Quarterly market update: NFPs and the fight against inflation

By Perpetual Private Insights
14 July 2022

Life - and investment markets - love a paradox.

After the initial shock, the Great Lockdown saw markets soar. Today, in spite of unemployment in major economies near record lows, consumer pockets stuffed with cash and business activity running hot, real estate, equities and fixed interest assets have all cratered.

The June 2022 Perpetual Private Quarterly Market Update looks at how markets and economies shifted over the past quarter and why the price of money explains the paradox above. You can download the full report – or read our concise review below.

[Download the report]

June Quarter 2022: What happened?

- After avoiding the worst of the inflation/rising rate selloff in the previous quarter, Australian Equities played catch-up with the rest of the world – dropping over 12%.
- Global shares lost nearly 8% over the quarter and are now down 15% for the first 6 months of 2022.
- Around the globe and here at home, rising rates brought listed property back to earth – down 17% in Australia and 9% for global indices.

- Global bond markets, traditionally a safe haven, were instead storm-tossed – down over 9% over the past two quarters.

(Indices referenced: S&P/ASX 300 index , S&P/ASX 300 Utilities (Sector) - Total Return, S&P/ASX 300 Energy (Sector) - Total Return S&P/ASX 300 Information Technology (Sector) - Total Return, MSCI AC World Index - Net Return. S&P/ASX 300 A-REIT (Sector) - Total Return index, MSCI World / Specialized REITs -SUB - Net Return index, Bloomberg Global Aggregate (AUD Hedge). All performance numbers for June quarter unless otherwise stated).

Post-traumatic inflation disorder

In opening every available cash spigot to offset the economic trauma of the Great Lockdown, central banks and governments around the world set inflation running. There was debate about how transitory that inflation would be but it's now clearly in danger of becoming embedded. So central banks are turning off the taps. In many cases the imperative to do so is baked into their charters and most are signed up to the view of the Bank of International Settlements (BIS): "As historical experience has shown time and again, the long-term costs of allowing inflation to become entrenched far outweigh the short-term ones of bringing it under control.[1]

By raising rates – sometimes dramatically – Central Banks are trying to reduce the excess demand that's driving inflation in the global economy. Their balancing act – between crushing inflation and crushing growth - is complicated by China's zero-Covid policies and the war in Ukraine, which the BIS called, "Probably the most significant geopolitical event since the fall of the Iron Curtain."

Implications for NFP's spending and investment policies

As Andrew Garrett, Investment Director at Perpetual Private points out in the video above, a world where interest rates are no longer set to 'emergency' is not something to fear – it's a return to normal. In this he's joined by the Governor of the Reserve Bank, Philip Lowe, who announced his recent 0.50% rate rise by talking about "normalising monetary conditions.

In a world where ultra-low interest rates aren't the norm, investors with an ability to buy quality asset cheaply – a so-called value style - may do well. The times may also suit 'active' investors– because when all assets valuations are not supported by a tide of cheap money, selective and well-timed moves in and out of securities becomes more important.

The NFP imperative

But what are the implications of this changing economic order for NFPs? According to Andrew, there are two key implications and they both relate to how NFPs manage their cash.

According to the ACNC's Australian Charities Report 8th Edition, more than half of the sector's costs come from paying employees. These costs are likely to rise as workers seek higher wages to help manage rising inflation. Similarly, NFPs will need to budget for a general rise in the costs of the goods and services they use in their operations and their programs.

On the income side of the balance sheet, NFPs face different pressures. With inflation at over 5% and going higher, the value of the cash in NFP investment portfolios is being eroded – and fast. “NFPs need to have cash on hand to manage programs and expenses,” says Andrew. “But many NFPs have grown comfortable holding high cash balances as part of a conservative investment approach. However, in a rising inflation world, NFPs need to make sure they’re maximising the income they’re getting from their cash. They need to consider moving some of that cash – prudently – into higher-returning assets. If they don’t, they’re effectively cutting into the funds they can deploy to achieve their mission, today and tomorrow.”

Perpetual Private’s Quarterly Investment Update for March to June 2022 offers detailed analysis of the performance and outlook for all the major asset classes including equities, fixed income, real estate, currency and alternatives.

Download the report

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[1] Sometimes called the "Central Banks', Central Bank" - see www.bis.org/publ/arpdf/ar2022e_ov.htm