Investment update – May 2022

What's rattling markets and what does it mean for investments

As we put this together, the Australian share market has started another day with a solid downward move. Early trading has it down 2.45%, following the lead of the US share market overnight, which dropped 3.2%. This follows a tough week, with the Australian market down approx. 6% in total, and the US market down 5.2%.

In fact, since the start of the financial year, the Australian share market has been volatile and is down approx. 7.6% year to date:

Source: Yahoo Finance

The movements in markets, particularly volatile moves, are generally caused by new information. That means that no one can accurately predict the future and when something happens or changes that is different to what was expected, all the information that goes into valuing a company is recalculated. Volatile moves are also caused by uncertainty, meaning that where we will be in 6,12 months or 2 years are a little less clear than before.

For example, February and March 2020, as the World first encountered COVID and realised the enormity of the problem, we saw the Australian share market fall approx. 37% in a 6 week period. Once the plan for vaccines, public health, lockdowns, government stimulus to the economy became known, we saw the Australian share market dramatically recover by the end of that year (including having the strongest month on markets in 50 years in late 2020) to almost the same point as before COVID, which was at all-time highs.

So what's different now:

- **Ongoing and unknown outcome of the Ukraine War** – Tighter and tighter sanctions on Russia, are putting a squeeze on other economies, due to Russia being the one of the top suppliers of oil in the world, along with Ukraine and Russia being a major farming region for much of Europe.

- **Zero-COVID policy in China** – the continuing approach from China on hard lockdowns has put a huge dampener on their economy, not only from supplying the world with goods, but also the growing middle class of Chinese population spending on foreign goods.
- **Inflation** – Towards the end of last year, while inflation was looking at moving above "normal" ranges (2-3% pa), the view was this was temporary due to supply issues. That is, major manufacturing nations couldn't get materials or not able to work at full capacity (like China with their lockdowns), meaning we had to pay more for the limited supply there was. It now appears that this issue is not as temporary as expected, making prices grow quicker and longer than expected.
- Interest Rates – The Reserve Bank adjusts interest rates to control inflation. Given the change in expectation, it now is looking like they will need to move them quicker and higher than thought, so there is speculation as to how well they get these calls right or if this "brake" on the economy will be pushed too hard.

Higher potential interest rates are the thing that most are focused on that the moment, as higher interest rates means that it costs more to borrow money, which in turn reduces the amount that you can afford to borrow. Hence the downward pressure on shares and property. It also means that the companies that are borrowing money, have higher costs within interest, potentially reducing the profit they expect to make, and again, leading to a share price dropping accordingly.

So, this is all bad news, Right?

The answer is………it depends.

- If you are a saver and have money in the bank – term deposits suddenly look pretty good as an investment again.
- If you are thinking of making some purchases in the near future - hopefully higher interest rates will hopefully stop the prices of what you are planning on buying from growing too much (like a potential property purchaser).
- If you are a borrower – your monthly costs may have gone up with interest rate changes. This means that it puts pressure on other areas of your budget, and not able to spend as much as other parts of your lifestyle.
- If you are a seller of an investment – then you may face the prospect of your price dropping as higher costs for the buyer (due to interest costs) reduces what they can't afford. Also a higher borrowing cost makes investors seek a higher potential return for the extra cost, which they now might not see.

Overall, this does not mean we throw all investments out the window and start again. When constructing a portfolio, we look at good long term quality investment managers with different investment styles and combine together. This provides diversification in approaches, across investment areas. For example, while Growth investment managers have done extremely well from 2016-2020, Value fund managers have seen great opportunities from 2020-now.

From now forward, Value managers appear to have great opportunity, BUT this can change and change quickly. Overall, this means that while we monitor markets, and research, wouldn't expect to make changes in client's overall asset allocation as this is built for long term success.

The saying goes "Time in the market, not timing the market." Trying to guess how the market will move in a day, a week or a month really can be a heads or tails call, but what we do know is staying

invested moves beyond the short-term volatility and produces the returns over the long term. So, in comparison to the graph above with YTD at -7.6%, by staying invested in the Australian share market over the last 10 years, up to today, and including this last year would have provided an overall growth of 74%. And this is before any dividends were received which would have added a much higher result on this!

Source: Yahoo Finance

We want our client's success to be due to good management and not good luck!

We are more than happy to discuss your investments, how your portfolio is positioned and why. Please feel free to reach out to your adviser.