 20.3% above pre-pandemic February 2020 levels.
- Federal Reserve Chairman Jerome Powell has declared that the U.S. economy is both healthy enough and in need of tighter monetary policy, sending a very clear signal of the Fed's intention to raise rates.

1. S&P/ASX 200 Price Index



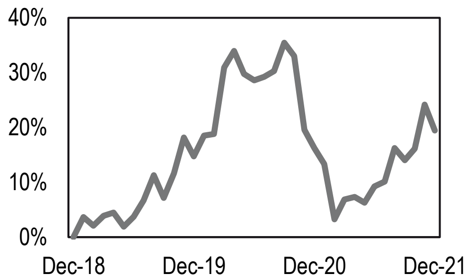
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



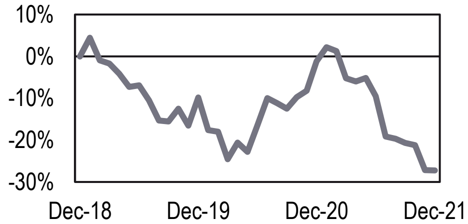
Source: Bloomberg, IOOF

3. Australia – Growth vs Value stocks



Source: Bloomberg, IOOF

4. Emerging markets vs Developed Markets, (In USD)



Sources: Bloomberg, MSCI, S&P, IOOF

Sector and stock returns

ASX/S&P 200 Sectors (GICS)				
	Monthly	**% Δ**	**Quarterly**	**% Δ**
▲	Consumer Discretionary	1.02	Consumer Discretionary	0.00
▼	Consumer Staples	-2.44	Consumer Staples	-0.49
▲	Energy	2.29	Energy	-8.82
▲	Financials ex Property	4.27	Financials ex Property	-3.35
▲	Financials	4.27	Financials	-3.35
▼	Health Care	-2.41	Health Care	-0.08
▲	Industrials	3.58	Industrials	1.14
▼	IT	-5.35	IT	-6.14
▲	Materials	6.43	Materials	12.44
▲	Property Trusts	3.79	Property Trusts	8.93
▲	Telecommunications	0.80	Telecommunications	4.86
▲	Utilities	6.88	Utilities	10.02

Source: Bloomberg, IOOF

Best and Worst S&P/ASX 200 Performers			
Top five stocks		**Bottom five stocks**	
Monthly			
Mineral Resources Ltd	+23.7%	Magellan Financial Group Ltd	-35.9%
Pilbara Minerals Ltd	+23.1%	Imugene Ltd	-27.3%
Graincorp Ltd-A	+21.5%	Afterpay Ltd	-23.7%
Champion Iron Ltd	+21.2%	Novonix Ltd	-23.1%
Iluka Resources Ltd	+17.2%	Life360 Inc-Cdi	-19.8%
Quarterly			
Pilbara Minerals Ltd	+56.1%	Magellan Financial Group Ltd	-39.9%
Nickel Mines Ltd	+52.1%	Zip Co Ltd	-38.7%
Lynas Rare Earths Ltd	+51.6%	Clinuvel Pharmaceuticals Ltd	-36.5%
Chalice Mining Ltd	+50.4%	Pendal Group Ltd	-32.6%
Reece Ltd	+41.3%	Afterpay Ltd	-31.6%

Source: Bloomberg, IOOF

Share Markets, December 2021

	Australian Indices	Dec-21 Price	1M return (%)	Sep-21 Price	3M return (%)
▲	S&P/ASX 200	7445	2.60	7332	1.53
▲	All Ordinaries	7779	2.53	7630	1.96
▲	Small Ordinaries	3529	1.15	3473	1.63
US Indices					
▲	S&P 500	4766	4.36	4308	10.65
▲	Dow Jones	36338	5.38	33844	7.37
▲	Nasdaq	15645	0.69	14449	8.28
Asia Pacific Indices					
▼	Hang Seng	23398	-0.33	24576	-4.79
▲	Nikkei 225	28792	3.49	29453	-2.24
UK & Europe Indices					
▲	FTSE 100	7385	4.61	7086	4.21
▲	CAC40	7153	6.43	6520	9.71
▲	DAX Index	15885	5.20	15261	4.09

Sources: Bloomberg, MSCI, FTSE, S&P, IOOF
Note: return is reported on a price basis and in local currency terms e.g. S&P500 performance is in US dollars and excluding dividends

Global equity markets

International markets generally performed well during the December quarter, with the exception of the Hang Seng index (down 4.79%) and the Nikkei (down 2.24%).

	1-mth	3-mth	6-mth	1-yr
MSCI World Index	1.7%	7.1%	11.3%	29.3%
Value	4.0%	6.2%	9.5%	28.9%
Value-Weighted	3.2%	5.0%	9.2%	31.5%
Momentum	-1.0%	4.8%	10.0%	21.2%
Growth	-0.4%	7.2%	12.3%	28.1%
Quality	1.4%	9.3%	13.7%	32.9%
Low volatility	3.6%	6.4%	9.8%	21.7%
Equal weight	2.7%	3.0%	6.5%	16.6%
Small caps	1.2%	1.3%	3.8%	22.4%

Source: Bloomberg, IOOF, MSCI

From a style perspective, all styles produced positive returns for the December quarter, with Quality being the standout. For the calendar year, all styles produced very favourable returns, with Momentum being one of the poor styles, but still retuning an impressive 21.2%.

Australian equity markets

The Australian market rose 1.53% in the December quarter. The leading sectors were Materials (up 12.44%) and Utilities (up 10.02%). Energy was the worst performer (down 8.82%). In the materials sector, BHP had a significant rebound after a relatively poor Q3 - this was a key driver for the sector.

	1-mth	3-mth	6-mth	1-yr
MSCI Australia Index	2.5%	1.5%	2.3%	16.3%
Value	4.6%	-0.6%	-1.3%	15.9%
Value-Weighted	4.1%	1.3%	2.2%	19.3%
Momentum	4.3%	2.5%	1.5%	8.6%
Growth	-0.4%	7.3%	12.5%	28.7%
Quality	0.9%	9.8%	14.6%	34.8%
Low volatility	2.7%	3.8%	5.9%	18.1%
Equal weight	2.7%	3.0%	6.5%	16.6%
Small caps	1.4%	2.0%	5.5%	16.9%

Source: Bloomberg, IOOF, MSCI

At a style level, Value was the worst performing style for the quarter, being the only style to produce a negative return, albeit a relatively small negative. Having said this, Value performed broadly in line with the Index for the year.

Overall, Quality and Growth continued to power ahead, both being the best two performers for the quarter and the calendar year.

Fixed Income

	Fixed Income	Dec-21 yield	1M mvt (bps)	Sep-21 yield	3M mvt (bps)
	Australian Cash rate	0.10	--	0.10	--
▼	10-year Bond Yield	1.67	-0.02	1.49	0.18
▲	3-year Bond Yield	0.91	0.05	0.31	0.60
▲	90 Day Bank Accepted Bills SFE-Day	0.07	0.02	0.02	0.05
▲	US 10-year Bond Yield	1.51	0.07	1.49	0.02
▲	US 3-year Bond Yield	0.96	0.12	0.51	0.05
▼	US Investment Grade spread	1.21	-0.04	1.07	0.14
▼	US High Yield spread	2.70	-0.62	2.56	0.14

Source: Bloomberg, IOOF

Australian bond market

Australian yields rose significantly during the quarter, with the three-year bond yield increasing by a very large 0.60%. The long end of the curve rose 18 bps, which again was a significant move. This led to a poor quarter for Australian Government bonds in general.

The size of the increase in the 3-year bond yield relative to the size of the changes in the cash and 10-year bond rates indicates that rate rises are expected but not immediately.

As more commentors around the world are suggesting that some inflationary pressures are less transitory than initially thought, bond yields will likely continue to trend higher.

US bond market

Similar to the Australian market, the U.S. three-year bond yield increased significantly (45 basis points) last quarter.

Credit spreads tightened over the quarter with both Investment Grade and High Yield spreads contracting by 14 basis points. Given the lower starting point of Investment Grade spreads, this is actually a more significant tightening for Investment Grade than High Yield, as the High Yield index spread is more than twice as wide to start with. Overall, U.S. credit had a favourable quarter.

The US Federal Reserve commenced tapering (reducing its bond purchases) in November. Since then, the Federal Reserve has provided multiple indications that its run of ultra-easy policy since the beginning of the pandemic is coming to a close, making aggressive policy moves in response to rising inflation. For one, the central bank said it will accelerate the reduction of its monthly bond purchases.

The Fed will be buying US$60 billion of bonds each month starting in January, half the level prior to the November taper and $30 billion less than it had been buying in December. The Fed was tapering by US$15 billion a month in November, doubled that tapering rate in December, then will accelerate the reduction further in 2022.

After that wraps up, in late winter or early spring, the central bank expects to start raising interest rates.

Recent projections indicate that Fed officials see as many as three rate hikes coming in 2022, with two in the following year and two more in 2024.

Currencies

	Currencies	Dec-21 Price	1M return (%)	Sep-21 Price	3M return (%)
▲	$A vs $US	72.63	1.91	72.27	0.50
▲	$A vs GBP	53.70	0.21	53.64	0.12
▲	$A vs YEN	83.68	3.75	80.42	4.05
▲	$A vs EUR	63.90	1.65	62.41	2.39
▲	$A vs $NZ	106.14	1.60	104.75	1.33
▲	$A TWI	61.10	1.50	60.80	0.49
▼	$US vs EUR	87.93	-0.29	86.38	1.79
▼	$US vs CNY	6.36	-0.13	6.44	-1.38
▼	$US vs GBP	73.92	-1.68	74.21	-0.39
▲	$US vs JPY	115.08	1.69	111.29	3.41
▼	$US vs CHF	91.29	-0.65	93.17	-2.02
▼	US Dollar Index	95.67	-0.34	94.23	1.53
▲	JPM EM Currency Index	52.57	0.27	55.24	-4.84

Source: Bloomberg, IOOF

The Australian dollar (AUD) rose 1.9% against the US Dollar (USD) to 0.7263 in December and rose 0.50% during the quarter. We also saw a 1.5% increase in value against major trading partners ($A TWI) in December and 0.49% for the quarter.

Since quarter end, the Australian dollar has weakened slightly to around $0.722. It is likely that the AUD will remain under pressure from the rising US dollar and Treasury yields, as traders brace for a hawkish surprise from the Federal Reserve. The US central bank is set to meet in late January, and although it is not expected to move rates immediately, a number of Fed officials have indicated readiness for a more aggressive path towards policy normalisation. Meanwhile, the Reserve Bank of Australia has repeatedly insisted that a hike in domestic rates is unlikely until 2023, or until inflation pushes sustainably within its 2-3% target range. The RBA also lagged behind other major central banks in dialling back pandemic-era stimulus, but is set to decide to end its bond-buying early this year at its February 1 meeting.

Commodities

	Commodities	Dec-21 Price	1M return (%)	Sep-21 Price	3M return (%)
▲	Aluminium	2803	6.96	2852	-1.71
▲	Copper	446	4.29	407	9.60
▲	Nickel	20874	4.50	17930	16.42
▲	Zinc	3580	11.57	2988	19.81
▲	Crude Oil - Brent	77.78	10.22	78.52	-0.94
▼	Natural Gas	3.73	-18.33	5.87	-36.42
	Metallurgical Coal	118	--	117	0.48
▲	Thermal Coal	177	3.78	196	-9.75
▲	Iron Ore	112.50	18.46	119.65	-5.98
▲	Gold	1829	2.93	1759	3.99
▲	Silver	23	2.35	22	5.71

Source: Bloomberg, IOOF

Commodities saw broad-based strength during the month, with Natural Gas being the only commodity shown in the table above to produce a negative return in December. Iron Ore prices increased at a rapid pace, as did Zinc and Crude Oil.

Concerns over the Omicron variant drove a major correction in **natural gas** selling off substantially during the month and quarter. Interestingly, Crude Oil rebounded during December.

Iron ore prices rebounded in December, but had a poor quarter. Overall, Chinese demand has slowed due to environmental controls on steel production. It has been forecast that China faces a deepening slump in its property sector in 2022, which will dampen growth and drag the price of iron ore down to $US90 a tonne, as authorities pursue only moderate stimulus and a zero-COVID-19 policy environment.

Nickel prices held up well in December and for the quarter. In days of consumption, exchange nickel stocks are at their lowest level for 15 years. Global demand is expected to increase by another 10% in 2022, chiefly driven by China's stainless steel and battery segments.

Australia

The Australian economy continues to perform well. Vaccinations continue with all states and territories now over 85% fully vaccinated (ages 16+). 92.2% of all Australians aged 16 and over are now fully vaccinated. Economic data continues to be solid, but it is likely that Omicron will impact economic activity, as supply chains struggle.

Coronavirus pandemic

While the number of Omicron cases has exploded across the country since late December, the number of people who have died or are in ICU are relatively low by previous wave standards, obviously helped by Australia's high vaccination rates. Based on ages 16+, as at 11 January 2022, the Northern Territory is now the least vaccinated state or territory in the country with 85.7% of the population double vaccinated. Western Australia, the second lowest, now sits at 86.6% double vaccinated. These are both high by world standards. Supply chains remain significantly disrupted by staff contracting COVID or having to isolate for a period.

Sentiment / Retail sales

Retail sales rose 7.3% month-on-month in November, well above the consensus for a 3.6% rise and following a 4.9% increase in October. That puts retail sales nationally 5.8% above their previous record high in November 2020 and 20.3% above pre-pandemic February 2020 levels.

Importantly in terms of Q4 GDP, monthly average retail sales for Q4 to date are 9.1% higher than they were in Q3 and are in fact 4.4% higher than they were in Q2. The retail data suggests it is possible the economy more than fully recovered its Q3 lockdown impacts as early as Q4 2021. Pent up demand from lost spending over lockdowns and anecdotes of some pull-forward of Christmas spending were likely factors.

The latest Omicron wave is also set to impact January figures, but as this data suggests, a swift rebound is likely once consumers are confident enough from a health perspective.

There are few indicators of service activity in the retail sales numbers, but of note café, restaurant and takeaway spending was up 9.3% month-on-month. The outsized strength was in goods demand, with clothing, footwear and personal accessory retailing up 38.2%, household goods retailing up 11.6% and department stores up 26.0%.

This most recent data again sees little evidence of the long-awaited rebalance away from goods spending. Instead both goods and services have risen together with spending on 'cafes, restaurants and takeaway services' recovering to be 4.2% above pre-pandemic February 2020 levels, while goods spending is an incredible 22.9% above pre-pandemic.

Labour market

Job vacancies rose 18.5% in the three months to November to 396k. That reflects some rebound after a 10% decline in August alongside lockdowns, but also sees vacancies comfortably reaching new highs. The level of vacancies is now 74% higher than pre-pandemic February 2020. There are now just 1.6 unemployed people per job vacancy, a new record low and well down from 3.1 prior to the pandemic. By state, the increase in vacancies were driven by Victoria (30.4% q/q) and NSW (27% q/q).

Job vacancy data continues to indicate a very high level of demand for workers post the lockdowns.

Growth

The International Monetary Fund forecasts that Australia's GDP will grow 4.1% in 2022 on the back of increased business activity and international borders reopening. However, the Omicron outbreak, which has spread rapidly since mid-December, is likely to make a reasonable dent in economic activity, with some economists and fund managers already reducing Q1 2022 GDP forecasts. Having said this, if the economy grows at anywhere near 4.1%, this would likely be a good outcome.

Other risks the country faces include prolonged global supply chain disruptions, tighter global financial conditions, geopolitical tensions, a house price correction, and climate-related events.

United States

Headline inflation again hits a 40-year high in December. Federal Reserve Chairman Jerome Powell declares that the U.S. economy is both healthy enough and in need of tighter monetary policy.

Coronavirus pandemic

On Monday, 11 January 2022, The United States reported 1.34 million COVID cases, with the daily case rate shattering global records as hospitalisations soared across the country.
At least 1,343,167 new COVID infections were identified, beating the previous record of 1,044,970 cases, set on 3 January 2022, by nearly 300,000.

The record in new cases came the same day as the nation saw the number of hospitalised COVID-19 patients also hit an all-time high, having doubled in just three weeks.

Across the United States, at least one in five eligible Americans, approximately 65 million people, are not vaccinated against COVID-19. More than 62% of the country has been fully vaccinated, but only 23% are fully vaccinated and boosted, according to data from the US Centers for Disease Control and Prevention.

Growth

The Federal Reserve Bank of Atlanta publishes data that estimates the GDP growth rate for the quarter until the official figures are released. The GDPNow model is showing the fourth quarter growth rate to come in at 6.8% for the 2021 calendar year. Going forward, the Conference Board currently forecasts U.S. GDP to be 3.5% for 2022 and 2.9% for 2023.

Inflation

The consumer price index rose 0.5% for the month of December, 7.0% on a year-on-year basis, and was again the fastest rate since June 1982. The annual move comes amid a shortage of goods and workers and on the heels of unprecedented cash flowing through the U.S. economy from Congress and the Federal Reserve. Core inflation (excluding volatile food and energy prices) also rose 0.6% for the month and 5.5% year-on-year, which itself was again the sharpest pickup since mid-1991. The Dow Jones estimate was for a 7.0% annual gain for headline CPI and 5.4% for core, so the high figures weren't unexpected.

Used vehicle prices, which have been a major component of the inflation increase during the COVID pandemic due to supply chain constraints that have limited new vehicle production, rose another 3.5% in December, bringing the increase from a year ago to 37.3%. Conversely, energy prices mostly declined during December, falling 0.4% as fuel oil was down 2.4% and gasoline fell 0.5%. Still, the energy complex as a whole rose 29.3% in the 12-month period, including a gain of 49.6% for gasoline. Shelter costs, which comprise about one-third of the CPI, increased 4.1% on the year, which again was the highest since 2007. Food prices broadly rose 0.5% for December and were up 6.3% on a 12-month basis, the largest rise since October 2008.

Investors largely expect the Fed to start raising rates in March. Fed Chairman Jerome Powell, at his confirmation hearing before the Senate banking panel, did not provide any specific dates, but acknowledged that as long as current conditions persist, rate hikes are on the way. As on 13 January, markets are pricing a nearly 79% chance for the first quarter-percentage point increase to come in May, and see about a 50% chance the Fed could enact four such hikes in 2022, according to the CME's FedWatch Tool.

Policy

Federal Reserve Chairman Jerome Powell declared that the U.S. economy is both healthy enough and in need of tighter monetary policy.
As part of his confirmation hearing before the U.S. Senate Committee on Banking, Housing and Urban Affairs, Powell said he expects a series of interest rate hikes this year, along with other reductions in the extraordinary help the Fed has been providing during the pandemic era.

"As we move through this year … if things develop as expected, we'll be normalizing policy, meaning we're going to end our asset purchases in March, meaning we'll be raising rates over the course of the year," he told committee members. "At some point perhaps later this year we will start to allow the balance sheet to run off, and that's just the road to normalizing policy.".

China

The producer price index (PPI) climbed 10.3% from a year earlier. While high, it was below expectations, which means lower factory gate inflation. The World Bank has lowered its forecasts for China’s GDP to 5.1% during 2022.

Credit growth

China's banks extended CNY 19.95 trillion in new yuan loans in 2021, up 1.6 percent from CNY 19.63 trillion in 2020, as the central bank stepped up efforts to support the slowing economic growth despite concerns over debt and property bubble risks. Household loans, mostly mortgages, increased to CNY 7.92 trillion, while corporate loans rose to CNY 12.02 trillion. In December alone, however, new bank lending fell to CNY 1.13 trillion from CNY 1.27 trillion in the previous month and below market expectations of CNY 1.25 trillion.

Policy

Expectations of an interest-rate cut in China are increasing after authorities pledged to ensure economic stability this year.

China’s central bank fuelled speculation it will ease monetary policy sooner rather than later with its vow in December to take “proactive” action. Fresh pandemic outbreaks and lockdowns add to challenges for an economy already grappling with weak private consumption and a property market slowdown. Looser policy contrasts to the U.S., where traders now expect the Federal Reserve will hike rates four times this year.

China’s policy shift became evident in early December. President Xi Jinping oversaw a meeting of the Communist Party’s Politburo that concluded with a signal of an easing on real estate curbs -- a key overhang for the economy. The PBoC then lowered the amount of cash banks needed to hold in reserve, adding liquidity to the financial system. Chinese banks followed with a cut to their key lending rate in December for the first time in 20 months.

Inflation

China's factory-gate prices rose more slowly than expected in December after government measures to contain high raw material prices, leaving room for easing monetary policy.

The latest data showed that the producer price index (PPI) climbed 10.3% from a year earlier. Economists in a Reuters poll had expected the PPI index to gain 11.1% after a 12.9% rise in November.

Factory inflation has moderated in recent months from a 26-year high in October as Beijing intervened to stabilise high raw material prices and ease an energy power crunch.

China's consumer price index (CPI) grew 1.5% year-on-year in December. Economists in a Reuters poll had expected a 1.8% uptick, after a 2.3% increase in November.

Growth

The World Bank cut its forecasts for economic growth in China and warned that new coronavirus outbreaks, high debt and persistent supply chain bottlenecks will jeopardise economic activity, particularly in developing economies.

The World Bank downgraded China’s GDP growth estimate to 8 per cent for 2021, from a previous forecast of 8.5 per cent, with the economy expected to slow to 5.1 per cent in 2022, from 5.4 per cent. It kept its forecast for 5.3 per cent growth in 2023 stable.

UBS is more bearish on Chinese growth than the World Bank, seeing GDP slowing to 4.5 per cent by the end of 2023, well below pre-pandemic levels, with the fall largely because of a declining property sector reaching “saturation point”.

China’s response to the property downturn will remain accommodative this year though further easing is likely to be very modest and within a prudent range. UBS does not expect any policy rate cut this year partly because of current inflationary pressures. China does not typically rely on rate instruments in setting monetary policy.

The world's second-largest economy is clearly facing a series of headwinds in 2022, including property woes, a slowing manufacturing sector and COVID-19 outbreaks.

Europe

The ongoing high energy prices and stretched supply chains remains a significant headwind on European economic activity, while the ECB continues to indicate no short-term interest rate rises.

Coronavirus pandemic

During December we saw the number of COVID-19 cases skyrocket. The number of cases in Europe is now over a million new cases a day if you include the UK, as at 9 January 2022. Vaccinations levels continue to rise with 80.5% of the EU adult population fully vaccinated as at 12 January, this is up about 6% when compared to 3 months ago. Since early September, Europe including the UK, has seen average daily cases climb from around 120k/day to now over 1m/day as of 9 January. We have also seen a sharp rise and then decline in daily deaths rising from around ~2,000/day in early September to ~6,000/day in late November, to now be down to ~2,350/day.

Policy

With the latest inflation figures higher than what many investors had anticipated, it raises the question as to whether it will lead the European Central Bank (ECB) to adjust policy.

The ECB has already said it will soon halt some asset purchases, but a further tightening seems unlikely given recent comments. The ECB's chief economist recently stated that the case for higher interest rates "is not there." The ECB leadership has consistently taken the view that the recent surge in inflation is temporary and that, as supply chains return to normal, inflation is expected to diminish. Recent reductions in shipping costs and increases in industrial output in Asia suggest some improvement in supply chain efficiency.

Growth

Average growth reached 5.5% on a year-on-year basis in the first three quarters of 2021, mainly driven by the effects of fiscal stimulus, re-opening of the economy and the rollout of vaccines. While the economic outlook remains positive, risks to European growth appear to tilt to the downside in the short-to-medium term.

A key risk is global supply constraints, which are significantly impacting the Euro area manufacturing sector. For example, supply chain bottlenecks are contributing to higher input costs and longer delivery times. This has contributed to the manufacturing Purchasing Managers Index (PMI) falling from a peak of 63.4 in June to 58 in December 2021. If supply chain bottlenecks are more persistent than expected, they will limit economic activity in the Euro area and negatively impact the current outlook, which at the moment remains relatively favourable.

Inflation

Inflation continued to accelerate in the 19-member Eurozone, with consumer prices up 5% in December versus a year earlier. This was the highest headline inflation since the Eurozone was created two decades ago. Prices were up 0.4% from the previous month. In addition, when volatile food and energy prices are excluded, core prices were up 2.6% in December versus a year earlier, also a record high. Core prices were up 0.4% from the previous month. The difference between the headline and core inflation was mainly due to the 26% annual increase in energy prices.

By country, annual inflation was 5.7% in Germany, 3.4% in France, 4.2% in Italy, 6.7% in Spain, 6.4% in the Netherlands, 6.5% in Belgium, and 5.7% in Ireland. The unusually high inflation rate in Germany is due, in part, to the reversal of the pandemic-related reduction in the value-added tax (VAT). The increase in the VAT is a one-off event and the impact will gradually fade, thereby reducing inflationary pressure. On the other hand, recent price increases will likely factor in upcoming collective bargaining, thereby boosting wages and possibly contributing to a wage-price spiral.

Euro zone inflation still looks set to remain well above the ECB's 2% target for much of next year, but at this stage, the ECB seems content to continue as planned. i.e. no short-term rate rises, but some reduction in asset purchases.

Company news - best and worst performers for December 2021

Pilbara Minerals Ltd (PLS, +56.1%)

Pilbara Minerals (PLS) rode the wave of positive momentum experienced by lithium miners in December. PLS released positive updates on both Pilgangoora and Mid-Stream Projects, with its Ngungaji Plant receiving improved concentrate production and is now expected to produce 180,000-200,000 tonnes per year from July 2022. Shipping guidance, however, has been delayed due to delays with commissioning, ramp-up initiatives, and extended plant shutdowns (labour shortage). Lithium explorers and miners also experienced a boost from a Chilean referendum that elected to write a new constitution to address climate change and the potential nationalisation of lithium within the company.

Nickel Mines Ltd (NIC, +52.1%)

Nickel Mines (NIC) benefitted from a strong nickel price that rebounded strongly from October's low, and rode along a general positive momentum in the lithium sector as nickel is a core ingredient used in EV batteries. NIC increased its ownership of Angel Nickel Project to 80% and released a series of positive results showing that the first shipment of ore is expected to occur materially earlier than expected (1Q CY22 vs. 3Q CY22). NIC also announced the acquisition of 70% equity interest in Oracle Nickel Project, which is expected to benefit from location synergies with NICs Angel Nickel Project.

Lynas Rare Earths Ltd (LYC, +51.6%)

Lynas Rare Earths (LYC) released a positive quarterly result showing that 1Q22 sales increased to $121.6m and total REO production increased to 3,166 tonnes. LYC benefitted from a strong increase in rare earths prices, with average selling prices rising from A$19.4/kg in 1Q21 to A$44.6/kg, and further benefitting from the general momentum experienced in the lithium sector as rare earths are also a core component in electric batteries.

Magellan Financial Group Ltd (MFG, -39.9%)

Magellan Financial Group (MFG) experienced a series of setbacks after announcing the departure of the group CEO Brett Cairns, the loss of a key retail client mandate, and general underperformance of their portfolio. Magellan reassured investors that the setbacks are all temporary and continue to remain focused on managing the portfolio.

Zip Co Ltd (Z1P, -38.7%)

Zip Co (Z1P) and the broader BNPL sector suffered a drawdown over the quarter as concerns stemming from rising interest rates and an RBA report suggesting that the regulator would shortly ban BNPLs "no surcharge" rules caused Z1Ps share price to retreat.

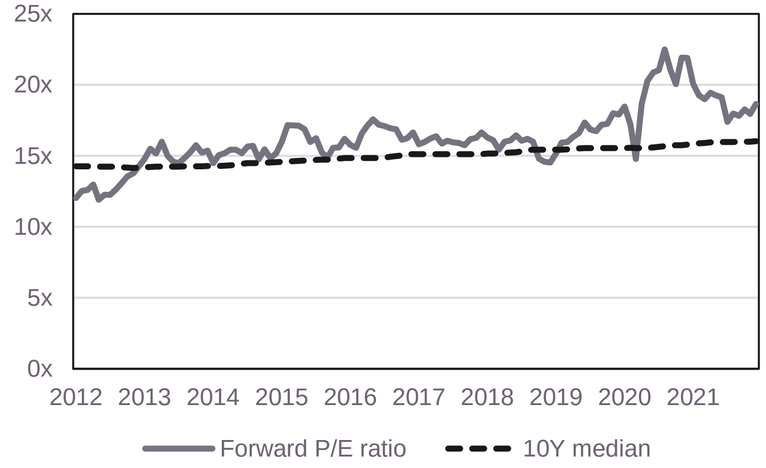
Clinuvel Pharmaceuticals Ltd (CUV, -36.5%)

Clinuvel Pharmaceuticals (CUV) retreated from its 4Q21 highs after releasing a series of positive test results relating to its R&D pipeline and strong manufacturing results of its lead product SCENESSE. CUV reported a record A$25.7m PBT and revenues of A$48.5m (+43% year-on-year). SCENESSE remains the only approved treatment for the metabolic disorder (EPP) that results in lifelong light intolerance.

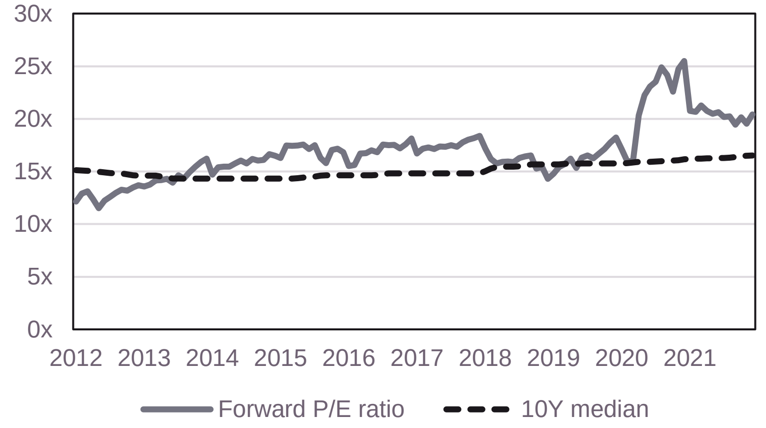
Sources: ASX company announcements, Bloomberg, Factset, Fund manager disclosures, Australian Financial Review, Sydney Morning Herald

Market valuations (Forward P/E vs 10Y median Forward P/E)

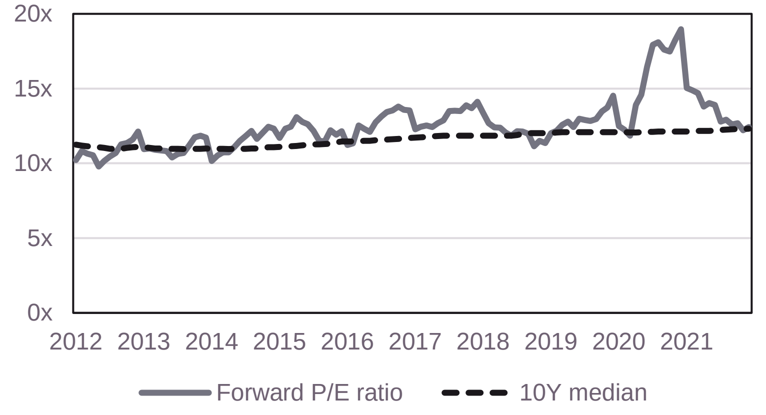
Australian Shares Forward P/E – spot vs trailing 10Y median (Jan-12 to Dec-21)



Global Shares Forward P/E – spot vs trailing 10Y median (Jan-12 to Dec-21)



Emerging Market Shares Forward P/E – spot vs trailing 10Y median (Jan-12 to Dec-21)



Sources: Bloomberg, MSCI, S&P

Indices (top to bottom): Australian Shares: S&P/ASX 200 Index; Global Shares: MSCI World ex Australia Index; Emerging Markets Shares: MSCI Emerging Markets index.

Asset class performance to December 2021 (Total returns in AUD)

				Annualised					
Asset class	**1-mth**	**3-mth**	**6-mth**	**1-yr**	**3-yr**	**5-yr**	**7-yr**	**10-yr**	**15-yr**	**20-yr**
Australian equities (S&P/ASX 200)	2.7%	2.1%	3.8%	17.2%	13.6%	9.8%	9.0%	10.8%	6.2%	8.5%
Australian equities - Mid caps	4.2%	5.8%	10.0%	21.3%	20.0%	14.3%	14.4%	14.3%	7.3%	11.1%
Australian equities - Small caps	1.4%	2.0%	5.5%	16.9%	15.7%	11.2%	11.3%	8.0%	3.4%	7.2%
Australian equities - Micro caps	4.3%	8.3%	28.6%	43.8%	33.7%	17.6%	17.8%	8.3%	5.0%	-
International equities	1.7%	7.2%	11.5%	29.6%	20.6%	15.1%	13.6%	16.8%	8.1%	6.1%
International equities (Hedged)	4.0%	7.9%	8.5%	23.9%	20.2%	14.0%	12.0%	14.6%	8.8%	9.0%
International equities - Small caps	1.2%	1.3%	3.8%	22.4%	17.9%	12.2%	12.3%	16.2%	8.4%	8.2%
Emerging Markets equities	-0.6%	-1.9%	-6.3%	3.4%	9.8%	9.8%	7.9%	9.2%	5.0%	7.7%
Australian REITs	4.9%	10.1%	14.7%	26.1%	12.8%	9.3%	10.6%	13.8%	3.3%	7.1%
Global REITs	3.7%	9.5%	12.7%	33.8%	10.6%	7.7%	7.8%	12.4%	4.1%	-
Global REITs (Hedged)	5.9%	10.2%	10.0%	28.6%	10.4%	6.9%	6.4%	10.5%	4.3%	-
Global Infrastructure	4.6%	6.8%	10.8%	21.9%	10.1%	9.3%	8.6%	12.7%	6.4%	-
Global Infrastructure (Hedged)	6.4%	7.3%	8.1%	16.4%	10.2%	8.7%	7.5%	10.9%	8.8%	-
Trend following (USD)	0.3%	-3.5%	-5.7%	2.9%	3.4%	0.4%	-0.5%	1.2%	3.2%	5.3%
Australian bonds	0.1%	-1.5%	-1.2%	-2.9%	2.9%	3.4%	3.2%	4.2%	5.2%	5.3%
Australian bonds - government	0.1%	-1.4%	-1.1%	-3.1%	2.9%	3.4%	3.2%	4.0%	5.2%	5.3%
Australian bonds – corporate	0.2%	-1.5%	-1.3%	-1.6%	3.5%	3.9%	3.8%	4.8%	5.6%	5.6%
Australian bonds - floating rate	0.0%	-0.1%	0.0%	0.3%	1.7%	2.1%	2.4%	3.1%	3.9%	4.4%
Global bonds (Hedged)	-0.4%	0.0%	0.1%	-1.5%	3.5%	3.2%	3.5%	4.6%	6.0%	6.4%
Global bonds - government (Hedged)	-0.7%	0.1%	0.1%	-2.0%	3.0%	2.9%	3.3%	4.5%	5.9%	6.2%
Global bonds - corporate (Hedged)	-0.1%	0.0%	0.0%	-1.0%	5.7%	4.4%	4.5%	5.8%	6.6%	7.0%
Global bonds - High Yield (Hedged)	1.6%	-0.5%	-0.4%	2.2%	5.8%	4.6%	5.8%	7.6%	8.1%	-
Emerging Market bonds (Hedged)	1.5%	-0.4%	-1.3%	-2.5%	5.1%	4.0%	4.8%	5.9%	7.2%	9.5%
Cash (AUD)	0.0%	0.0%	0.0%	0.0%	0.6%	1.1%	1.4%	1.9%	3.1%	3.7%

Sources: Bloomberg, IOOF calculations
* AUD total returns as at Dec-21 assuming reinvestment of dividends unless otherwise specified
** Returns reflect index performance excluding any fees; Actual ETF/managed fund performance will vary due to both fees and tracking error.

Appendix – Index sources

Asset class	Index
Australian equities (S&P/ASX 200)	S&P/ASX 200 Accumulation Index
Australian equities - Mid caps	S&P/ASX Accumulation Midcap 50 Index
Australian equities - Small caps	S&P/ASX Accumulation Small Cap Ordinaries Index
Australian equities - Micro caps	S&P/ASX Emerging Companies Total Return Index
International equities	MSCI World ex Australia Net Total Return (in AUD)
International equities (Hedged)	MSCI World ex Australia Hedged AUD Net Total Return Index
International equities - Small caps	MSCI World Small Cap Net Total Return USD Index (in AUD)
Emerging Markets equities	MSCI Emerging Markets EM Net Total Return AUD Index
Australian REITs	S&P/ASX 200 A-REIT Accumulation Index
Global REITs	FTSE EPRA/NAREIT Developed Index Net Total Return (in AUD)
Global REITs (Hedged)	FTSE EPRA/NAREIT Developed Index Net Total Return (Hedged to AUD)
Global Infrastructure	FTSE Global Core Infrastructure 50/50 Net Total Return in AUD
Global Infrastructure (Hedged)	FTSE Global Core Infrastructure 50/50 100% Hedged to AUD Net Tax Index
Trend following	SGI Cross Asset Trend Following Index (USD)
Australian bonds	Bloomberg AusBond Composite 0+ Yr Index
Australian bonds – government	Bloomberg AusBond Govt 0+ Yr Index
Australian bonds – corporate	Bloomberg AusBond Credit 0+ Yr Index
Australian bonds - floating rate	Bloomberg AusBond Credit FRN 0+ Yr Index
Global bonds (Hedged)	Bloomberg Barclays Global Aggregate Total Return Index Value Hedged AUD
Global bonds - government (Hedged)	Bloomberg Barclays Global Aggregate Treasuries Total Return Index Hedged AUD
Global bonds - corporate (Hedged)	Bloomberg Barclays Global Aggregate Corporate Total Return Index Hedged AUD
Global bonds - High Yield (Hedged)	Bloomberg Barclays Global High Yield Total Return Index Hedged AUD
Emerging Market bonds (Hedged)	J.P. Morgan EMBI Global Core Hedged Index Level AUD
Cash (AUD)	Bloomberg AusBond Bank Bill Index

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Research Analyst Disclosures:

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