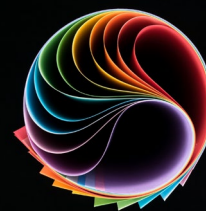


# Multi-asset review Q1 2022



*Here our Multi-Asset team discusses Russell Investments' performance in the March quarter and their outlook for 2022.*

## What drove markets during the first quarter of 2022?

The first quarter of 2022 saw growth assets largely underperform their defensive counterparts against a backdrop of rising inflation, global rate hike expectations and heightened geopolitical risks.

Several events helped shape market movements over the quarter:

### 1. Reserve Bank of Australia (RBA) maintains cash rate, ends its bond purchase program<sup>1</sup>.

The RBA left the official cash rate on hold at a historically low 0.10% throughout the quarter. The Bank also decided to cease any further purchases under its bond purchase program, with final purchases taking place on 10 February. The Bank's decision to end its bond purchases followed a review of the actions of other central banks, the functioning of the local bond market and the progress toward the RBA's goals of full employment and inflation consistent with its target. In terms of the economic outlook, the Bank said the Australian economy remains resilient and that spending is picking up following the Omicron setback. However, officials did recognise that the war in Ukraine is a major new source of uncertainty. The RBA expects the unemployment rate to fall below 4.0% later this year and remain below 4.0% next year, while underlying inflation is

<sup>1</sup> Source: RBA

expected to increase further in coming quarters to around 3.25% before declining to around 2.75% over 2023 as supply-side issues are resolved and consumption patterns normalise. The RBA concluded its March meeting by saying it remains committed to maintaining highly supportive monetary conditions to achieve its objectives of a return to full employment and inflation consistent with its target. The Bank also reaffirmed that it won't increase the cash rate until actual inflation is sustainably within its 2-3% target range.

### 2. Commodity prices surge on supply concerns<sup>2</sup>.

Commodity prices rose for an eighth consecutive quarter, with the Refinitiv/CoreCommodity CRB Commodity Index closing the period up 27.0% on concerns Russia's invasion of Ukraine will significantly impact supply. Oil extended its gains, with the price for West Texas Intermediate crude closing the quarter 30.3% higher at USD100.28 a barrel as investors worried that Russia sanctions could see up to 4.3 million barrels a day removed from the market. Oil had hit as high as USD123.70 a barrel in early March, though prices did ease toward the end of the period amid fears country-wide lockdowns in China would sap demand and confirmation the Biden Administration will release as many as 180 million barrels from the country's strategic reserves over the next six months. For the year, oil returned 69.5%. Gas, wheat and base metals were also

<sup>2</sup> Source: Bloomberg

higher; the latter led by very strong gains in nickel (53.7%). Nickel rose amid concerns over Russian supply – which accounts for around 5% of global output – at a time when global stockpiles are already at multi-year lows. Iron ore (33.5%), aluminium (24.0%), zinc (17.9%) and copper (6.4%) also performed well, while lead (3.5%) recorded more modest returns. Meanwhile, gold made further gains over the quarter; the precious metal returning 5.9% on the back of rising inflation, a surge in new coronavirus infections in China and heightened geopolitical risks.

Global shares fell 8.4%<sup>3</sup> in the March quarter. Australian shares significantly outperformed their global peers over the period, returning 2.1%<sup>4</sup>. The local market benefited in part from the RBA's insistence that it's still too early to discuss raising interest rates despite the market bringing forward its rate hike expectations following the latest inflation figures. Stocks also benefited from strong gains across the major mining companies and a series of encouraging economic data, including a strong rebound in December quarter growth and a further decline in the unemployment rate. Limiting the gains were heightened geopolitical risks following Russia's invasion of neighbouring Ukraine, fears that rising US inflation will force the Federal Reserve (Fed) to lift interest rates faster than expected and a fresh outbreak of COVID-19 in China. Emerging markets equities underperformed their developed counterparts over the period, closing the quarter 9.9%<sup>5</sup> lower.

The Australian dollar (AUD) rose over the period, with the Australian Trade-Weighted Index closing the quarter up 4.1%<sup>6</sup>. The AUD benefited from strong gains across the wider commodities complex, stronger inflation and employment figures and domestic rate hike expectations. Limiting the currency's advance were heightened geopolitical risks and US rate hike expectations.

Interest rate sensitive assets were mixed for the quarter. Australian and global listed property both underperformed over the period. Global and

Australian bonds were also weaker, while global listed infrastructure performed strongly.

Credit markets were weaker for the quarter. Spreads on US and European investment-grade and high-yield debt widened as investors turned more cautious amid increasingly hawkish central bank comments and the war in Ukraine. The war in Ukraine, together with a surge in new COVID-19 infections across China, also weighed on local and hard currency emerging markets debt.

### How did Russell Investments' active multi-asset portfolios perform in the March quarter? What was rewarded by the market and what wasn't?

**Absolute returns.** The Russell Investments Balanced Fund returned -3.3%<sup>7</sup> for the quarter on a net of fees and tax basis. Performance was driven primarily by negative absolute returns from the Fund's fixed income and global equity exposures.

**Returns relative to fund benchmark.** The Russell Investments Balanced Fund underperformed its strategic benchmark by 0.6% on a net of fees and tax basis.

#### Positive contributors included:

- An overweight to Australian equities.

#### Negative contributors included:

- Overweight exposures to global equities and listed property trusts.
- Negative excess returns from the Russell Investments Tax Effective Global Shares Fund and the Russell Investments Australian Shares Core Fund.
- An overweight to Australian bond duration.

<sup>3</sup> Global shares measured by the MSCI World ex Australia Net Accumulation Index (in AUD)

<sup>4</sup> Australian shares measured by the S&P/ASX 300 Accumulation Index

<sup>5</sup> Emerging markets measured by the MSCI Emerging Markets Index Net (in AUD)

<sup>6</sup> The trade-weighted index for the AUD is an indicator of movements in the average value of the AUD against the currencies of our trading partners. Source: RBA.

<sup>7</sup> Source: Russell Investments. Past performance is not a reliable indicator of future performance.

## What is Russell Investments' outlook for 2022? How is it impacting your active multi-asset positioning?

The war in Ukraine adds to near-term growth risks for the global economy and will likely keep inflation elevated for longer. Whilst uncertainty is high, we believe equity markets are oversold and should recover if tensions ease in the coming months.

We believe the conflict will lead to lower global growth – with Europe taking the largest hit – as well as higher inflation. Even so, we believe global growth could still be above trend this year, provided the hostilities ease and global energy prices stabilise. Whilst above-trend growth should support equities over bonds and cash, the conflict has created significant uncertainty, which likely means more market volatility.

We expect the US economy to be among the most resilient to the conflict given its energy independence and lower share of commodity consumption in gross domestic product. Further, with interest rate hikes now priced in for each of the Fed's remaining meetings this year, we see this as a maturing risk factor to markets.

Despite the war in Ukraine, we have a small preference for non-US developed equities over US equities. Provided the hostilities do subside, above-trend global growth should favour relatively cheaper non-US markets.

For fixed income assets, government bonds have mixed valuations after the recent selloff. US bonds

are now fairly valued but Japanese, German and UK bonds are still expensive. Yields will face upward pressure from rising inflation and central bank hawkishness. One positive we see is that markets have fully priced in hawkish outlooks for most central banks, which should limit the extent of any further selloff in government bonds.

In the currency space, the US dollar (USD) has gained on the back of Fed hawkishness and its traditional 'safe haven' characteristics during the war in Ukraine. We believe the USD should weaken if hostilities subside and if reduced inflation outcomes later in the year lead to less Fed tightening than markets currently expect. The main beneficiaries in this scenario are likely to be the euro, which has become more undervalued, and the Japanese yen, which has weakened on commodity price inflation and China growth concerns.

Moving forward, the more complex risks come from Russia and Ukraine's integration into global supply chains and their importance in commodity markets. Surging motor vehicle prices, due to parts shortages, were one of the important drivers of rising inflation globally in 2021. The war in Ukraine could delay the recovery in global automobile production and prevent prices from declining. Rising food prices also pose a significant risk, with about a quarter of the world's wheat exports coming from Russia and Ukraine. Food prices are an issue for inflation as well as a risk for political stability in many emerging economies.

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