

Investment Newsletter – July 2022

Muddle through continues...

Slowing not stalling - The Australian economy continues to flash amber light, indicating that the general level of economic activity across the nation continues to slow with businesses and consumers feeling nervous. However, most seasoned forecasters are not predicting a recession. The Australian federal treasurer, Jim Chalmers, recently provided the official government forecast for economic growth of 3% and 2% in 2023 and 2024, respectively. That is an acceptable level of economic growth considering there is a bit of uncertainty about - we will take that with a smile!

By the way, economic growth is slowing by design and is exactly what the Reserve bank had been wishing for. Simply put, the Reserve bank would like us all to buy a little less of everything to give the supply side of the economy a bit of breathing space from coping with shortage of labour to shortage of raw materials & products in various supply chains.

Turning to markets, investors' portfolios should have posted positive gains in July and early August after two months of negative returns in Australian equities (-13%) in April and June. Since 1 July (incidentally the start of the new financial year) the share market has been enjoying a relief rally of sorts with ASX200 benchmark index rising 500 points or +7.5% over the past five weeks. The rally in share prices came after investors formed the view that the Reserve Bank of Australia (RBA) may slow down the pace of its interest rate hikes in the coming months as opposed to the previous expectation of no retreat, no surrender approach to interest rate increases.

Profits & dividends are under pressure - As we write this piece in the first week of August 2022, Australian companies, listed on the stock exchange, commenced reporting their full year financial results to 30 June 2022.

Of the handful of companies that have reported so far, we can see those with market power, such as the major insurers and banks, have shown resilience in holding their revenues mostly steady with some pluses and minuses. Operating profits have in most part taken a hit due to higher costs and abnormal trading conditions at times such as weather impacts. However, where possible, companies such as Telstra & Commonwealth Bank have grown their dividends leveraging their strong cash position but at the same time they have painted an uncertain outlook for dividends over the coming year.

Insurance sector stocks are a clear example of strong price inflation being passed onto consumers. Insurance Australia Group (owner of NRMA and CGU), Suncorp, and QBE have made firm statements that consumers will be seeing +10% growth in insurance premiums this year. This augurs well for insurers' profits to bounce later this year. Resultingly,

share prices of insurers have charted a decent recovery in recent weeks.

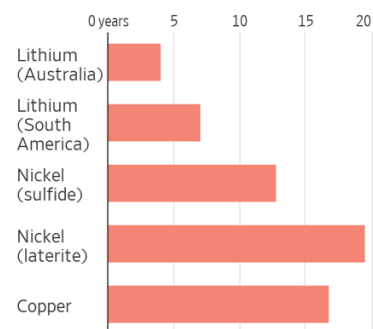
In commodities, strong long-term prospects for Copper must have motivated BHP to make its recent takeover bid for OZ Mineral which is a pure play copper miner and very synergistic to BHP's own operations. The \$8.4 billion cash bid was rejected by OZ Minerals as being too low. As we wait for BHP to respond to the rejection it is worthwhile recapping the long-term outlook for Copper.

Copper is used extensively in electric vehicles and battery storage, which means it will be a major beneficiary of global **efforts to decarbonise**. The looming supply shortfalls could hamper nations' goals of reaching net-zero emissions by 2050. Electric vehicles (EV), solar and wind power, and batteries for energy storage all run on copper. An EV requires 2.5 times as much copper as an internal combustion engine vehicle.

Copper demand is expected to double to 50 million metric tons per annum by 2035. By 2050, demand will reach more than 53 million metric tons per annum. To put this figure in perspective, that's more than all the copper consumed in the world between 1900 and 2021.

But here is the issue with meeting this demand for Copper. Firstly, Copper at present is produced in a range of politically volatile regions ranging from Africa, South America, China and Russia. The transition metals such as Copper are increasingly being seen as a basis for developing new world order. Countries are rushing to secure supplies of copper, lithium, nickel and other vital raw materials. The chart below shows that with new copper mines taking over 15 years to get first production, it clearly poses an unsettling lead time to get new mines developed in time when carbon emissions related climate catastrophes and transition to electrification has already started!

Average observed lead times from discovery to production for selected minerals, 2010-2019



Source: IEA

BHP is already a top global producer of copper which should ease many a shareholder nerve of the fear of missing out!

GLOBAL MARKETS OVERVIEW

	Units	Month End Value	Price Performance (% Chg)			
			1-day	1-mth	6-mths	1-year
Developed Markets Equities						
ASX 200	AUD	6,945	0.80%	5.74%	-0.38%	-6.05%
ASX 200 Futures	AUD	6,860	1.02%	6.18%	1.18%	-3.89%
Dow Jones	USD	32,845	0.97%	6.73%	-6.51%	-5.98%
S&P 500	USD	4,130	1.42%	9.11%	-8.53%	-6.03%
Stoxx Europe 600	EUR	438	1.28%	7.64%	-6.52%	-5.08%
FTSE 100 (UK)	GBP	7,423	1.06%	6.73%	-6.51%	-5.56%
DAX (Germany)	EUR	13,484	1.52%	5.48%	-12.84%	-13.25%
CAC (France)	EUR	6,449	1.72%	8.87%	-7.87%	-2.48%
Nikkei 225	JPY	27,802	-0.05%	5.34%	2.96%	1.90%
Emerging Markets Equities						
MSCI Emerging Markets	USD	994	-0.38%	-0.69%	-17.75%	-22.23%
Shanghai Composite	CNY	3,253	-0.89%	-4.28%	-3.22%	-4.24%
South Korea	KRW	2,452	0.67%	5.10%	-7.95%	-23.45%
Taiwan	TWD	15,000	0.73%	1.18%	-15.13%	-13.03%
Brazil	BRL	103,165	0.55%	4.69%	-8.01%	-15.30%
South Africa	ZAR	62,474	0.49%	3.93%	-7.88%	-6.60%
Foreign Exchange						
AUDUSD	Currency	0.6985	-0.06%	1.19%	-1.16%	-4.89%
AUDGBP	Currency	0.5739	0.00%	1.24%	9.19%	8.63%
AUDEUR	Currency	0.6834	-0.31%	3.77%	8.65%	10.44%
AUDCNY	Currency	4.71	-0.04%	1.95%	4.63%	-0.87%
Commodities						
LME ALUMINUM 3MO (\$)	USD/mt	2,489	1.32%	1.76%	-17.63%	-3.92%
LME COPPER 3MO (\$)	USD/mt	7,918	2.00%	-4.12%	-16.71%	-18.61%
LME NICKEL 3MO (\$)	USD/mt	23,619	7.68%	4.06%	5.78%	20.80%
SILVER FUTURE Sep22	USD/oz	20.20	1.66%	-0.76%	-10.37%	-21.62%
ICE Newc Coal Fut Oct22	USD/mt	384.75	-2.72%	10.26%	158.92%	277.58%
62% Import Fine Ore in USD	USD/t	106.33	0.00%	-7.96%	-19.75%	-40.47%
Gold Spot \$/Oz	USD/oz	1,766	0.58%	-2.29%	-1.74%	-2.66%
WTI Oil	USD/bbl	98.62	2.28%	-4.35%	22.19%	49.06%
Henry Hub	USD/mmBtu	8.33	-3.81%	28.15%	49.82%	113.04%
Corn	USD/Bu	616.25	0.20%	-17.14%	-1.56%	12.66%
Wheat	USD/Bu	807.75	-1.13%	-7.02%	6.11%	14.78%
Fixed Interest						
10-Yr Bond Yield						
Australia	AUD	3.06%	-0.15%	-0.60%	+1.16%	+1.88%
US	USD	2.65%	-0.03%	-0.36%	+0.87%	+1.43%
Germany	EUR	0.82%	-0.01%	-0.52%	+0.81%	+1.28%
Japan	JPY	0.19%	-0.02%	-0.05%	+0.01%	+0.16%
Italy	EUR	3.02%	-0.15%	-0.24%	+1.73%	+2.40%
Australian Rates						
Cash Rate	AUD	1.35%	+0.00%	+0.50%	+1.25%	+1.25%
90-Day BBSW	AUD	2.15%	-0.02%	+0.31%	+2.08%	+2.13%
180-Day BBSW	AUD	2.77%	-0.11%	+0.06%	+2.53%	+2.72%
CBOE Options						
CBOE VIX (Volatility Index)	Index	21.33	-4.48%	-25.71%	-14.10%	16.94%

Data as of 31 July 2022

ECONOMIC NEWS

• **In Australia the RBA** delivered its first ever consecutive 0.5% interest-rate hike, taking cash rate to 1.35%, the highest since May 2019, with RBA Chief Philip Lowe signalling a steady series of interest rate increases, expecting rate to rise to 2.5% neutral level, as he highlighted the difficult road to a soft landing for the economy. The Australian government downgraded economic growth outlook for both 2023 and 2024 to 3% and 2%, respectively, due to accelerating inflation, higher interest rates and a slowing global economy with Treasurer Jim Chalmers forecasting Australian inflation peaking at 7.75% by December before moderating to 5.5% in June 2023 and then returning inside the RBA's 2-3% target in 2024.

• **Global growth outlook.** IMF cut its global growth outlook for 2022 to 3.2% with advanced economies down to 2.5% (U.S. down to 2.3%, euro area down to 2.6%, U.K. down to 3.2% and Japan down to 1.7%) and developing economies down to 3.6% (China down to 3.3% and India down to 7.4%), and 2023 to 2.9% with advanced economies to 1.4% (U.S. to 1.0%, euro

area to 1.2%, U.K. down to 0.5% and Japan to 1.7%) and developing economies to 3.9% (China 4.6% and India to 6.1%), warning that the world economy may soon be on the cusp of an outright recession as it upgraded world inflation outlook for both 2022 and 2023 to 8.3% and 5.7%, respectively.

• **U.S.** The Fed raised interest rates by +0.75% for the second straight month to 2.25-2.5%, however, Fed Chair Jerome Powell said it will likely be appropriate to slow rate hikes at some point, while rejecting speculation that the US economy is in recession. U.S. Economy shrank for a second straight quarter in June quarter with GDP declining -0.9% annualized rate, as decades-high inflation undercut consumer spending and Federal Reserve interest-rate hikes stymied businesses and housing. US consumer confidence declined in July to the lowest level since February 2021 on dimmer views of the economy amid persistent inflation with US Census Bureau survey revealing the share of Americans who report having difficulties paying their bills has surpassed its 2020 pandemic peak in July, and US manufacturing activity continued to cool in July with a gauge of factory activity easing to the lowest level since June 2020.

• **China** Economy grew at the slowest pace in two-years in June quarter 2022 with GDP growing +0.4% p.a. the second weakest growth ever recorded. Factory activity unexpectedly contracted in July with official PMI falling below the 50-mark that indicates a contraction in activity.

• **Europe.** ECB raised its key interest rate by +0.5% to 0%, the first increase in 11 years and the biggest since 2000 and President Christine Lagarde announced prior guidance on September rate move no longer applies as policy makers may be more dovish during the next meeting. Euro-zone economy expanded by more than three times the amount economists expected in June quarter 2022, with GDP growing +0.7% over the quarter and +4% p.a. which saw European Commission maintaining real GDP forecast for EU of 2.7% for 2022. However, downgraded economic growth to 1.5% for 2023 and for euro area to 2.6% for 2022 and 1.4% for 2023, while upgrading inflation projections for EU to 8.3% p.a. for 2022 and 4.6% p.a., and for euro area to 7.6% p.a. for 2022 and 4% p.a. for 2023. Confidence in the euro-area economy fell to the weakest in almost 1.5 years in July with consumer confidence slumping to lowest level on record amid worries over rising inflation with July inflation surging by +8.9% p.a. with core inflation also reaching a new high of 4%.

• **Japan.** The central bank of Japan (BOJ) kept rates and its 10-year treasury yield target unchanged and announced it remains prepared to ease further if needed, despite upgrading inflation (ex food) forecasts for 2022 to 2.3%, for 2023 to 1.4% and for 2024 to 1.3%, while downgrading 2022 GDP growth forecast to +2.4% and upgrading 2023 and 2024 GDP growth forecast to +2.0% and +1.3%, respectively. BOJ's quarterly survey revealed Japanese households' medium-term inflation expectations have climbed to the highest level in almost 14 years with households seeing an annual inflation of 5% in the next five years, the highest reading since September 2008

GLOBAL MARKETS UPDATE

• The ASX200 gained +5.7% and US markets were stronger in the month, with the Dow Jones up +6.7% and S&P500 up +9.1%.

- Long-dated US treasury yields declined with the 2-and-10-Yr yield curve inverting, with 2-Yr yield at 2.89% and 10-Yr yield at 2.65%.
- WTI oil price declined -4.4% on weaker demand outlook.

THE LONG READ

Gold-plate your portfolio against inflation

With the ghost of the 1970s haunting investors around the world, hard assets can provide some protection

The past six months have been torturous for investment portfolios, with no place to hide. Bonds and equities are in negative, while holding cash in the bank would have dented your purchasing power. We all know that inflation is the clear culprit behind the current economic malaise.

Now the real fear is that, since general prices have been rising for the past 12 months, higher inflation may have become malignant and entrenched in the economy. By raising interest rates in quick succession, central banks seem to be exercising an unflinching resolve to fight surging inflation. The market in general appears to be accepting the narrative that central banks may just succeed in capping inflation and may just bring it back down to the modest level of 2-3% p.a. ***Don't be so sure, just yet!***

What if central banks cannot bring inflation down sustainably because the price pressures resulting from Ukraine/Russian war and global supply chain disturbances are essentially out of their control?

What will happen if the reserve bank of Australia, after excessive interest rate increases, becomes nervous seeing the economy sink into a recession resulting in high unemployment, social unrests, and pressure from politicians; and yet it still cannot get inflation down far enough? Would it then try and cut rates quickly?

This abrupt raising and cutting of interest rates while the underlying causes of inflation from overseas remain unresolved can very easily result in persistently high inflation. That scenario would not be unprecedented, just read the economic history of the late 1960s to late 1970s.

Under that scenario, you will have entrenched stagflation where inflation will stay at higher levels maybe 5% -10% (higher if additional global risks materialise) and economic growth becomes stuck between 0%-2% p.a. at the best of times.

If the above scenario unfolds, and I am hoping it doesn't, then the U.S. Dollar will likely lose its value against harder assets such as gold which is seen as a better preserve of economic value in times of uncertain inflation, during wars, and general economic uncertainty. For 2020–2030, currencies are in danger of being overproduced by the central banks in an attempt to resolve economic and financial crises unleashed due to the pandemic of 2020.

More generally, politicians have worked out that they really don't need to raise taxes, cut spending, and/or balance the government budget when they can just print money to fund their burgeoning funding needs of wars, national defence (big theme emerging), education, healthcare, and welfare.

All this means inflation! ***Gold and silver excel during inflationary times.***

Those poor, roughed up crypto visionaries dusting off from the most recent and vicious sell off in crypto currencies had the right idea about central banks' money printing causing obvious depreciation of fiat currencies.

But it is clear that the alternatives the crypto bros offered for preserving value are opaque, unruly, and infantile in many instances. Cryptos have time and again failed the first test of maintaining price stability.

Meanwhile, gold (and other hard assets such as silver) has clearly won the contest for offering a mature and sensible alternative to fiat currencies as a source of diversification in investment portfolios.

During the high inflationary period of the 1970s, gold price went from \$US34/oz in 1970 to \$US650/oz in 1980 that is a rise of 19x over the ten-year period. This happened because investors believed holding long-term cash or low returning investments in US dollars when inflation was running high and higher was less beneficial than preserving wealth via holding gold.

More recently, if you analyse the selloff in the share market earlier this year you will notice that the gold price was actually rising as shares were being sold off between January and March. Since April 2022, though, gold price weakened in line with the share market when the reserve bank of Australia started to make certain calls about how it will raise interest rates to fight inflation. Investors have taken this as a signal that they don't have an immediate need to insure their portfolios with gold as the thinking is that the RBA may just control the inflation.

But as we have alluded to earlier, if RBA fails then the gold trade will be on.

Therefore, amidst the uncertainty of the future direction of inflation and the elevated risk of monetary policy missteps by central banks, investors may want to place some protections against inflation in their investment portfolio. ***Gold based investments may just be the answer!***

For enquiries:

- geoff.walley@investwisely.co
- Phone (02) 9634 6698 (within Australia), or
- Write to:
Investwisely Pty Ltd
Shop 7, 1 Circa Boulevard
Bella Vista NSW 2153

IMPORTANT DISCLAIMER – Please read carefully
This newsletter is copyright and is for the clients of Investwisely Pty Ltd. The reproduction of any part of the letter, for any purpose, is not permitted. The view expressed in the newsletter are for general information purposes only and are not meant to be taken as personal financial advice.