

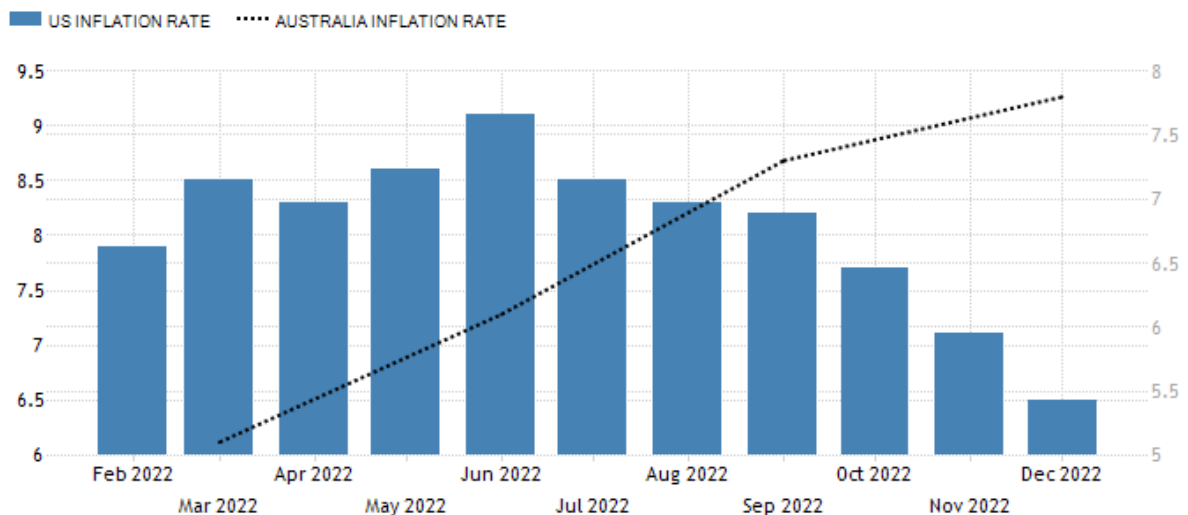
## Divergences

We talk a lot about divergences between markets. But equally interesting is when they don't. We examine the very high correlation between bonds of countries at radically different points in the inflation and policy cycle.

**Australian and US bonds have traded almost in synch** for a year.

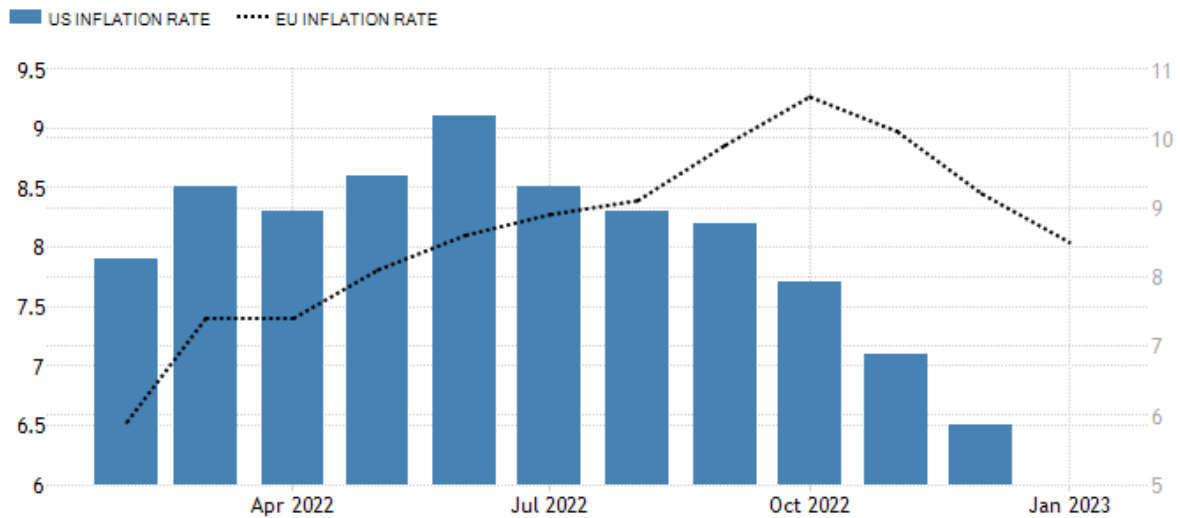


Curiously, US bonds initially outperformed as US inflation soared. But examining inflation:



US inflation peaked in June. **Australian inflation has risen continuously since then**, but bond have traded in lockstep anyhow.

Similarly, Eurozone inflation peaked later and higher than in USA:



**But their bond yields are dramatically lower** (shown on different scales), and narrowing only marginally:

Germany 10Y | US 10Y



Australian CPI is said to have peaked in December, as an article of faith. *But has it?*

- 1Q22 CPI of 2.1% rolls out of the data (there was no monthly data until 3Q22). **There is no guarantee 1Q23 will improve on it**, after some hefty annual increases in utilities.
- However, December retail sales plunged -3.9%, which could be the **long-awaited sign of the consumer capitulating** to higher interest rates.

**Overall, we are sceptical about the domestic bond rally. Globally, we feel that markets are overreacting to good news – in Australia, there is no good inflation news.**

## Leading Markets

Stocks and bonds soared, on another wave of optimism that inflation is easing. The US Dow Jones, S&P500 and NASDAQ jumped +2.9%, +6.3% and +10.7% respectively with MSCI EU +10.4% to be +25% over the quarter. MSCI World ex-AUS rallied +6.5% in local terms.

Emerging Markets rebounded +7.9% in \$US, driven by China 50's +13.8%. Frontier Markets gained +4.5%.

US 10-year bonds soared to 3.48% (-40bp tighter), with the 2-10 inversion widening from -53bp to -69bp in anticipation of recession. High yield boomed to 430bp spread (-71bp).

## Other Highlights

China reopened borders as the final step in abandoning COVID19 restrictions. They have suggested the massive initial reopening wave has now abated.

Global COVID19 deaths are 6.76m (+60k), although Chinese data is probably incomplete, from 665m reported cases.

US Q4 GDP was estimated at +2.9%, comparable to Q3's +3.2% p.a.

Unemployment eased to 3.5% (-0.1%) in December as Non-farm Payrolls slowed to +223k vs a revised down +256k. Participation rose to 62.3% (+0.1%). Youth unemployment was steady at 8.2%.

Headline inflation fell to 6.5% YoY (another -0.6%) on a -0.1% month. Core CPI eased to 5.7% (-0.3%) as a 0.3% month. Retail sales fell again, by -1.1%.

Eurozone prices eased -0.4% in December taking YoY inflation to 9.2% from a peak of 10.6%. Core CPI rose to 5.2% (+0.2%).

Chinese unemployment fell to 5.5% (-0.2%). YoY inflation rose to 1.8% (+0.2%) with prices flat in December.

UK unemployment was steady at 3.7%, just off the 50-year record 3.5%. Inflation eased to 10.5% (-0.2%) on a +0.4% month.

German GDP contracted -0.2% in Q4.

The Bank of Japan's 10yr bond cap of ½% held well, trading in the 40-50bp range.

Employment plunged with a sharply lower participation of 62.4% (-0.4%) keeping unemployment at 2.5%.

## Domestic

There was no January RBA meeting. Bond yields plunged on offshore leads. 2-year bond yields closed 3.18% (-50bp), 5-year at 3.27% (-42bp) and 10-year at 3.56% (-48bp) outperformed developed markets ignoring very poor inflation data.

China allowed Australia coal shipments, after 2 years of unofficial sanctions.

COVID19 cases reached 11.3m, slowing from 14k/day to a reported trickle of 1.5k. But deaths soared to 76/day from December's 29, suggesting mild cases are no longer being reported. 72% (+4%) of over 16's have now received a booster. Deaths YTD Sept were +16% to baseline.

The ASX200 bounced +6.2%, with the Small Ordinaries +6.5%.

CoreLogic reported -1.1% nationally from property in January with every capital lower. Sydney houses lead YoY falls with -15%.

Inflation set a new multi-decade high 7.8% YoY after prices rose +1.9% in Q4. The RBA's trimmed mean set a record 6.9% (vs 6.5% expected) after a +1.7% quarter.

Unemployment was unchanged at 3.5%, with employment down -15k after an outlier high November; participation slipped to 66.6% (-0.2%). Underemployment jumped to 6.1% (+0.3%). Hours worked fell -0.5%.

November turnover fell in 8 of 13 ATO industries, although each was positive YoY.

Building commencements fell -5.2% in Q2 to be -21% YoY.

November's trade surplus grew to \$13.2bn (+3.6%).

Retail sales collapsed -3.9% in December but was +7.5% YoY (slightly below CPI).

## Commodities and Currency

WTI closed at \$79.15 (-1.6%). Gold rose to \$US1927/oz (+5.7%). Iron ore jumped to \$US128.8/t (+9.9%), from November's \$80 low.

Base metals all gained, with Nickel +1.0%, Copper +8%, Tin +18%, Zinc +13%, and Aluminium +7%.

\$A rose to US70.55c (+3.5%).

**KEY FINANCIAL MARKET DATA – AS AT 31<sup>ST</sup> JANUARY 2023 (UNLESS SPECIFIED)****Interest Rate Markets**

Index Performance	1 month	3 months	6 months	1 year	2 year	3 year	5 year
					p.a.	p.a.	p.a.
Bloomberg AusBond Bank	0.27%	0.77%	1.31%	1.52%	0.77%	0.61%	1.03%

Key Rates	Jan-23	Dec-22	Nov-22
Australian Cash Rate	3.10%	3.10%	2.85%
90 day BBSW	3.37%	3.26%	3.09%
3 Yr Commonwealth Bonds	3.14%	3.51%	3.17%
10 Yr Commonwealth Bonds	3.56%	4.04%	3.44%
CDX North American 5 Yr CDS	71bp	79bp	81bp
iTraxx Europe 5 Yr CDS	79bp	85bp	91bp
iTraxx Australia 5 Yr CDS	82bp	88bp	91bp
US Fed Funds Rate	4.25-4.50%	4.25-4.50%	3.75-4.00%
US 10 Yr Bond Rate	3.48%	3.88%	3.70%

**Equity Markets**

Domestic	1 month	3 months	6 months	1 year	2 year	3 year	5 year
					p.a.	p.a.	p.a.
S&P/ASX 200 TR	6.23%	9.59%	10.32%	12.21%	10.82%	5.96%	8.51%
S&P/ASX Small Ordinaries TR	6.56%	7.64%	2.35%	-4.44%	0.95%	2.41%	4.35%
S&P/ASX 200 A-REIT TR	8.12%	9.69%	0.47%	-4.95%	6.34%	-0.91%	5.62%

International	1 month	3 months	6 months	1 year	2 year	3 year	5 year
					p.a.	p.a.	p.a.
US: S&P 500 (\$US)	6.28%	5.76%	-0.44%	-8.22%	6.38%	9.88%	9.54%
US: NASDAQ (\$US)	10.72%	5.69%	-6.08%	-17.95%	-5.15%	9.04%	10.34%
MSCI World Acc. (Local Currency)	6.50%	6.73%	1.09%	-6.37%	5.64%	8.13%	7.40%
MSCI World Acc. (AUD)	2.97%	-0.72%	0.94%	-7.90%	8.28%	5.75%	9.52%
FTSE 100 (£)	4.35%	10.12%	6.42%	8.04%	14.21%	5.80%	4.56%
MSCI Emerging Markets (\$US)	7.90%	22.16%	4.92%	-12.12%	-9.71%	1.40%	-1.48%

**Fixed Interest Markets**

Bonds	1 month	3 months	6 months	1 year	2 year	3 year	5 year
					p.a.	p.a.	p.a.
Bloomberg Global Agg TR AUD	-0.60%	-1.33%	-2.57%	-11.70%	-4.84%	-5.48%	1.53%
Bloomberg AusBond Composite	2.76%	2.20%	-0.85%	-6.26%	-4.87%	-2.74%	1.14%
ICE BofA US High Yield TR USD	3.91%	5.06%	1.22%	-5.14%	-1.60%	1.05%	2.77%

Data*	Current Period		Previous Period	
<i>Employment Data</i>				
Employment Growth	December	-14,600	November	64,000
Unemployment Rate	December	3.50%	November	3.50%
Participation Rate	December	66.60%	November	66.80%
<i>Lending Finance</i>				
Housing Finance	December	-4.30%	November	-3.70%
Personal Finance	December	-2.80%	November	-1.30%
Business Construction	December	99.40%	November	-62.10%
<i>Other</i>				
Balance on goods and services	November	13,201m	October	12,743m
Retail Sales	December	-3.90%	November	1.40%
Building Approvals	December	18.50%	November	-9.00%

\*All data is seasonally-adjusted.

<b>Median Fund Manager Returns (Morningstar)</b>	<b>1 month</b>	<b>3 month</b>	<b>6 month</b>	<b>1 year</b>	<b>2 year p.a.</b>	<b>3 year p.a.</b>	<b>5 year p.a.</b>
Australian Equity Large Cap	5.77%	8.04%	9.19%	8.97%	10.55%	5.80%	7.18%
Australian Equity Small Cap	5.21%	4.75%	2.09%	-5.54%	1.57%	3.94%	5.39%
Global Equity Large Cap	3.61%	2.11%	3.17%	-6.32%	6.49%	5.35%	8.03%
Global Equity Small Cap	4.56%	3.65%	1.69%	-10.52%	2.06%	4.14%	7.17%
Australian Fixed Income	2.89%	2.52%	-0.81%	-6.74%	-5.22%	-2.87%	0.94%
Global Fixed Income	2.30%	3.90%	-3.14%	-9.25%	-6.14%	-3.23%	0.16%
Australian Listed Property	7.73%	9.60%	0.42%	-4.96%	6.04%	-1.02%	5.29%
Australian Cash	0.27%	0.77%	1.32%	1.48%	0.75%	0.60%	1.01%
Conservative <sup>1</sup>	2.50%	2.82%	0.83%	-2.72%	-1.44%	-0.47%	1.35%
Moderate <sup>2</sup>	2.64%	3.05%	1.09%	-2.63%	0.36%	0.65%	2.40%
Balanced <sup>3</sup>	3.44%	4.09%	2.01%	-2.09%	2.34%	2.00%	3.79%
Growth <sup>4</sup>	3.91%	4.57%	2.62%	-1.74%	3.94%	2.85%	4.78%
Aggressive <sup>5</sup>	4.62%	5.43%	3.65%	-1.29%	6.03%	4.15%	5.86%

<sup>1</sup> Growth Assets 0% - 20%

<sup>2</sup> Growth Assets 21% - 40%

<sup>3</sup> Growth Assets 41% - 60%

<sup>4</sup> Growth Assets 61% - 80%

<sup>5</sup> Growth Assets 80%+

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