Market and Economic Review
July 2022

A shifting backdrop

June was another very tough month for markets, with broad based selling across shares and bonds. Whilst we have retained defensive positions across our Funds, including significantly increased cash levels, the breadth of selling meant it was very difficult to avoid negative performance across the Funds this month.

The landscape is shifting. The last six months have been characterised by sharp increases in interest rates, coupled with increasing expectations for hikes over the rest of this year. But now there is evidence that economic growth is rapidly weakening as the headwinds of inflation, higher interest rates and higher energy prices impact consumer spending.

Expectations of weaker growth weighed disproportionately on energy, resource and financial stocks in the month. This sent the previously resilient Australian market lower, ending the month down 8.9%. Even defensive stocks struggled in June, although they still outperformed the broader share market. Contact Energy (-2.3%), Woolworths (+2.7%) and Telstra (-0.8%) all fall into this category.

A rapidly deteriorating growth outlook keeps us more cautious on the outlook for shares. Our Funds are still very defensively positioned, with much lower exposure to shares than we would usually hold. But falling growth should also result in lower inflation in due course, which in turn should enable central banks to slow or stop their interest rate hiking plans (the key source of market weakness this year). One implication of this is that bonds, which have suffered significant losses since the start of the year, should start to stabilise. Furthermore, with many bonds offering yields in the range of 5-10%, future returns are looking more promising.

Over the past month we have increased our exposure to bonds. Corporate issues such as a Barclays Bank bond offering around 10% yield and a Brisbane Airport bond offering around 7% yield are just two examples of attractively valued investments. We will likely continue to selectively add to bond positions over coming weeks.

Halfway through the year, the short-term outlook remains challenging. However, as described above, some attractive investments are becoming available. For those investors that can weather the volatility, this bodes well for longer-term returns.

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