



2022

GLOBAL MARKET OUTLOOK

CONTENTS

Overview: Cautiously Optimistic in 2022	1
Economic Outlook	4
Key Investment Topics for 2022 & Beyond	11
Investment Strategy	16
Asset Classes	18

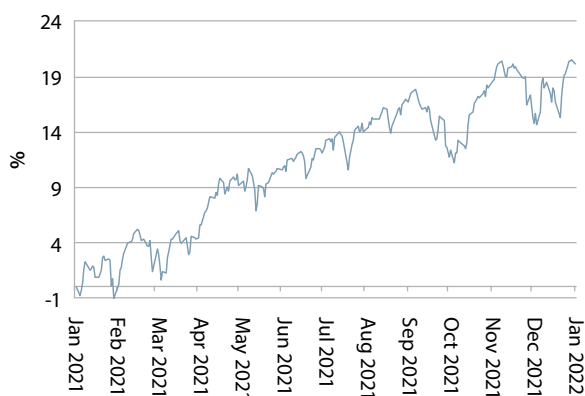
OVERVIEW

CAUTIOUSLY OPTIMISTIC IN 2022

Scene appears set for equities to grind higher amidst heightened volatility.

2021 was a year in which we anticipated a perhaps surprisingly optimistic outlook for markets. As it transpired, even the most bullish of investors would have been impressed by the gains from equity markets last year. Another year of global lockdowns, the emergence of new COVID-19 variants, stagflation fears, a major oil shock and regulatory reforms in China were just some of the headlines causing consternation for investors in 2021. Despite this, equity markets, as measured by the MSCI World Index climbed a staggering 20%, led by the United States, where the S&P 500 for the first time in more than two decades recorded its third successive year of double digit returns. These gains were supported by incredibly strong earnings growth and the continuation of unconventional monetary policy and fiscal tools usually reserved for wartime.

FIGURE 1: MSCI WORLD INDEX 2021 PERFORMANCE



Source: Bloomberg, ANZ PB&A CIO, as at 1 January 2022

As 2022 gets underway, we maintain our broadly optimistic tone for risk assets but would warn against any expectations of double digit returns from equities like those experienced in 2021. Rather, we commence the year with a mild overweight to risk assets based on cautious

optimism and a belief that, despite more moderate returns in 2022, equities should continue to outperform bonds and cash — albeit against a backdrop of heightened volatility, particularly in H1 as central banks continue the withdrawal of liquidity measures implemented during the height of the pandemic. Here, we expect US equities to again be the leader, marking what would be the fifth successive year of outperformance relative to the rest of the world — a feat not achieved in the last 50 years.

This expectation of moderate gains for equities is underpinned by an outlook of strong growth, where robust consumer demand, elevated household savings accumulated throughout the pandemic and the continuation of relatively easy policy should see GDP rise globally by roughly 4% in 2022 — led by Australia (5.1%), the United States (4.5%) and Europe (4.4%). In China, growth is expected to slow to 4.6% this year, which 2020 aside, would represent the weakest figure in modern history.

This scenario represents our base case for 2022, and as always there are potential downside and upside risks to any setting. At this point, key downside risks centre on Omicron, the potential for further COVID-19 mutations and inflationary pressures or more specifically how central banks tackle these.

COVID-19 variants have the potential to unhinge the global recovery, bring further widespread lockdowns, more persistent supply-chain pressures and with them sustained elevated inflation. Positively though, despite the rapid spread of the newest mutation Omicron, so far it appears to be less virulent than Delta and governments are largely resisting the need for broad-based lockdowns. Medical advances, rising inoculation rates and nuanced restriction measures provide hope that Omicron or any further virus mutations will become speedbumps rather than brick-walls for the global growth agenda in 2022.

Inflationary pressures and more precisely the reaction function of central banks will perhaps be most telling for asset prices this year. In 2022, we expect inflation to moderate in H2 from the highs seen in late 2021 as supply-chain dynamics begin to normalise and base effects

continue to wash through the data. Nonetheless, inflation is still expected to settle above pre-pandemic levels and this 'stickier' inflation will present an interesting dynamic for policy makers, particularly if growth shows any signs of dissipating earlier than expected.

If inflationary pressures do indeed ease, then this may release some of the need for central banks to hike so aggressively in the second-half of the year. 10-year US government bond yields should track around the 2% mark, leaving real yields negative; this environment is likely to be supportive for risk assets.

Conversely, if supply-side pressures persist and inflationary pressures remain elevated into H2 then this could trigger a belief that central banks may need to tighten more aggressively than currently expected, resulting in a strong risk-off scenario for equities. Here, growth is likely to be constricted, which alongside stubbornly high inflation would present a very unpleasant hand for policy makers.

Historically, central banks have been able to loosen monetary policy to stimulate growth, but with rates at historic lows across much of the developed world, this lever remains partially redundant. The Bank of England (BoE) commenced its hiking cycle in late 2021 and should be joined by the US in early 2022. While these increases will provide central banks with some 'dry powder' for future crises, any hiking is unlikely to be enough to see monetary policy become the dominant policy tool for central banks in the near-term. Rather, fiscal policy looks set to become the tool of choice for policy makers in 2022 and the years ahead.

While there are downside risks to our cautiously optimistic outlook for 2022, any near-term pullback in markets is likely to signal a healthy correction from what are already 'frothy' global share markets. If conditions are attractive it may even provide the opportunity to increase risk assets further.

As always, we advocate for a long-term, diversified investment strategy to help navigate changing market environments. In 2022, we will be making several changes to our strategic asset allocation as well as looking out for longer-term structural shifts in markets, to better prepare portfolios not only for 2022 but also for the decade ahead. You can read further about some of these in our 'Key Investment Topics' section later in the document.

Personally, I'm extremely excited to have joined ANZ late last year – and with the hope of borders remaining open and a return to normalcy long-overdue, I'm looking forward to meeting many of you and discussing our investment views further. As always, we trust this publication provides you with an understanding of what we are expecting in the year ahead. On behalf of ANZ, I'd like to take this opportunity to thank you for your ongoing support. We look forward to continuing to assist you with your investment needs in 2022 and beyond.



Lakshman Anantakrishnan

Head of Investment Strategy, ANZ Private Banking & Advice

TABLE 1: INVESTMENT RETURNS

Asset class	2012-2021 annualised returns	2021 returns	2021-2031 forecast annualised returns*
Australian shares	10.8%	17.5%	6.0%
International shares (unhedged)	16.8%	29.6%	6.7%
International shares (hedged)	14.6%	23.9%	6.7%
Emerging market shares	9.2%	3.4%	8.3%
International property (hedged)	10.5%	31.3%	5.7%
Infrastructure (hedged)	11.6%	18.5%	6.2%
Australian fixed income	4.2%	-2.9%	1.3%
International fixed income (hedged)	4.6%	-1.5%	1.7%
Cash	1.9%	0.0%	1.6%

Index information: To 31 December 2021. Australian Shares - S&P/ASX 300 Accumulation| International shares unhedged - MSCI World ex Australia (Net)| International shares hedged - MSCI World ex Australia Net Index (hedged to AUD)| Emerging market shares - MSCI Emerging Markets (Net) in AUD| International property - FTSE EPRA/NAREIT Developed Rental Index ex Australia (hedged)| Infrastructure - FTSE Developed Core Infrastructure Net Hedged to AUD| Australian fixed income - Bloomberg AusBond Composite (0+Y)| International fixed income - Bloomberg Barclays Global Aggregate (AUD Hedged)| Cash - Bloomberg AusBond Bank Bill. Source: FactSet, ANZ PB&A CIO.

* Annualised returns are forecast through to September 2031 using Willis Towers Watson (WTW) capital market assumptions (CMA) from September 2021. CMAs are gross of fees and taxes unless otherwise stated.

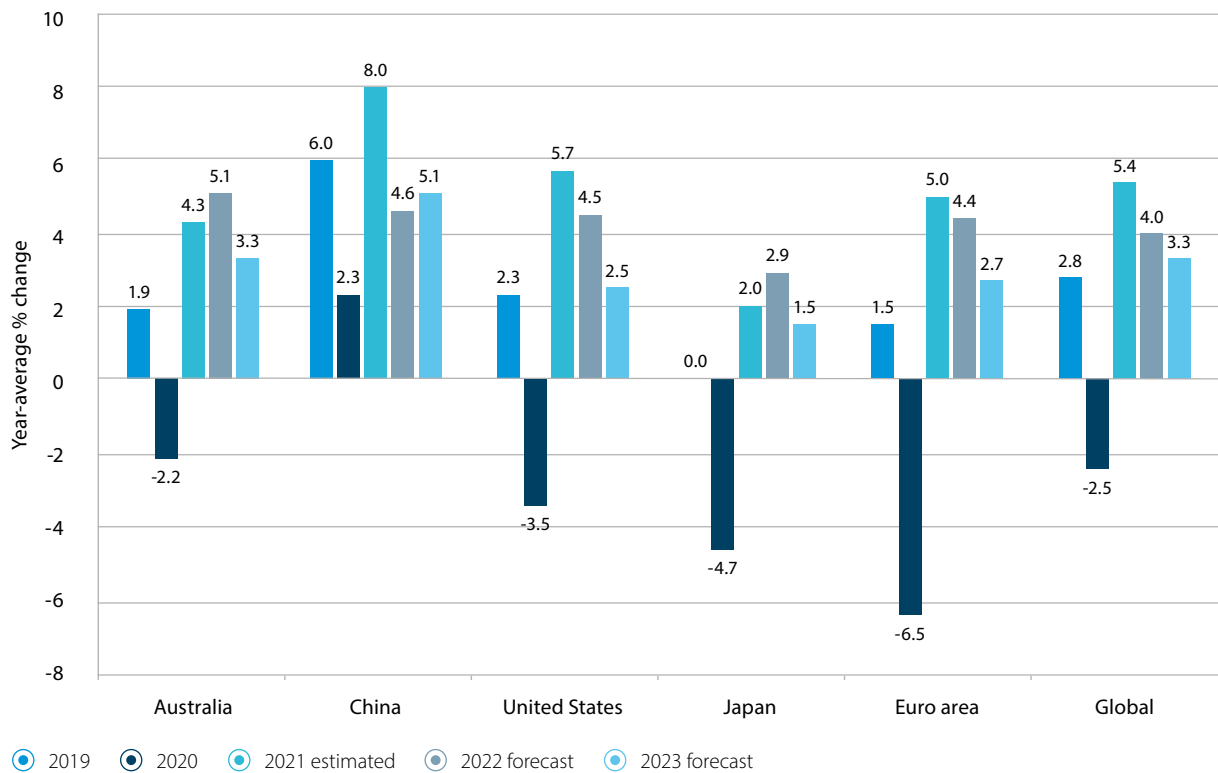


ECONOMIC OUTLOOK

CENTRAL BANKS TO EARN THEIR KEEP

With inflation running hot and the global recovery seemingly ensconced, central banks appear set to commence a meaningful, albeit later tightening cycle. Correctly adjusting this policy shift will be critical to the fortunes of economies and financial markets in 2022.

FIGURE 2: GLOBAL GDP GROWTH



Source: ANZ Research, PB&A CIO, December 2021

In 2021, the global economy rebounded incredibly strongly from the depths of the 2020 pandemic low. Despite the ongoing challenges of Delta and now Omicron, the economic and health impact of new COVID-19 waves appear to be subsiding and the growth agenda looks set to be solidified in 2022. This is not to discount the risk of COVID-19. Indeed, the spread of Omicron, which has led to renewed restrictions and appears set to become the dominant strain globally shapes as the most significant downside risk to our 2022 outlook. However, we believe Omicron, or any other new variant would need to be particularly damaging to have a meaningful impact on growth this year. Underpinning this belief is the accommodative policy conditions which are still prevalent globally. Unprecedented quantitative easing has resulted in money-supply being well above pre-pandemic levels in most economies and unlike previous crises, where there has been propensity for households and businesses to stockpile emergency funds, unemployment has fallen sharply, and bankruptcies have been limited. Therefore, spending should be strong and inflation stickier than initially anticipated.

Inflation fundamentals have not been this strong since the 1980s and having dominated headlines for much of 2021, the potential for policy tightening looks set to continue as a major talking point in 2022. Numerous central banks have downgraded the role of inflation forecasting and have

shown a willingness to tolerate elevated inflation figures for a period. As a result, tightening is occurring later and if not calibrated correctly could eventuate in being much faster also.

We anticipate a strong growth outlook this year, with global GDP expected to rise 4.0% in 2022 before moderating in 2023 but remaining in line with post-GFC trend growth at 3.3%. This includes a Chinese slowdown, where 2020 aside, forecast growth of 4.6% would be the weakest in modern history. Here, there is an expectation for some policy easing, an outlier amongst most other major economies which, except for Japan, look set to commence a tightening cycle. The UK commenced hiking late in 2021, appears set to be joined by the US Federal Reserve (Fed) in 2022 and followed shortly thereafter by Australia and potentially the euro area in 2023.

Set against a continuing threat of renewed mobility restrictions, elevated inflation prints and strong to extreme asset price valuations, policy makers will be working overtime to correctly calibrate the hiking cycle and withdrawal of other stimulus measures in 2022. Get it right and 2022 should be a positive year for growth and risk assets.

Disclaimer: Components of the 'Economic Outlook' section, associated charts and content relating to the Australian dollar on page 24 have been derived from the ANZ Research Quarterly, December 2021.



AUSTRALIA

The vaccine led recovery, removal of border restrictions (both domestic and international), and a combination of high levels of household savings and pent-up demand provide a strong backdrop for the domestic economy to solidify its rebound in 2022. As a result, we expect GDP to grow 5.1% over the year in what would be the strongest annual domestic growth since the late-1980s.

Inflation continues to rise but is lagging other major economies. Here, the Reserve Bank of Australia (RBA) continues to message a patient approach, waiting for inflation to lift sustainably to the middle of the 2-3% target band before hiking rates. Conversely, the market continues to challenge such rhetoric. Wages growth remains critical. Higher prices due to supply-side disruptions are unlikely to lead to sustained inflation pressure if real wages are falling. Things are looking up on the wages front though. After rising again during the Delta-lockdowns, we expect unemployment to trend downward once again — reaching 4% by the end of 2022. Underemployment is also expected to fall and this should place upward pressure on wages growth. We expect annual wages growth to reach just above 3% by the end of 2022.

Despite this, the pick-up is likely to be slower than in other countries like the US and therefore the impact of wages growth on inflation should be delayed. In 2022, global supply cost pressures are expected to moderate somewhat as supply chains adjust and spending switches from goods to services. This should ease Australia's tradables inflation, offsetting the impact of rising wages growth, leaving inflation a touch below 2.5% by the end of 2022.

Our wages outlook suggests inflation will return to 2.5% by Q1 2023 and rise further that year. This will satisfy the RBA that inflation is sustainably at the mid-point of its target band and so should trigger the first rate increase in the first half of 2023. We think the RBA will increase the cash rate to 0.25% initially and then follow with a further 75bps of rate hikes by year-end.

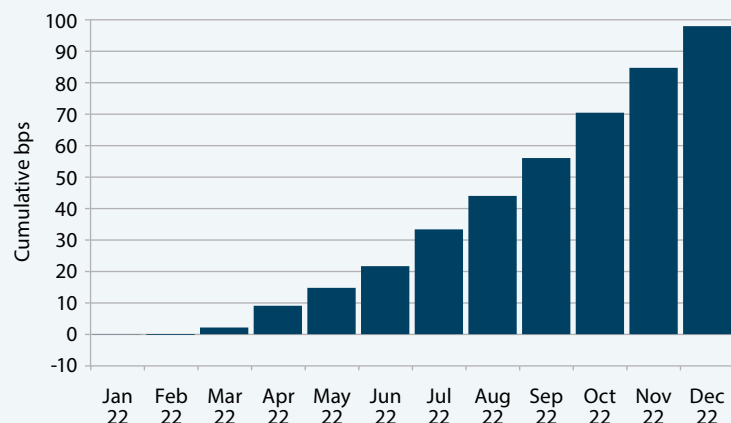
This doesn't mean that policy is on hold. The end of the term-funding facility and 3-year yield target have contributed to a tightening in financial conditions and subsequent sharp rise in fixed mortgage rates. The termination of the RBA's bond purchase program (QE) — potentially as early as February this year — will further heighten market expectations that the RBA will hike sooner than expected.

Risks currently appear tilted towards an earlier rate cycle. Downside risks centre primarily on the pandemic and specifically whether further outbreaks and more hostile variants could lead to prolonged lockdowns. Upside risks include the potential for spending to outpace already strong forecasts, and the risk that labour market tightening or wages growth acceleration occurs faster and earlier than expected.

Markets are currently backing these upside risks to prevail with almost 100bps of cash rate tightening priced in over the next year. Here, there is a clear mismatch with the RBA's view that the conditions for tightening will not be met until the end of 2023. Australia is not alone, with the US and others facing a similar dynamic. Like 2021, this stand-off between central banks and markets should remain a dominant theme in the year ahead.

FIGURE 3: THE MARKET IS CHALLENGING THE RBA VIEW OF RATE HIKES

Source: Bloomberg, Macrobond, ANZ Research, as at December 2021





UNITED STATES

The outlook for US growth this year is promising and despite a pullback in consumer and business sentiment over the latter part of 2021, we expect GDP growth of 4.5% in 2022. New variants of COVID-19 would be a downside risk to this forecast, although notably each new wave of COVID-19 has had diminishing negative implications for activity. They do however exacerbate the supply side difficulties, resulting in more persistent inflation.

The backdrop for household incomes and subsequent spending in the US is positive amid buoyant job prospects and solid wages growth. A sizeable USD34trn (or 160% of GDP) rise in net wealth since the start of the pandemic and an estimated USD2trn in excess savings also bodes well for household purchasing power. Corporate profits have been growing strongly amid firm demand and a window of renewed pricing power. With labour shortages a constraint to output, conditions seem primed for an upswing in capex.

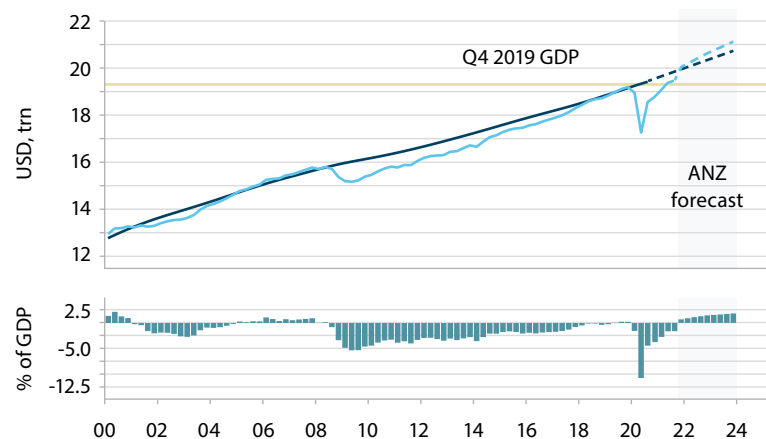
Recent inflation data show there is a broadening and intensification of pricing pressure, while several labour market indicators point to a very tight jobs market. Headline CPI was running close to 7% year-over-year (y/y) at the back end of 2021, a figure not reached since the early 1980s. At this time, then Fed Chair Volcker commenced an aggressive tightening program to curb a prolonged period of elevated inflation. Although the backdrop to today's inflation is much different to the 80s, we believe US inflation is likely to stay elevated well into 2022.

There was a growing chorus of Fed officials voicing a willingness to speed up the tapering of asset purchases late in 2021. This hawkish narrative lends itself to an expectation of a first rate hike of 25bps from the Fed by early-2022, likely followed by several more prior to year-end. Some uncertainty about the Fed's potential hiking path lies with the fact that it may soon start normalising its balance sheet — leading to a tightening in financial conditions. Such an approach would be different to the 2017 episode when it had waited three years before normalising its balance sheet.

FIGURE 4: US GDP - ACTUAL, FORECAST AND POTENTIAL

■ OPG
— Potential GDP
— Actual GDP

Source: US Congressional Budget Office, US Bureau of Economic Analysis, Bureau of Labor Statistics, Macrobond, ANZ Research, as at December 2021





JAPAN

Strong momentum from late 2021 is likely to continue into 2022, with Japan's GDP expected to grow 2.9% this year amid rising vaccination rates, an easing in movement restrictions and ongoing macroeconomic policy support.

Like other developed markets, further COVID-19 variants will remain a lingering threat, however, prospects for consumer spending is bright amid improving confidence, pent up demand, and increased household savings. Furthermore, business fixed investment is picking up in response to strong global demand for durable goods, and a push for carbon neutrality is expected to provide longer-term capex opportunities.

The retention of a lower house majority by Prime Minister Kishida's LDP party in late 2021 has provided a smoother path for Kishida to continue his economic agenda — specifically reducing inequality and reviving the economy before restoring fiscal balance.

The larger than expected fiscal stimulus package (JPY55.7trn) announced in late November 2021 could further boost consumption, this includes direct cash transfers of JPY100,000 to households that have children 18 years or younger and tax breaks to companies that raise wages.

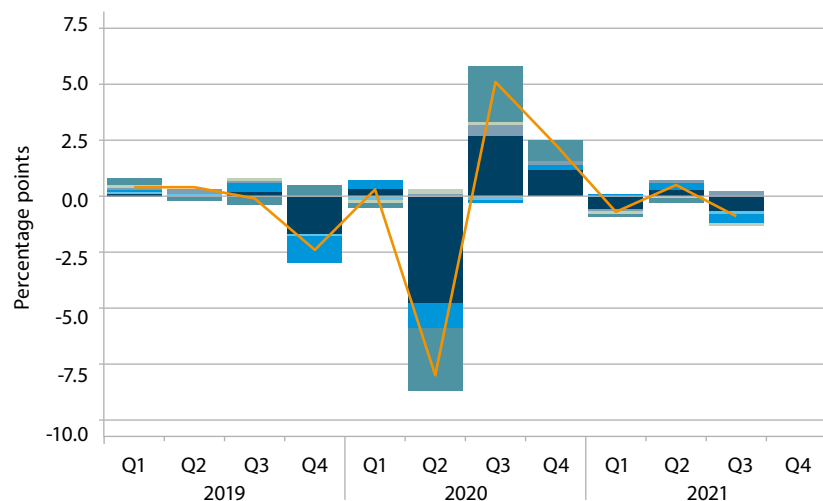
Japan is an outlier of sorts; its inflation dynamic is very different to other nations and core inflation remains near zero. This is for numerous reasons including a subdued domestic demand recovery; the unwillingness of firms to pass higher costs to consumers; and lower wage pressures. This substantial negative output gap means broad-based inflationary pressures remain some time away. Accordingly, its monetary policy settings are expected to remain on hold for some time with the Bank of Japan (BoJ) expected to continue with accommodative monetary policy settings until its 2% price stability target is achieved.

There is some speculation that the BoJ could react to a weakened yen, based on the argument that a softer yen will lead to a rising inflation rate and potentially result in a scenario of unhealthy stagflation. However, commentary from BoJ officials indicates the yen's recent depreciation is accretive for the economy. A weakened yen should boost the competitiveness and profitability of Japanese firms, be supportive of increased business fixed investment and potentially encourage both foreign and offshore based Japanese firms to relocate to the 'land of the rising sun'.

FIGURE 5: JAPAN GDP - CONTRIBUTION TO GROWTH



Source: Japanese Cabinet Office, Macrobond, ANZ Research, as at December 2021





EUROPE

The surge in COVID-19 cases across Europe, even pre-Omicron was concerning for growth and renewed restrictions have begun to weigh on the region. The Q4 GDP forecast has been revised down to 0.5% quarter-over-quarter (q/q) as a result, this is in comparison to 2.3% q/q in Q3.

While there is a strong chance this will spill over into the start of this year, our expectations are for the COVID-19 environment to slow rather than reverse the economic path. Fiscal policy remains expansionary at a countrywide level, albeit below the pandemic peak, as economies strive to embed the recovery. We expect high levels of green investment in 2022 as countries seek to ensure climate policies are aligned with the targets in European climate law. Furthermore, the European labour market is making a sound recovery and supply-constrained manufacturing disruption should ease over time. We remain constructive on the euro area's growth profile in 2022 and expect GDP to rise strongly by 4.4%, albeit down slightly from the anticipated 5.0% for 2021.

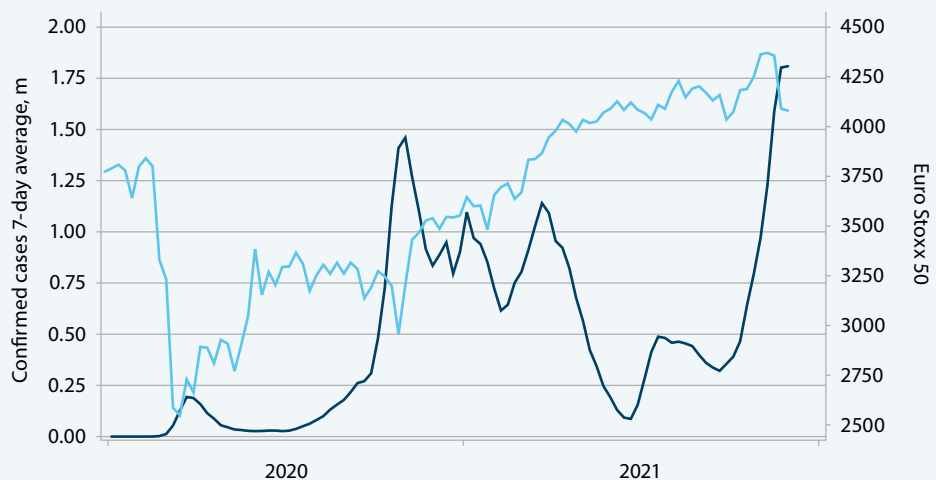
Much like other central banks, the European Central Bank (ECB) faces a challenging period for policy. The ECB believes that most of the rise in inflation is transitory, but the upward pressure on services inflation suggests inflationary pressures may be broadening. In March, the EUR1.85trn Pandemic Emergency Purchase Programme (PEPP) will cease against a backdrop of continuing pandemic related disruptions and record inflation levels.

Despite these concerns, the majority of the ECB Governing Council remains dovish and firmly in the transitory camp when it comes to the sustainability of price rises. With 2012 still echoing for some, there are concerns about withdrawing stimulus too early. With a very uncertain backdrop, including the potential for further variants and stickier inflation, we expect a recalibration of QE from the ECB for the post PEPP environment, allowing it to maintain high policy optionality in order to react swiftly to any speedhumps as it sees fit.

FIGURE 6: EA ECONOMIC CONFIDENCE HOLDING UP, DESPITE RECORD COVID-19 SURGE

— EU/EEA & UK, Novel Coronavirus (COVID-19), Confirmed Cases, Aggregate, LHS
— Euro Area, Equity Indices, STOXX, 50, Index, Price Return, Close, EUR, RHS

Source: European Centre for Disease Prevention and Control, STOXX, ANZ Research, as at December 2021





CHINA

After securing at least another five years of leadership at the 6th Plenum of the 19th Communist Party of China (CPC) Congress in December, Xi Jinping should become the first person, since the 1949 founding of the People's Republic of China, to officially hold the presidency for more than 10 years.

This is likely to mark a new economic regime focussed less specifically on GDP growth and more so on the execution of politico-economic ideas. For several years, the National Development and Reform Commission forecast an average GDP growth rate for the entire period covered by each Five-Year Plan. While still forecasting GDP, the State Council will now be less specific. Here, leadership is willing to accept lower but stable growth. 2022 could see a wider target range of say 4.5–5.5%. Our forecast for GDP growth in 2022 is 4.6%.

The structure of inflation in China is also expected to change in 2022. The headline figure of the Producer Price Index (PPI) should decline rapidly over the next few months, while the Consumer Price Index (CPI) is likely to gradually pick up — in part due to base effects. In the first half of 2022, this gap between PPI and CPI inflation should narrow quickly before CPI inflation surpasses PPI in the second half of the year. Supply shortages

and rising global energy prices are partly to blame for the high PPI in 2021. This 'industrial stagflation' resulted from high imported prices and the impact is expected to be transitory. Furthermore, inflationary pressure in the non-traded sector has been weak, reflecting a sluggish outlook for household incomes. Service sector employment continues to stay in the contractionary zone and a weak jobs market should continue to drag on the price recovery in 2022.

As China's economy slows, there will be further focus on property prices, with expectations of positive property price growth seen as crucial for financial stability. Following the drop in property prices in top-tier cities this year, markets will be watching to see how Chinese authorities react. The consensus view is that the property sector will slow, but recent government actions point to an upside risk in 2022.

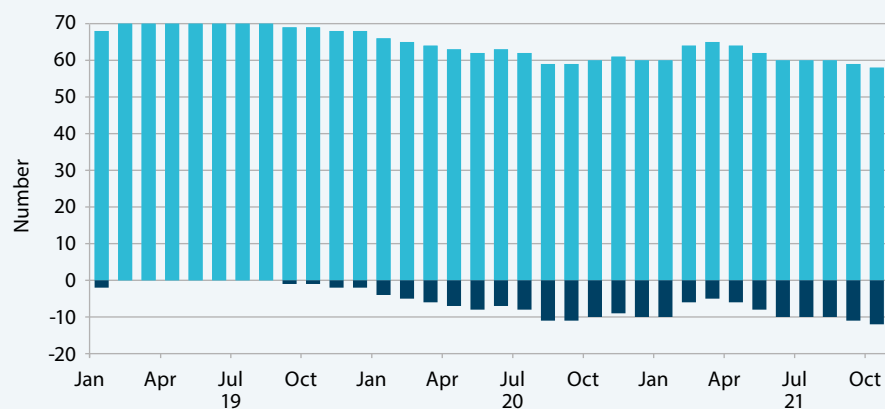
Amidst a deteriorating economic outlook, China's authorities are also likely to increase counter-cyclical support. While significant monetary easing is unlikely, the People's Bank of China (PBoC) could deploy different policy measures such as reserve requirements or liquidity injection tools interchangeably throughout 2022.

FIGURE 7: CHINA'S PROPERTY PRICES

- No of cities reporting negative y/y growth of property price
- No of cities reporting positive y/y growth of property price

Note: The data is based on the monthly 70-city residential property price survey from the National Bureau of Statistics of China (NBS).

Source: NBS, Macrobond, ANZ Research, as at December 2021



KEY INVESTMENT TOPICS FOR 2022 & BEYOND

Aside from the usual focus areas this year — asset valuations along with macro, risk and surprise indicators — there are specific topics we will be watching closely in 2022, with a view to the decade ahead.

EMERGING NO MORE? THE RISE AND RISE OF EMERGING MARKETS.

By Samantha Chien, Equities Portfolio Manager, ANZ Private Banking & Advice

Over the course of 2021, emerging market (EM) shares underperformed developed markets, as measured by the MSCI World Index by almost 25%. Underperformance has been a consistent story since the Global Financial Crisis (GFC), where, aside from some brief stints of outperformance, EM equities have trailed developed market peers by an annualised rate of roughly 4% since 2009.

The relative valuation gap between emerging and developed market equities is now at its widest margin since 2002-2003. Given this, there may come a time, potentially in 2022 when asset allocators commence a structural transition of capital towards EM equities. We believe this could herald the start of a sustained period of longer-term outperformance from EM equities. While headwinds exist in the near-term – specifically COVID-19, geopolitical tensions, inflationary pressures, and a slowing Chinese economy – longer term the market is beginning to look more interesting.

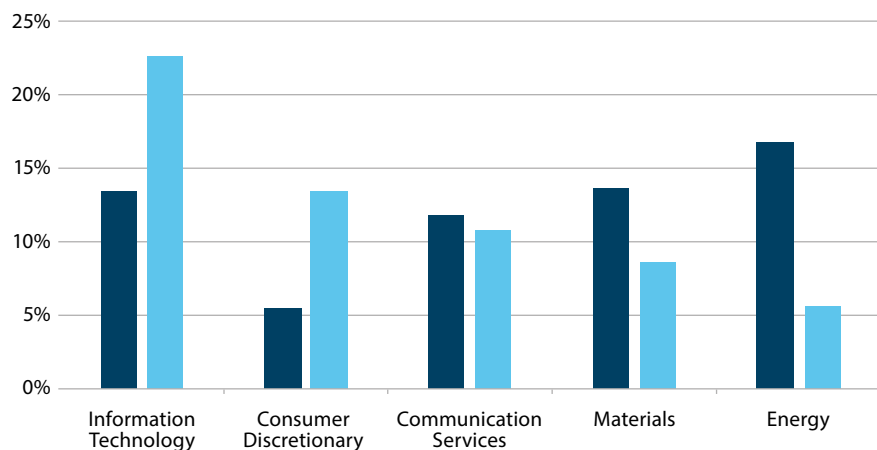
Much of this appeal lies in the index transformation over the almost 13 years since the GFC. Traditionally thought of as a commodity focused cyclical play, EM economies have expanded the growing wealth of middle classes, transitioning to consumption led economies. Most notably in North Asia, these emerging economies are increasingly dominated by advanced digital technologies. Ecommerce, social media and digital infrastructure companies have risen to become market behemoths and industry leaders. Household names include Alibaba, Tencent and Samsung. Whilst perhaps a lesser known name, Taiwan Semiconductor is the largest holding in the MSCI EM index and is currently the ninth largest company by market capitalisation globally.

As the figure below shows, prior to the GFC, old economy sectors, materials and energy, dominated the investible universe of EM companies — combining to account for almost 35% of the index. Today, the new economy sectors of consumer discretionary (including ecommerce), communications services (social media) and technology (including world leaders in computer chip manufacturing), accumulatively make up more than 45% of the index weight.

FIGURE 8: SECTOR SHIFTS IN MSCI EM INDEX

■ December 2006
■ December 2021

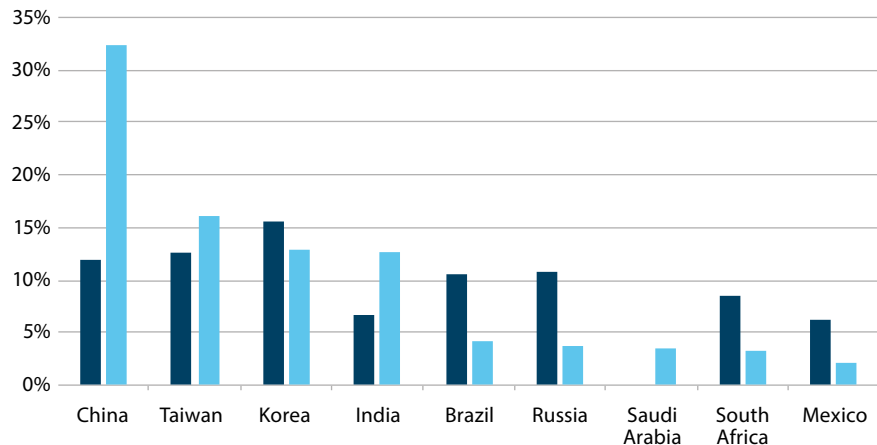
Source: FactSet, ANZ PB&A CIO, as at January 2022



**FIGURE 9:
REGIONAL SHIFTS
IN MSCI EM INDEX**

■ December 2006
■ December 2021

Source: FactSet, ANZ PB&A CIO,
as at January 2022



It's true that much of the transition has occurred alongside the rise of China. The superpower now accounts for almost 35% of the index as opposed to just over 10% prior to the GFC. Measures including the introduction of mainland equities into the MSCI EM Index and the relaxation of restrictions on ownership of Chinese stocks have helped propel an incredible surge in the value of China's stock market. Herein lies part of the dilemma and perceived risk of investing in a market where performance is so heavily dictated by news flow from China; 2021 proved this time and time again. However, while China and North Asia more broadly have led the transition, innovative new sector companies can be found in Russia, Brazil and many other traditional 'commodity nations'.

Promisingly, while China remains the largest consumer of many key commodities, the economy itself is no longer dominated by commodity intensive industries. According to the Chinese National Bureau of Statistics, 'secondary' industries (largely commodity intensive sectors like Manufacturing) have declined from almost 50% of GDP at the beginning of 2010 to less than 40% today. Conversely, 'tertiary' industries (like services) have expanded from around 45% of GDP to be closer to 55% of output — further decoupling Asian growth from commodity prices.

We commence the year at benchmark to EM equities, however, in early 2022 we will be increasing our strategic weighting to the asset class in our more aggressive risk profiles and introducing a discrete allocation to our balanced portfolios. Like many investors, we will be watching closely for signals indicating the time may be right to make a more meaningful allocation to the asset class.

IS THE TRADITIONAL BALANCED PORTFOLIO EXTINCT?

By Lakshman Anantakrishnan, Head of Investment Strategy, ANZ Private Banking & Advice

In the basic sense i.e. a portfolio consisting of only equities and government bonds, perhaps. In a more modern-day portfolio construction sense, we think the answer is likely no. However, a more nuanced approach will be necessary in the years ahead — particularly within a portfolio's defensive bucket.

In 2016, German bund yields turned negative and since then many multi-asset investors have been seeking alternative ways to diversify portfolios. At that time, it was still relatively easy to find defensive assets offering decent levels of yield. In 2018, as the US Federal Reserve commenced the withdrawal of a decade long bond purchasing program, the debate surrounding the defensive part of portfolios intensified. Global bond yields are now roughly 1% to 1.5% lower than 2018 having endured an incredible bond bull market and historic all-time low yields. To this end, it could be argued that government bonds turned out to be the best diversifiers. So why make things more complicated than they need be?

In our view, this time things are different, at least compared to the prior two decades. Over that time, and more specifically in the last ten years, the global economic cycle has been dominated by central banks and the utilisation of monetary policy as the primary tool. Not only has this led

to historically low interest rates, but also an incredible era of asset price inflation i.e. a long bull market in all assets.

Looking at where we are now, the general macroeconomic environment is much different as supply chain disruptions around the globe and inflationary pressures continue to creep upwards. Fiscal policy now appears the policy tool of choice, with monetary policy decisions at risk of becoming increasingly politicised. In short, 'fiscal dominance', or more specifically the indirect monetisation of fiscal policy could turn out to be the main concept for economic policy making in the decades to come. This potential shift in the economic regime means that, asset class relationships that we have become accustomed to, and that we take for granted, might not hold in the future.

With the starting point for global bond yields currently at 1%, the reality is that the ability for bonds to act as an adequate hedge against a major risk-off event is much lower as yields can only turn negative to a point. Given this, and the already low return on cash, investors may need to seek alternative sources of return in the decade ahead. Lower weightings to cash in portfolios alongside higher strategic allocations to growth assets are obvious ways to increase return potential but also bring the possibility of further risk. Allocations of capital to non-traditional asset classes like private markets, high-yield debt and alternative assets are potential diversifiers. In early 2022, we will be adjusting our strategic asset allocation with the aim of better preparing client portfolios for whatever the decade holds.

TABLE 2: ANZ BALANCED PORTFOLIO* STRATEGIC ASSET ALLOCATION AS OF APRIL 2022

Asset Class	Strategic Weighting
International Equities	15%
International Equities (Hedged)	6%
Australian Equities	14%
Emerging Markets Equities	3%
Global Listed REITS (Hedged)	2%
Global Listed Infrastructure (Hedged)	2%
Alternatives	5%
High Yield Debt (Hedged)	3%
Australian Fixed Income	16%
International Fixed Income (Hedged)	16%
Short-Dated Fixed Income	8%
Cash (at call)	1%
Private Markets	10%

Note: Figures may not sum to 100% due to rounding.

*Strategic Asset Allocation (SAA) includes an allocation to private markets. The SAA for those portfolios holding only liquid assets will vary.

Source: ANZ PB&A CIO



MEGATRENDS THAT DRIVE THEMATIC INVESTING

By Benjamin McBride, Head of Research & Governance,
ANZ Private Banking & Advice

Electric cars are not new. Indeed, at the beginning of the 20th century, electric cars were at their heyday, accounting for around a third of all vehicles on the road in the United States. Electric cars were more practical than steam engine cars and more reliable than petrol powered cars of the day. Then, Henry Ford came along with his model-T, cementing the role of internal combustion engine (ICE) cars as the dominant form of road transport for the next century.

Fast forward to the present and the confluence of disruptive technology and climate concerns seems destined to reverse the fortunes of the electric car. Elon Musk, a modern-day innovator and entrepreneur, runs Tesla, the world's largest manufacturer of electric cars.

To understand how powerfully markets are viewing the megatrends driving the growth of this company and the likely shift it will cause in corporate earnings, Tesla is now not only the most valuable car company globally, but is one of the top 10 most valuable companies in the world — with a market capitalisation of more than USD1trn. Early detractors of the Tesla are now the same crowd predicting that the old incumbent carmakers, including Ford, will head towards bankruptcy by the end of the decade and the only 'ICE' seen at service (recharging) stations will be of the frozen water variety.

Megatrends like those driving the enormous shifts in the automotive industry are powerful, transformative forces that can change the trajectory of the global economy. They are shifting the priorities of societies, driving innovation and redefining business models. They can have a meaningful impact not just on how we live and how

we spend money, but also on government policies and corporate strategies.

Identifying the potential for structural change and investing in expected transformations early can be a key driver of successful investing. Here, there may be an opportunity for investors to position their portfolios for long-term growth potential. In other words, investing in the future could be key to securing your future. This approach, often labelled thematic investing, seeks to invest where markets and economies are going rather than where they have been. This includes themes revolving around disruptive technology, like robotics, big data and artificial intelligence. People and demographic changes, like the rise of emerging market consumers and ageing populations are similar themes. The impact of climate change, renewable energy and resource scarcity are all likely to play a big role in markets as well.

Successful thematic investing is not as simple as identifying a theme. For thematic investing to be effective, a skilled portfolio manager needs to be able to distinguish between a durable driver of above average growth and a passing fad. As the tech wreck of the 90s reminded investors, valuations are always important. This time is no different. Knowing where a product or technology is in its adoption is critical for assessing its risk and return profile. Too early, and the risk and return profile may resemble more of a venture capital like investment, with a high possibility of failure. Once a technology is ubiquitous, upside may be limited. The relationship between an adoption curve and share price is not always direct. Research and development and market share growth can come before sales and profitability. Finding the sweet spot between being an early adopter and a laggard is key.

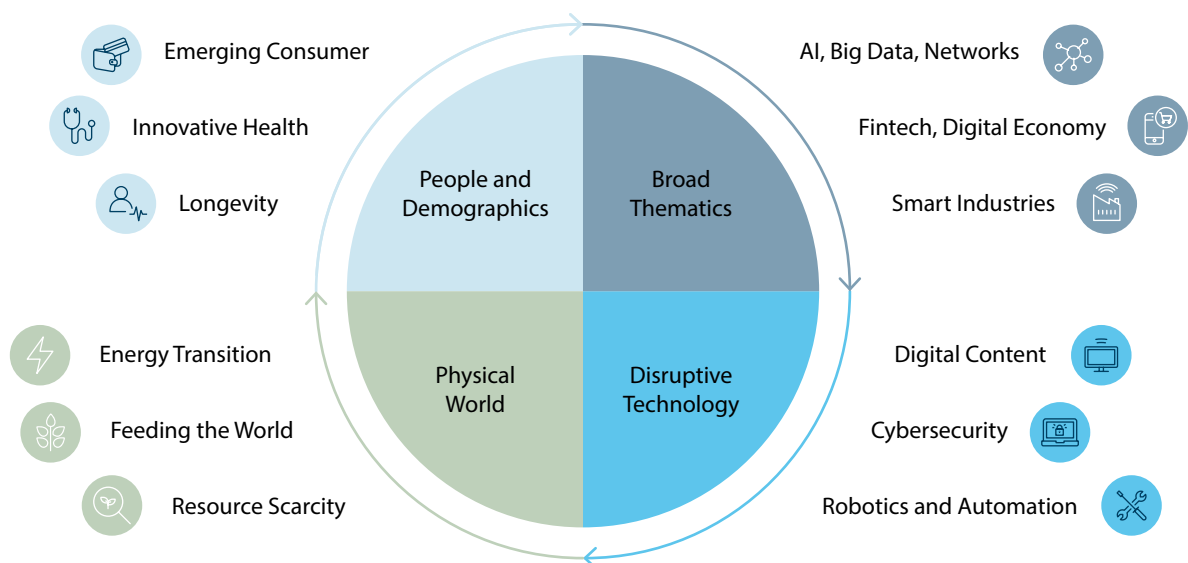
The best investors need to be able to think globally and identify companies that have both material exposure

to the theme and companies that are leaders within segments. Many technologies start out in markets that are highly contestable, but the most innovative companies (not necessarily those with the best technology) can change this into a 'winner takes all' scenario, generating super profits for their investors. As Elon Musk has shown, in today's business world, big may no longer beat small, rather it could be the fast beating the slow.

At ANZ we retain a long-term approach to investing and in the year ahead we will be looking to provide opportunities to gain exposure to long term trends in your portfolio as we continually strive to add value for clients.

FIGURE 10: PRIMARY CATEGORIES OF THEMATICS

Source: ANZ PB&A CIO



INVESTMENT STRATEGY

NO REPEAT OF 2021 BUT THE GROWTH OUTLOOK SHOULD BE SUPPORTIVE OF RISK ASSETS IN 2022

Volatility appears set to be a constant in 2022 as policy makers continue the unwind of stimulus on the path towards normalisation.

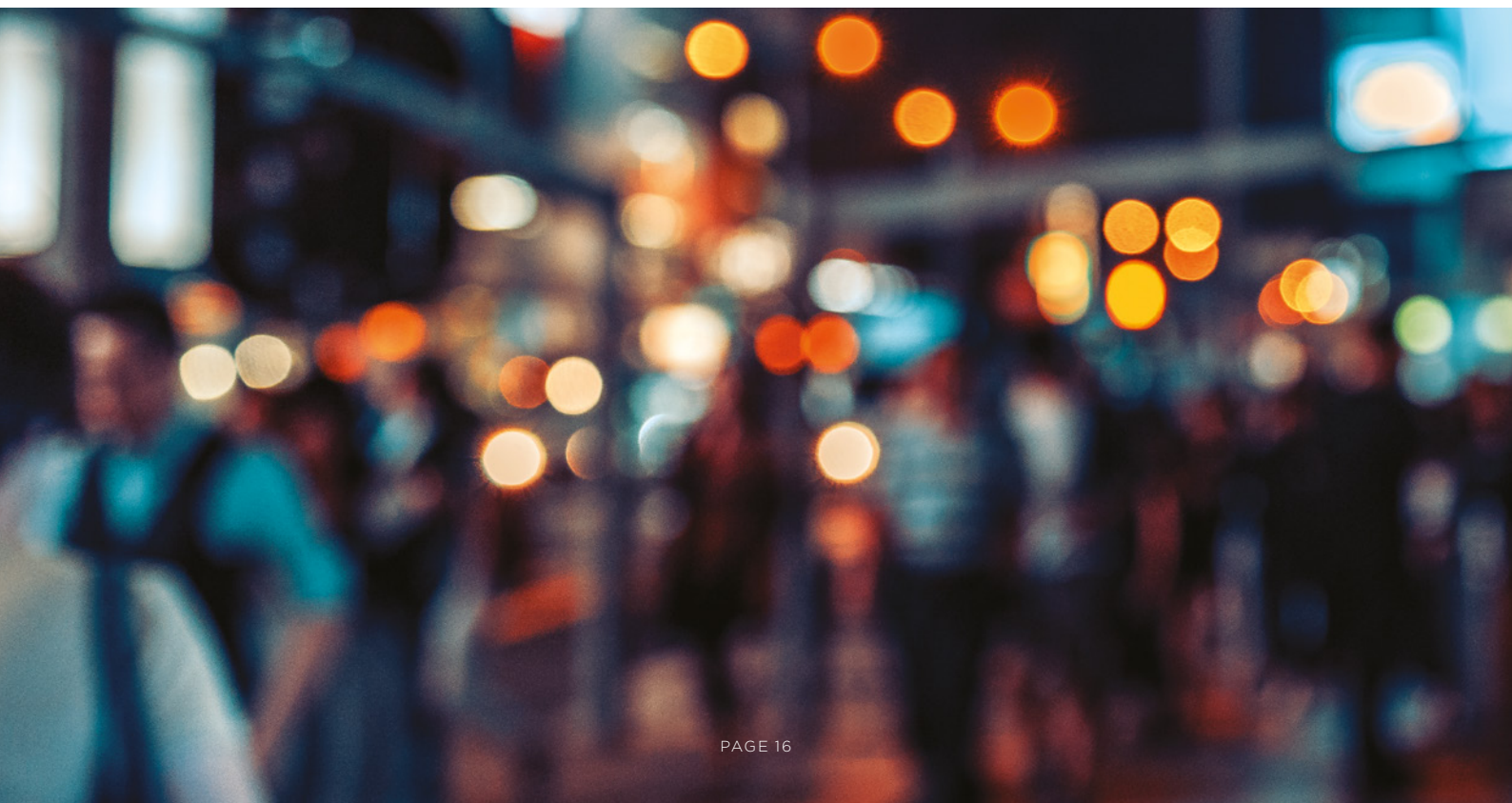
In 2021, we weren't shocked by the broad-based rise in risk assets, rather it was the quantum of gains which left us pleasantly surprised. We start 2022, with a mild overweight to risk assets, based on an expectation of continued outperformance from equities amidst a backdrop of strong global growth underpinned by relatively easy policy, pent-up consumer demand and increased household savings. In 2022, we expect equities to again outperform traditional defensive assets, but point to more modest gains in the year ahead.

As already seen in early January, investors may be playing a game of 'snakes and ladders' this year, with markets taking 'two steps forward and one step back'. We expect this volatile environment to persist throughout 2022 and as 2021 proved, the ability to make quick tactical shifts to portfolio allocations throughout the year could pay dividends for investors.

Risks currently appear elevated compared to this time last year. In H1, Omicron, or further variants of COVID-19, alongside inflationary pressures and just how sticky they prove to be, present the greatest challenge to our relatively positive outlook. More specifically, the reaction function of central banks and policy makers in dealing with such risks is likely to be the key driver of markets in 2022, as investors watch keenly for any downside surprises.

As H2 approaches we expect inflationary pressures to ease somewhat from the mid-to-high single digits experienced in the latter half of 2021, settling at a more modest 2-4% across most of the developed world as demand and supply side dynamics begin to realign and the impact of base effects begin to fade.

On a regional basis we continue to see a greater probability of outperformance from the US in 2022 — with its quality bias expected to outperform in a more turbulent year



ahead. Europe and Japan, while potentially lagging, should deliver constructive gains, with value characteristics across both markets helping drive positive returns.

The domestic share market is again expected to lag global peers in 2022, any outperformance here hinges greatly on the ability of both the banks and miners to provide strong gains concurrently — something we see as unlikely at this point. If central banks begin normalising policy as expected, then financials may become more attractive. Materials, however, are likely to be constrained by a slowing Chinese economy and further easing in the price of iron ore.

Emerging market shares remain the most interesting asset class at this point. Extremely cheap relative valuations are likely to become too attractive to overlook at some point. We are not there yet though, the potential for negative headlines from a slowing Chinese economy — which accounts for almost 35% of the index — and further disruptions owing to COVID-19 are likely to be the main headwinds early in the year.

Within the defensive bucket we envisage a more favourable outlook for international bonds relative to domestic bonds in 2022. This year, we wouldn't be surprised if global yield curves start to steepen yet again. Inflationary pressures and a continuing economic recovery are likely to push the 10-year US Treasury yield to 2%, but probably not much further. While credit valuations can't be described as cheap, sound fundamentals, carry and ongoing demand should be supportive of this segment of the market as central banks continue the withdrawal of liquidity.

2022 looks to be another year in which investors are reminded of the importance of a long-term investment strategy. Volatility is almost a given as central banks look

to normalise policy and fiscal stimulus is withdrawn from the system. In this environment, a well-diversified portfolio should continue to provide the best possibility of preserving capital and creating wealth. We start the year with a mild overweight to risk assets and look forward to helping guide investors through what shapes as another fascinating year for markets.

TABLE 3: ASSET CLASS PREFERENCES

	Current
Growth assets	MO
Developed market equities	MO
Australian equities	B
Emerging market equities	B
Real assets	B
Defensive assets	MU
Australian fixed income	MU
International fixed income	B
Cash	B
AUD	B

U Underweight MU Mild underweight B Benchmark
MO Mild overweight O Overweight

Source: ANZ PB&A CIO, as at 14 January 2022

ASSET CLASSES

CURRENT STRATEGY AND OUTLOOK



AUSTRALIAN EQUITIES

B Current

Our current preference is to be **benchmark Australian equities**.

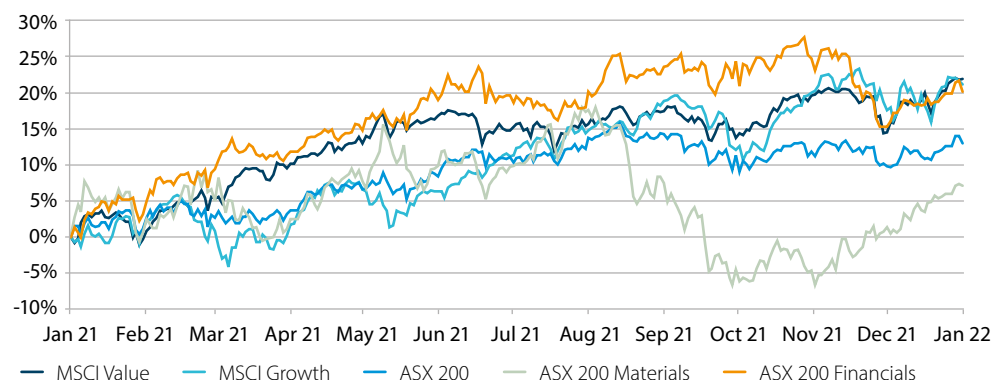
Despite a more upbeat outlook for Australia as a whole, the outlook for Australian equities in 2022 remains clouded — the market seemingly stuck between two opposing forces. On one side is the sustained economic reopening, a return to normalcy for Australian citizens and a renewed green energy driven commodity super cycle. Pushing against this is a return to a more orthodox monetary policy stance by central banks.

Solid performance from the domestic share market over the final quarter of 2020, continued into the early part of 2021, as the value rally persisted and strong gains from the financials sector in particular, and to a lesser degree materials pushed the broader market higher, keeping pace with global peers. In the latter half of the year, Australian equities trailed global markets by a wide margin as a Chinese slowdown and weakening iron ore price weighed on the mining heavyweights — dragging on the local index in the process. At year-end, the ASX 300 index (17.5%) had underperformed the MSCI World ex-Australia index (23.9%) by more than 5%. This underperformance came despite 'value'

stocks finishing the year broadly in line with 'growth' stocks. Looking closer, however, the composition of the market offers some further clues as to why. The domestic market is heavily skewed towards financials and materials stocks, in an almost barbell approach. Financials followed the strong performance of global counterparts. Materials similarly followed global peers, however, performance here was more muted amidst the backdrop of a weakened demand for iron ore and negative news flow from China. So what? Well the big question heading into 2022 is whether financials and materials can outperform at the same time.

For financials the case seems more straightforward, if global central banks continue to look for policy normalisation, albeit at somewhat reduced pace, financial equities remain cheapish, and therefore offer better upside potential. The case for materials on the other hand is not so clear cut. China appears set to continue curbing resource intense property development, and its reliance on coal (particularly Australian coal) as a source of energy. Consequently, 2022 is shaping up as another year where despite an expectation of positive gains, we believe better opportunities are likely to lie further abroad. We start 2022 at benchmark accordingly.

FIGURE 11: MSCI WORLD VALUE VS. MSCI WORLD GROWTH VS. ASX 200 V ASX 200 MATERIALS VS. ASX 200 FINANCIALS



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as of January 2022



DEVELOPED MARKET EQUITIES

MO Current

Our current preference is to be **mildly overweight developed market equities**.

Inflation and the precise form it would take dominated marketed headlines for much of the second half of 2021. Transitory, sticky, deflationary, reflationary — were just some of the adjectives put forward. In the second half of 2021, 'stagflation' was the word causing most consternation amongst investors. Stagflation is an economic environment where both inflation and unemployment are elevated, and economic growth is below potential. In this scenario, persistent inflation is the most troubling aspect for policy makers, representing a significant conundrum as those fiscal and monetary measures traditionally used to combat the issue, actually have the potential to escalate it.

As 2021 rolled on some market commentators were predicting an environment of a purgatory state of mild but persistent stagflation. With that could come flatter yield curves globally and a less than prosperous environment for equities. In short, stagflation would mean a generally negative environment for risk assets, whereby defensive sectors such as healthcare, technology and consumer staples might provide the most reliable returns and one where bond markets would likely become increasingly volatile.

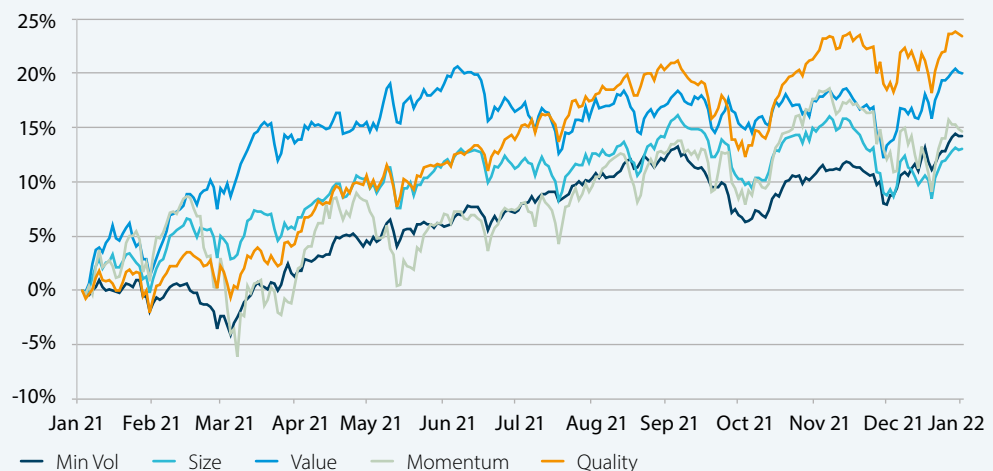
As we enter 2022, it is indeed true that the chances of a somewhat slower growth environment have increased. Manufacturing and Services Purchasing Manager Indices appear to be peaking out, albeit on high levels.

Higher goods prices have led to a faster than anticipated squeeze of household's disposable income. Moreover, it is becoming increasingly evident that supply chain bottlenecks have started to affect the so far rather upbeat outlook of Corporates. While guidance has broadly remained intact, it seems to be much more muted now than in the past. But the very same supply chain bottlenecks have also led to a substantial drawdown in inventories, at a time when the global economy is still expanding strongly. And the fact that the ability to pass on price increases to customers remains rather strong, would suggest that this growth spurt the global economy has witnessed throughout 2021 has further to run.

This means that at least in the first half of 2022, much like we have noted in the latter stages of 2021, 'reflation' rather than 'stagflation' should continue to be the prevailing driver of equity market performance. Later in 2022 there is scope for another word — 'disinflation' — to become the newest market headline.

Much like 2021, relative preferences will be critical to driving outperformance in this segment of the market. We see 'quality' and 'value' shares being the leading performers as 2022 gets underway. This partly informs our regional preferences where the US — with its quality bias — is again expected to outperform in 2022. Europe and Japan are likely to be laggards, although the value characteristics from both markets should help deliver positive gains again this year.

FIGURE 12: MSCI WORLD — STYLE PERFORMANCE 2021



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as of January 2022



EMERGING MARKET EQUITIES

B Current

Our current preference is to be **benchmark emerging market (EM) equities**.

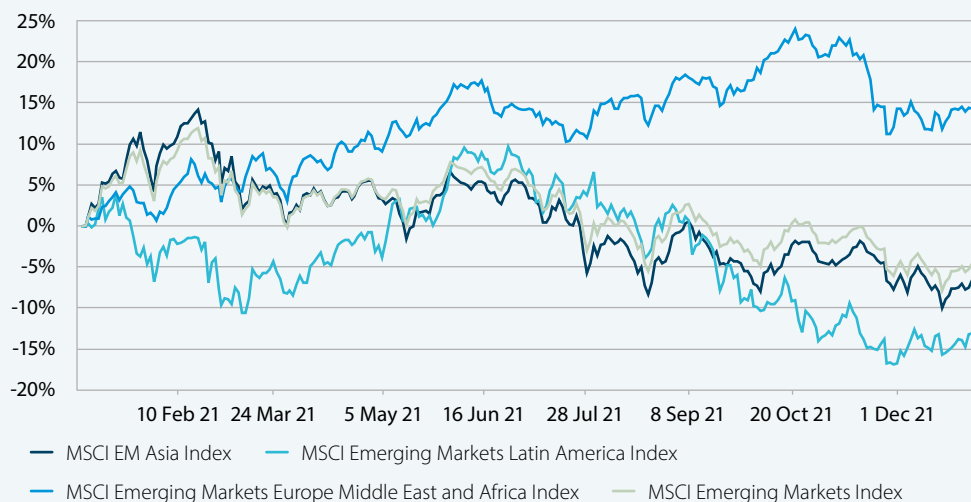
When framing the 2022 outlook for EM equities our focus is dragged towards the Asian region which dominates approximately 80% of the index, and in particular China, which accounts for almost 35%.

Much like 2021, it is the performance and news flow from this region that is likely to shape the outcomes for the asset class more broadly. In 2021, headlines from China were downright dastardly — trade spats, the Evergrande debacle and increasing regulation to name a few. More recently, the noise about a looming Evergrande default has calmed and Chinese authorities appear to be proactively looking to neutralise the situation. Evergrande might indeed be the tipping point for the government and Chinese central bank — the People's Bank of China. The slowing property sector is seen as crucial for financial stability in China and there are signs the government wants to marginally adjust its policy stance, to prevent a 'hard landing'. The effects of increased regulatory scrutiny have undoubtedly taken its toll on economic growth and equity prices. Given the high stakes poker games within the Chinese communist party as to the succession of Xi Jinping, this increased scrutiny and regulatory

push might ebb somewhat in 2022. Xi's "Common Prosperity" initiative, which looks to narrow the income and wealth gap between China's elite and the working class, has earned the incumbent party leader special status within the Chinese communist party, paving the way for further terms in power. This means that Xi's decision-making horizon in terms of imposing new curbs has become somewhat longer, so there is less imminent need for further regulation in the near term. Given the upcoming Beijing Winter Olympics and the 20th Party Congress this year, one can reasonably expect a continuation of China's 'zero Covid' policy, so the recovery in household consumption might continue to be gradual.

Generally speaking, we expect a stabilisation in China in 2022, which in light of 'cheap' valuations across Chinese and EM equities, could provide an interesting entry point. We enter the year at benchmark to EM equities and alongside a steady 'Middle Kingdom', a combination of a shift higher in real yields, US dollar weakness — which is traditionally a tailwind for the asset class — and/or the easing of geopolitical tensions across other key areas could provide a catalyst for increasing exposure to the asset class.

FIGURE 13: EMERGING MARKET PERFORMANCE 2021



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as of January 2022



AUSTRALIAN FIXED INCOME

MU Current

Our current preference is to be **mildly underweight Australian fixed income**.

Owing to their high sovereign quality, Australian government bonds are strongly correlated to other western sovereign bond markets and will typically move in the same direction. However, given the nature of the Australian economy and its dependence on resource prices, as well as the fact that the RBA has a somewhat looser inflation target than other developed market central banks, Australian government bonds tend to be a little more volatile than their western counterparts. While the second half of 2021 led many to believe that global central banks are intending to raise interest rates rather swiftly, having triggered a pronounced flattening in global yield curves, we believe that there is a chance that this is only temporary.

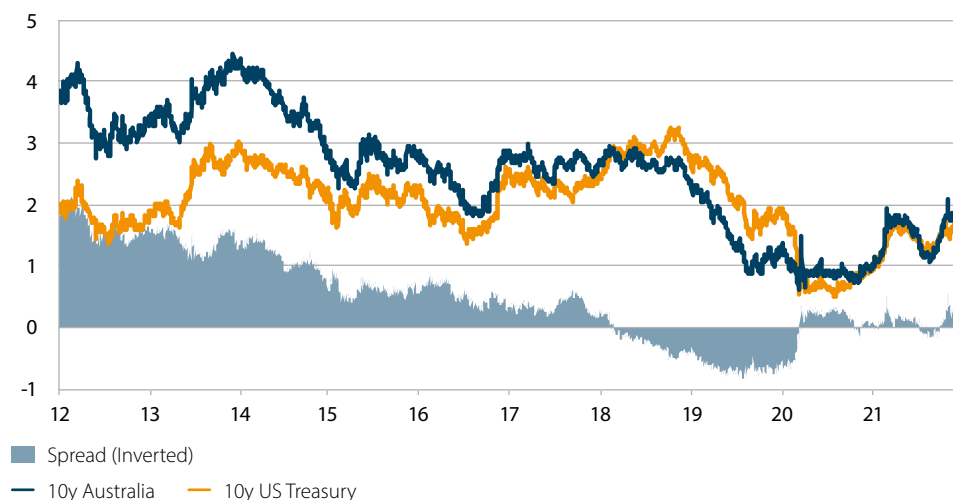
Throughout 2021 the RBA's forward guidance was nuanced and carefully managed, the most recent change to its unofficial policy was the dropping of any explicit reference to the year 2024 when mentioning a 'first rate hike'. This rhetoric, much like other central banks allows the RBA a great deal of flexibility. While officially abandoning its 'yield curve control' policy late in 2021, the RBA has

committed to continuing its quantitative easing program until early 2022, however, any further policy is explicitly dependent on the actions of other central banks and much more data dependent than before. To this end, we believe that in 2022, Australian government bonds are going to be largely driven by what is happening in the rest of the world.

Even with the abandonment of the '2024' reference, RBA Governor Philip Lowe continues to strike a rather dovish narrative relative to other central bank leaders. As with all other western central banks there is a good chance that investors might find themselves surprised by even more dovishness in monetary policy going forward, but the risk in yields remains to the upside, and a likelihood for curves to be steeper.

As 2022 commences, our relative preference within fixed income remains broadly unchanged. Despite our mild dislike for duration and the fact the local market typically has lower duration than its global peers, in the event of broad-based sell-off in bonds we would expect domestic rates to shift more aggressively than global rates. Therefore, we start 2022 with a mild underweight to domestic bonds.

FIGURE 14: RATE DIFFERENTIAL



Past performance is not indicative of future returns.

Source: Bloomberg Finance L.P., DWS Investment GmbH as of December 2021



INTERNATIONAL FIXED INCOME

B Current

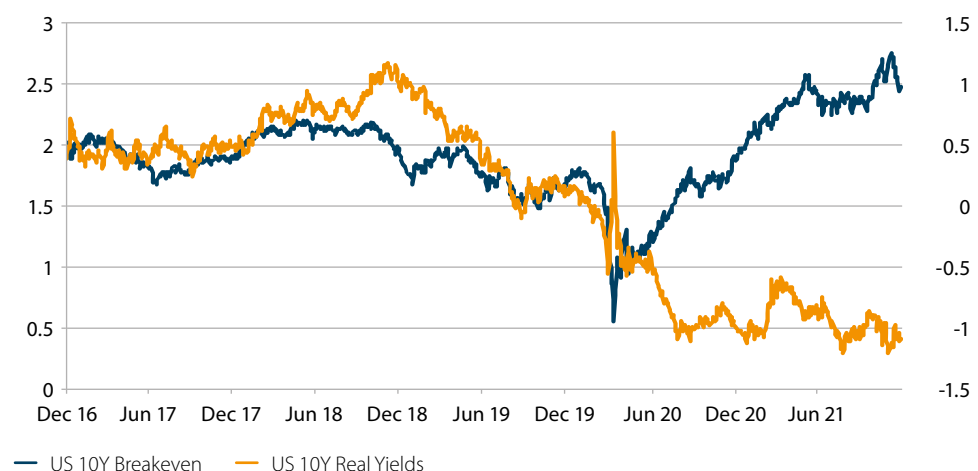
Our current preference is to be **benchmark international fixed income**.

Ever since mid-2021, when the US Federal Reserve's question of "to taper or not to taper" kept investors occupied, market participants have been looking for a new narrative to cling onto. As mentioned in the developed market equities section, stagflation is one such buzzword. Fund manager surveys during the 2nd half of 2021 reflected this state of mind. 34% of fund managers participating in one such survey expected growth to be below trend, paired with inflation that is higher than what trend would suggest. At the same time, the number of investors that expected steeper yield curves had dropped to 23%, while close to 85% of fund managers expected central banks to hike rates — implying an environment dominated by a bear flattening of global yield curves.

Moreover, in late 2021, short term interest rate markets went through a period where investors were questioning the stance of central banks, leading to a somewhat silent taper tantrum. A rather puzzling move given central banks will most probably do all they

can to hold their accommodative monetary stance. While it doesn't seem that way in the very near term, over the course of 2022 we wouldn't be surprised if global yield curves start to steepen yet again. Nonetheless, the ongoing economic recovery and inflation pressures might well push the 10-year US Treasury yield to 2.0% in 2022, but probably not much beyond that. Furthermore, continued COVID-19 news flow and geopolitics might bring renewed volatility to sovereign bond markets. Carry assets remain in demand driven by deleveraging and ongoing negative real Treasury yields. The fact that global central banks have essentially underwritten international credit markets, has suppressed volatility in the asset class. While central banks continue withdrawing some of the extra liquidity that was injected into markets following the onset of the pandemic, we believe that credit will continue to be well supported in 2022, albeit valuations do not look as attractive as in the past. Given this, and the higher credit exposure within global bond markets relative to our domestic market, we favour the outlook for international fixed income compared to Aussie bonds in 2022.

FIGURE 15: 10Y BREAKEVEN VS. 10Y REAL YIELD



Past performance is not indicative of future returns.

Source: Bloomberg Finance L.P., DWS Investment GmbH as of December 2021



LISTED REAL ASSETS - GREITs & INFRASTRUCTURE

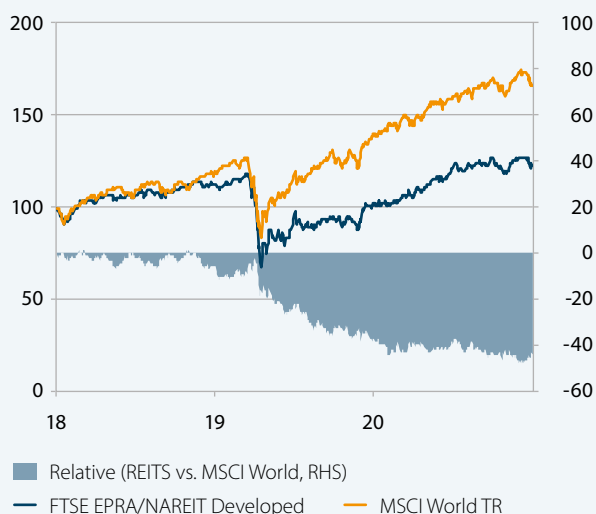
B Current

Our current preference is to be **benchmark listed real assets**, the position a construct of our **benchmark exposure to Global Real Estate Investment Trusts (GREITs) and mild underweight to listed infrastructure**.

Following the depths of the COVID-19 sell-off, GREITs massively underperformed global equity markets. This resulted in historically very cheap valuations. At this point, it appears investors overestimated the negative impact the pandemic would play in the way business models across this asset class would operate moving forward. Subsequently, the asset class experienced a significant recovery in asset prices over 2021. As we enter 2022, it is this valuation dynamic and recent relative outperformance from GREITs that frames our outlook for the asset class. Undoubtedly, uncertainty over the office REITs segment will remain, the same is true for shopping centres as they are forced to adapt their business models. While health care and residential REITs show more promise at this juncture. At this stage we see better opportunities in other risk assets this year.

It's a similarly mild outlook for listed infrastructure in 2022, albeit for different reasons. Despite large fiscal spends and global promises of investment in infrastructure, the long-duration nature of these assets, the outlook for rates and resulting potential of a rise in valuations kept the asset class subdued over 2021 and unfortunately we envisage much of the same again in 2022. Despite this, the asset class remains important to multi-asset investing, offering a unique balance of defensive characteristics to withstand drawdowns as well as higher-beta traits to capture upside swings.

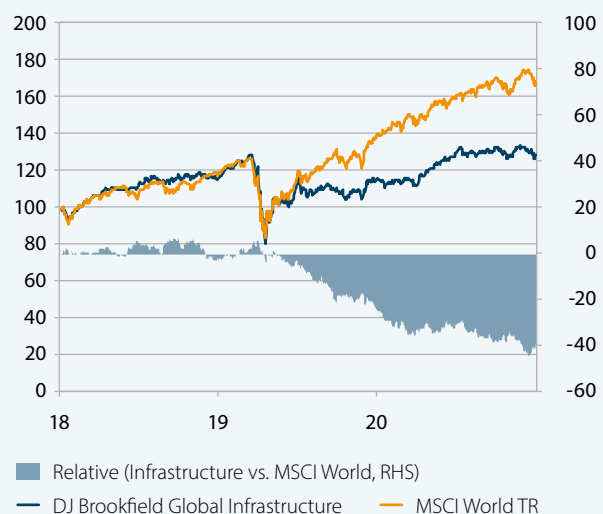
FIGURE 16: GLOBAL REITs VS. MSCI WORLD



Past performance is not indicative of future returns.

Source: Bloomberg Finance L.P., DWS Investment GmbH as of December 2021

FIGURE 17: GLOBAL INFRASTRUCTURE VS. MSCI WORLD



Past performance is not indicative of future returns.

Source: Bloomberg Finance L.P., DWS Investment GmbH as of December 2021



AUSTRALIAN DOLLAR

B Current

Our current preference is to be **benchmark the Australian dollar (AUD)**.

2021 was a tumultuous year for currencies and in 2022 we see a similarly mixed outlook for the AUD as global markets continue to experience heightened volatility.

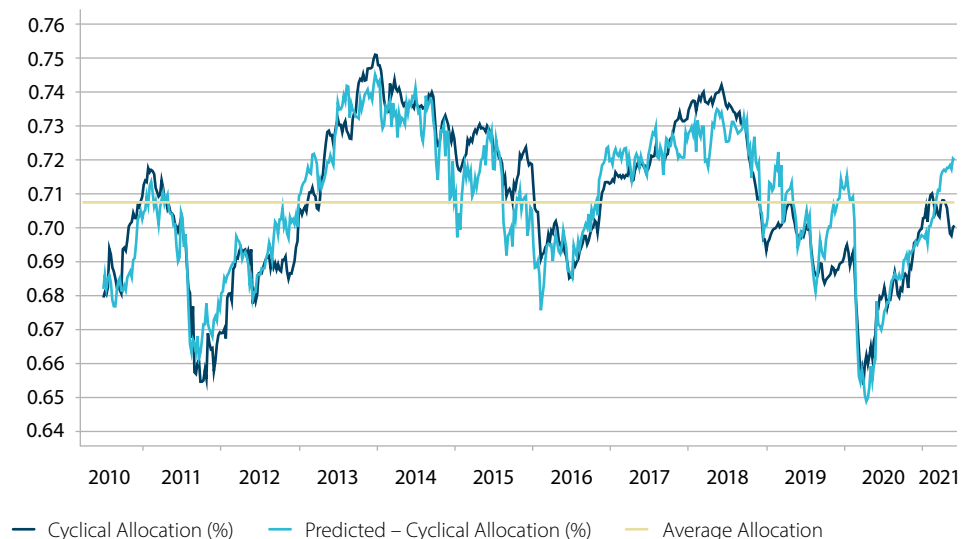
The outlook for the Australian economy appears rosier, with high vaccination rates and the subsequent loosening of mobility restrictions paving the way for a sustained increase in domestic activity. Two years of significant fiscal stimulus has provided households with a solid buffer and this should continue to support spending habits.

Like many of its peers, the tone for domestic rates markets and the RBA will be dictated by just how sustainable inflationary pressures are. Here, we believe there are a few reasons why the RBA will continue to lag global counterparts when it comes to policy normalisation. Firstly, Australia is likely to lag the global inflation cycle, thanks mainly to

lower wage pressures and less intense supply side frictions. Secondly, the rollover of fixed rate mortgages should lift borrowing costs separately to any change by the RBA to the official cash rate.

Further abroad, we believe policy and growth remain the key risks for the AUD. The ever-present COVID shadow continually threatens further restrictions, however, more broadly the growth outlook remains positive. This tightening cycle is expected to come against a global economic backdrop with greater momentum and inflation than any other cycle over the previous four decades. This environment should be supportive of cyclical asset allocations, and in turn the AUD which is highly leveraged to the global cycle. Balancing the risks of central bank tightening against above-trend growth, the outlook for the AUD looks relatively positive. We believe the AUD is likely to finish 2022 somewhere in the mid-0.70USD range.

FIGURE 18: CYCLICAL POSITIONING SHOULD LIMIT THE DOWNSIDE



Source: Fed, Bloomberg, Macrobond, ANZ Research, December 2021

