



**ANZ INVESTMENTS 2022
MARKET OUTLOOK**

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A QUICK LOOK BACK AT 2021

Looking back for a moment, 2021 was another stellar year for equity markets, with most global indices we track ending the year with double-digit gains – for some equity benchmarks, it was the third-straight year of returns above 10%.

These exceptional global equity returns saw the majority of our investment funds continue to deliver outstanding returns, reaffirming our belief in active management – the process where our investment specialists take a more hands-on approach to investing. This approach, alongside having well-diversified funds, allows us to capitalise on opportunities and smooth out the bumps during periods of uncertainty.

The COVID-19 outbreak remained the major news story, and while vaccination rates picked up and new treatments for the disease came to market, the virus still circulated in most parts of the world. Furthermore, a new variant, Omicron, was discovered in late 2021 that was thought to be more transmissible than the dominant Delta variant.

Inflation was another hot topic, and despite decade-high rates of inflation, pushing government bond yields higher, sentiment among equity investors remained upbeat.

In the US, the S&P 500 and the NASDAQ 100 both hit all-time highs, finishing the year up 26.9% and 26.6%, while many European markets also finished with double-digit gains. It was a mixed story in Australasia, with the ASX 200 ending the year up 13%, benefiting from the global reopening, while in New Zealand, the NZX 50 underperformed, falling 0.4%.

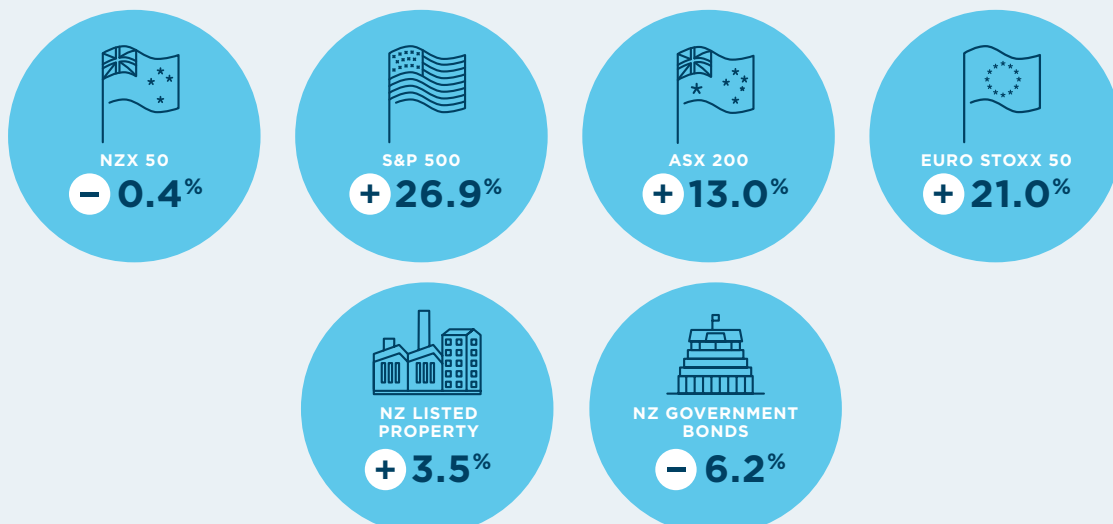
However, as we just alluded to, government bond yields finished the year mostly higher, which meant bond prices struggled. The weakness in bonds came about as investors prepared for central banks to slowly unwind the easy/stimulatory monetary policy put in place during the early stages of the COVID-19 outbreak.

In fact, some central banks began unwinding policy before the year end, including the Reserve Bank of New Zealand (RBNZ), which became one of the first developed nations central banks to raise interest rates, lifting the Official Cash Rate (OCR) 50 basis points to 0.75% as the Consumer Price Index hit its highest level since 2011.

As we head into 2022, COVID-19 will remain at the forefront of conversations, especially from a societal perspective. New lockdowns and restrictions will be met with frustration and anger. However, even in countries with no official restrictions, high levels of sickness may impact labour availability in essential services like healthcare. This could lead to more cautious consumer behaviour, slowing the demand for goods and services. Meanwhile, restrictions in China will likely continue to impact on global supply chains.

For financial markets, rising interest rates and relatively expensive equity valuations will provide challenges. Nevertheless, there is a lot to be optimistic about as the global reopening continues to underpin a strong rebound in growth. As we turn the calendar, here's ANZ Investments' 2022 Market Outlook.

THE GLOBAL EQUITY RALLY CONTINUED IN 2021, WHILE NEW ZEALAND EQUITIES AND BONDS STRUGGLED



WE EXPECT INFLATION RATES TO EASE, BUT REMAIN ABOVE HISTORIC LEVELS

Inflation was a prominent theme in 2021, with levels reaching decade-highs in New Zealand, the US, and several other countries. As we head into 2022, we expect inflation to remain one of, if not the key issue investors will face.

Our base case is that rates of inflation in most developed nations will slow in 2022, however, we expect them to remain above pre-pandemic levels. The easing of inflation will come from both a slowing of consumer demand and improvements in the supply side of the global economy.

On the demand front, a combination of rising interest rates, which will increase consumers' borrowing costs, and the reduction of fiscal stimulus, will slow consumer spending – a key contributor to the jump in prices during 2021.

Meanwhile, supply chain pressures, which plagued the global economy since the start of the pandemic, should start to moderate as ports and other key transport hubs improve capacity, helping to alleviate product shortages, and in turn, improve international commerce.

Elsewhere, we expect to see a significant pullback in some idiosyncratic sectors that were notable contributors to headline inflation in 2021. These include used-car prices, airfares and hotels. The surge in these outliers is best

illustrated by the price of used cars. The Manheim US Used Vehicle Value Index, which provides monthly updates on the prices of used cars sold at wholesale auctions in the US, rose from around 141 in January 2020 to a high above 230 in November 2021.

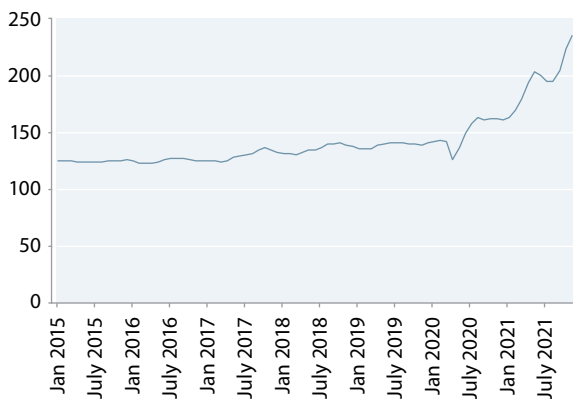
As we assess the outlook for inflation, the risk to our view is that core inputs such as energy prices, rents, and wages continue to rise at an above-average pace. Under this scenario, central banks would be forced to raise interest rates faster than we first thought, pushing bond yields higher, which in turn, would weigh on equity valuations.

“2021 ended with central bankers, including the US Federal Reserve, responding to high inflation by reducing asset purchases and indicating that rates will rise in 2022.

Understanding how the post-COVID-19 investment landscape evolves will be very important, particularly whether the factors that have supported equity markets until now can persist. Since mid-2020, the recovery in company earnings has been driven by strong private sector demand for goods, which have been sustained by fiscal transfers and elevated savings. However, 2022 may be more challenging due to tighter labour markets, rising global interest rates, rising geopolitical risks and slower Chinese growth.”

The value of a used car has been increasing

The Manheim US Used Vehicle Value Index



Source: Manheim Consulting



Maaïke van Tol, Head of Asset Allocation, Investment Strategy & Portfolio Management at ANZ Investments

CENTRAL BANK ACTIONS COULD CREATE ASSET VOLATILITY

In March 2020, numerous central banks, almost in unison, cut interest rates and enacted bond-buying programmes to support the global economy as the COVID-19 outbreak worsened and lockdowns brought business activity to a halt.

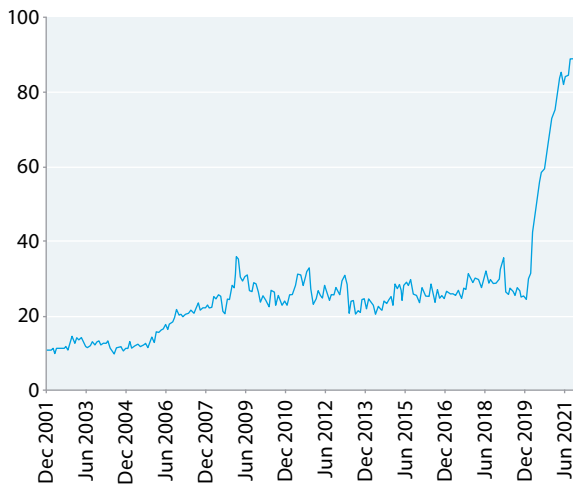
Just as the interest-rate cuts were in lockstep, many had assumed that as the global economy recovered, policy normalisation across the major central banks would occur at roughly the same time; policy rates would rise and central bank balance sheets would slowly be reduced.

However, as we saw in the latter parts of 2021, several factors meant some central banks, including the RBNZ, were early to act as inflation rose to decade-highs and capacity constraints tightened. On the other hand, the Reserve Bank of Australia (RBA), US Federal Reserve ('the Fed') and European Central Bank have been slower to respond to inflationary pressures, with recent comments and market pricing indicating a start to the removal of monetary accommodation.

In New Zealand, the RBNZ appears to be on track to raise the OCR several times in 2022 after it shifted to a tightening bias in 2021, which saw interest rate markets price in an OCR of 2.25% by December 2022.

Our base case is that the OCR is lifted to just 1.5% by the middle of 2022. We believe an OCR significantly higher than 1.5% could weigh on the domestic economy given its high debt-to-income and debt-to-GDP ratios. Moreover, as the government crafts policy to slow house price growth, higher interest rates, which increase borrowing costs, could exacerbate any weakness in house prices.

New Zealand's debt has grown considerably
RBNZ balance sheet (all assets) in NZ\$bn



Source: Reserve Bank of New Zealand

Furthermore, as the domestic economy reopens and supply-side constraints (both goods and labour) improve, inflationary pressures should ease, which could lead to a scenario of a slowing economy, declining inflation, but rising interest rates.

Overseas, the Fed has signalled it will begin raising interest rates in 2022 and markets have moved to price in a faster pace of rate hikes – with just under four hikes expected in 2022. However, for most of 2021, the Fed had appeared more cautious, with policymakers believing that inflation rates would ease in the later stages of 2022. The pace of rate hikes now hinges on how inflation develops during 2022 and how the labour market evolves versus the Fed's assessment of "maximum employment". The risk is that continued inflation from wages and shelter (i.e. rents) force the Fed to hike more quickly, which could result in an abrupt slowdown in economic activity.

Finally, in Australia, the RBA has indicated that raising interest rates in 2022, at this stage, is unlikely. Its Governor, Philip Lowe, said in December that "In our central scenario, the condition for an increase in the cash rate will not be met next year (2022)".

Against this backdrop, we see a benefactor of a slower, and potentially less volatile interest rate path from the RBA in 2022 being the Australian dollar versus the New Zealand dollar. Our medium-term view is that the New Zealand dollar will continue to underperform the Australian dollar.

"The risk for New Zealand is that when its economy reopens the current supply-led inflation dissipates, and the structural forces which have been capping local inflation and GDP growth over the last decade reassert themselves. Therefore, the RBNZ in 2022 will need to get the hike path just right to avoid a housing-led deflationary outcome, especially as the impact of several government policies aimed towards slowing house price growth have yet to have a full impact."



Ray Jack, Credit Analyst, ANZ Investments

LEARNING TO LIVE WITH COVID IN OUR COMMUNITIES, AND ECONOMY

Having all but eliminated COVID-19 from the community, the first half of 2021 saw rapid growth in the New Zealand economy as the Government's pandemic response allowed a return to some sense of normality. But having successfully managed to keep the Delta variant at bay, August saw the variant enter the community and quickly spread, sending the country into further lockdown.

Nevertheless, economic data showed that, once again, the economy remained resilient, with growth only contracting by 3.7% in the third quarter of the year – much better than many had expected. However, despite this, it did not translate into a good year for domestic equities with the NZX 50 ending the year down 0.4%, as it underperformed most global counterparts.

Although New Zealanders are enjoying new-found freedoms, thanks to very high levels of vaccination, the introduction of vaccine passports and the promise of a gradual reopening of New Zealand's borders, the outlook for the local economy looks challenging. The strong economy and ongoing supply constraints saw the RBNZ begin to raise interest rates in 2021, and we expect this to continue in 2022, although, as we alluded to earlier in this report, not at the same pace that many others expect.

Moreover, we expect the economy to cool as two key sectors – housing and immigration – face headwinds.

House prices have headed higher, increasing 23.8% in the year to end November 2021 (REINZ data). But monetary policy is tightening quickly, and mortgage rates have increased significantly since the start of the current interest rate tightening cycle. The effect on house prices, and the knock-on impact on consumers, will therefore be key.

Another question mark will be around immigration. Will people come to, or leave, New Zealand? There may be New Zealanders overseas who intend to return home

once borders open up – either to visit, or to relocate more permanently. But will this be offset by people going overseas? Many younger Kiwis have put their OEs on hold and, in the past, Australia has opened its door for our workers, and this may well be repeated. Continued border closures resulting in net negative migration is a key risk to the economic outlook in 2022 through demand for housing and its impact on the labour market.

From an investment perspective, despite a relatively muted outlook for domestic equities, there remain a number of quality companies that can continue to adapt and thrive in this ever-changing environment.

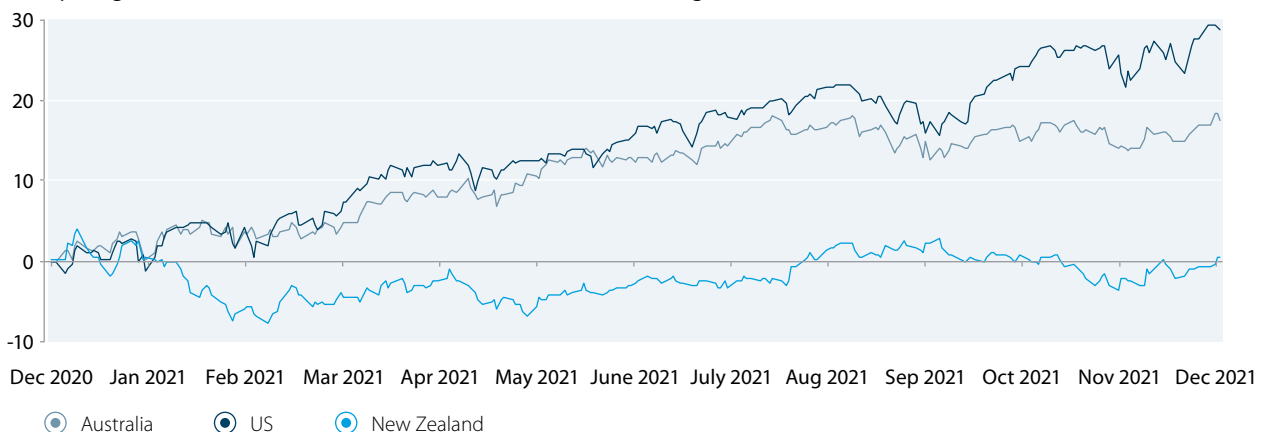
“With the likelihood of ongoing disruption from COVID-19, 2022 is looking like another year of uncertainty in financial markets. This is likely to be in combination with ongoing disruptions to global supply chains which will continue to put pressure on the pricing and availability of goods in and out of New Zealand. Pressure on wages driven by a shortage of labour across many industries will keep inflation front of mind and see interest rates continue to edge higher. Against this backdrop, the New Zealand share market is expected to deliver muted returns given its bias to interest-rate sensitive stocks.”



Craig Brown, Head of Australasian Equities at ANZ Investments

New Zealand shares underperformed in 2021

Comparing New Zealand shares to Australian and US shares (% change)



GLOBAL GROWTH AND EARNINGS TO REMAIN ABOVE-TREND, BUT EXPECT TO SEE SOME SLOWING

2021 was a year of very strong growth, despite the constant threat posed by COVID-19. Progress was driven by a sharp post-lockdown recovery, as the global vaccination roll-out continued at pace, allowing many countries to gradually scale back restrictions and open for business once more.

As we head into 2022 however, uncertainty has come back to cloud the outlook. Persistently high inflation is a risk that raises the prospect of higher interest rates, while a resurgent pandemic in the form of the Omicron variant is the biggest risk to economic growth.

Our view is that growth will remain above-trend, albeit at a lower rate relative to last year – which included the rebound off the 2020 slowdown. It’s a view shared by the IMF, who in its October 2021 World Economic Outlook projected the global economy to grow by 5.9% in 2021 (which was 0.1% lower than in its July forecast) and by 4.9% in 2022.

“The downward revision for 2021 reflects a downgrade for advanced economies—in part due to supply disruptions—and for low-income developing countries, largely due to worsening pandemic dynamics. This is partially offset by stronger near-term prospects among some commodity-exporting emerging market and developing economies.”

The threat posed by Omicron is real given the sharp increase in infection rates and evidence it is well on its way to becoming the most dominant variant of the virus. While current vaccines should provide some protection against the risk of severe infections, a concern is that Omicron’s rapid spread could see a return to lockdowns across Asia, which would further disrupt supply chains and add to inflationary pressure.

Even under a scenario of no restrictions in developed markets, cautious consumer behaviour has the potential to slow the demand for services relative to goods, keeping goods inflation elevated. It could also hinder the return to work for parents, keeping labour markets tight and wage pressures high.

The key differences – at least when compared to the start of the pandemic in March 2020 – is that vaccine manufacturers should be able to quickly adapt current vaccines to better target the Omicron strain, and the new antiviral drugs which are now readily available. This should provide the global economy with some support given that known solutions could be delivered in the first quarter of the year.

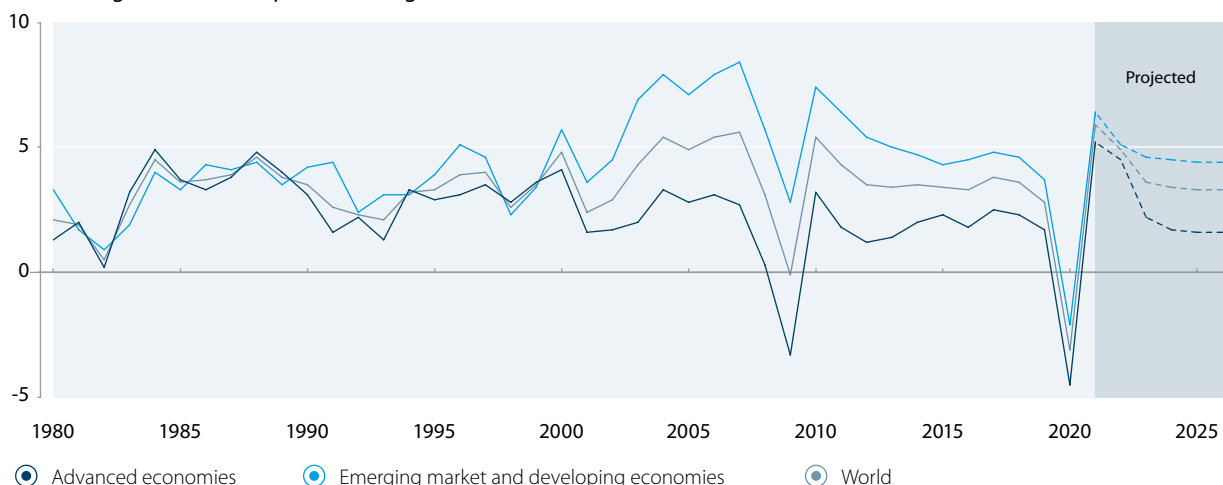
The most recent third-quarter earnings season showed company earnings and revenue that were better than average, but slowing compared to the very strong growth off the 2020 lows. The question is whether companies can continue to grow earnings against the backdrop of lingering COVID-19 infections and lower, but above-trend global growth.

Our view is that earnings should be supported by elevated demand, as consumers spend down their savings accumulated during prior lockdowns. We’re also seeing low inventories in manufacturing industries. So even if demand is not as robust as hoped, the manufacturing cycle should remain strong into 2022 as inventories are rebuilt. This supports the earnings and growth outlook for the time being.

Against this backdrop and from what we know at present, we are comfortable to remain overweight to growth assets, but we will remain alert to the development of inflation, and the impact that Omicron has on the recovery.

Global growth to remain above trend, albeit at a lower rate relative to last year

Real GDP growth (Annual percent change)



Source: International Monetary Fund

RESPONSIBLE INVESTING: ANZ IS AHEAD OF THE GAME - BUT THERE'S ALWAYS MORE WE'RE WORKING ON

Over the last 12 months there have been a number of significant events across the responsible investment landscape, with the most notable of these being the 2021 United Nations Climate Change Conference (COP 26) held in Glasgow, where countries came together to pledge targets signalling a move to a lower-carbon world.

Globally, ESG (Environmental, Social and Governance) investing continued to gain traction, shown through record inflows to ESG-labelled funds and investors demanding greater transparency and commitments from portfolio companies. One such example was investor group Engine No.1 taking three seats on ExxonMobil's board in an effort to speed up the company's decarbonisation strategy.

As we head into 2022, our view is that interest from investors will grow as they demand both accountability and transparency of company's targets and their progress towards climate-related goals and reducing carbon emissions.

The ball is also rolling in New Zealand, with a significant milestone being the introduction of climate-related financial disclosures. Listed companies, fund managers and a number of other entities will be required to report on the climate-related risks and opportunities that their companies, assets, investments and portfolios face, and the strategies that they will implement to respond to these. New Zealand joins a small, but growing list of countries around the world that require business entities to publish these disclosures.

This means the companies that we invest in across New Zealand will be required to publish their risks, opportunities and strategies to combat climate change. As an active investment manager, we can factor these into our decision making by selecting companies that we believe will be resilient to climate change, and which have the ability to adapt their business models to continue to thrive over the long term.

ANZ Investments will be required to report under this framework. We already undertake a significant amount of work to assess the risks and opportunities our funds face over the short, medium and long term, and we believe this requirement will give our investors greater transparency on where the risks and opportunities lie in their KiwiSaver and investment accounts.

Walking the talk: Measuring and reporting on sustainability focussed funds

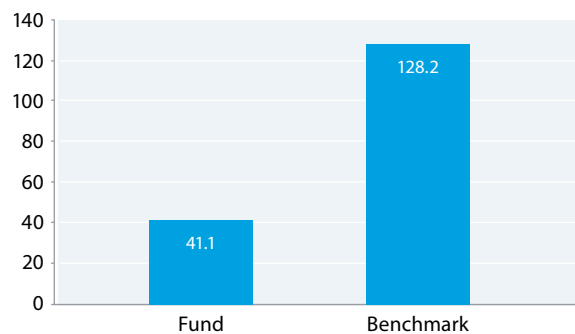
In 2021, we set a number of sustainability-linked goals for the OneAnswer KiwiSaver Scheme Sustainable International Share Fund and we publish a quarterly update detailing progress towards these goals.

One of the measures we use to show the carbon footprint of the fund is the weighted average carbon intensity (WACI), which represents each company's total Scope 1 and Scope 2 carbon emissions (measured in tonnes) per US\$1m in sales. This allows for comparison between companies of different sizes.

As at 31 December 2021, the carbon intensity of the fund was 68% below that of the MSCI benchmark, as a result of the fund's tilting towards companies that have a lower carbon intensity. You can view the full report on the ANZ website.

Weighted Average Carbon Intensity (WACI)

OneAnswer KiwiSaver Scheme Sustainable International Share Fund



Source: ANZ Investments and MSCI (see MSCI disclaimer on page 10)

Throughout 2022, we will see more companies start to publish emissions data for their own operations, and the impact of their supply chain, which will give a more complete picture of a company's end-to-end operations.

Improving data quality over the coming years will also allow investors to make more meaningful decisions by combining a company's climate outlook with the financial outlook, and how these factors might influence the company's valuation in the long term.

A CHALLENGING YEAR AHEAD – BUT PLENTY OF OPPORTUNITIES

More than two years into the global pandemic, we would be remiss to not think it will remain at the forefront in 2022.

The pandemic did, and will continue to, test societies resilience as democracy continues to be challenged around the world. However, we believe the challenges faced in 2021 can be alleviated through global cohesiveness as we look to a life that somewhat resembles the pre-pandemic era.

At home, New Zealand has a stable government and a robust set of societal values that makes it an attractive place to be amid the challenges seen around the world. In saying that, there is a lot to be optimistic about when we look overseas. The unabated work on the vaccination front – and now even more pertinent – at-home treatment for COVID-19, will play a significant role in a return to pre-pandemic living.

From an investing standpoint, 2022 is shaping up as a challenging year for both equities and bonds as central banks navigate policy normalisation. They will have to balance raising interest rates without stifling the economic recovery. And on the flipside, if policy normalisation is slow, the inflation concerns could exacerbate.

Nevertheless, no matter what 2022 brings, we believe our active management approach, alongside our well-diversified funds, will serve as a fundamental tool to smooth out the bumps and capitalise on the opportunities, of which both we are likely to be faced with in the year ahead.

Just as we did before, and during the pandemic, our focus remains on quality companies and assets that exhibit strong governance and values. This approach should continue to serve our investors well, targeting above-average returns on a consistent basis over the long-term.



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