Quarterly Market Update – 30 September 2022

Keeping At It

Paul Volcker was Chairman of the US Federal Reserve from 1979 to 1987, and his memoir is titled “*Keeping At It: The Quest for Sound Money and Good Government.*” Volcker was widely credited with having ended the high levels of inflation seen in the United States throughout the 1970s and early 1980s.

Many see the current Chairman, Jerome Powell, emulating Volcker by doing “whatever it takes” to get inflation under control. Currently inflation is raging at 40-year highs and interest rates are rising at their fastest pace in history. Recession in the US, UK and China seems inevitable.

Year to date the Australian market is down nearly 10%, while the US market is down over 20%. However, one must look at the current market downturn in the context of the last few years. Between March 2009 – the start of the recovery from the GFC – and December 2021 the Australian market gained 280% in total return, while the US market – powered by the large tech stocks – had a total return of 740%.

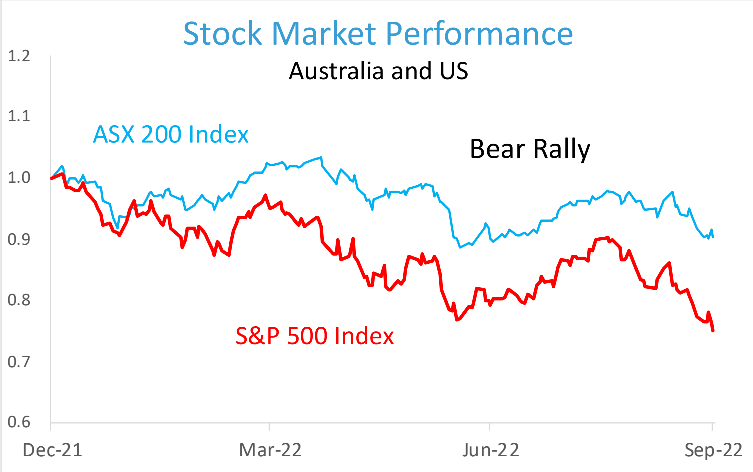
This year has been a roller coaster ride for investors. Early in the year inflation turned out to be higher and more persistent than the central banks – and the market for that matter – had expected. This resulted in falling stock prices and rising bond yields and was further compounded in February by the Russian invasion of Ukraine, which caused food and energy prices to spike.

Between 1 January 2022 and the middle of June the Australian market fell by 11.3%, the S&P 500 by 22.5% and the NASDAQ, the measure of tech stock performance, was firmly in bear territory and down just over 30%. But markets turned the corner in mid-June. Economic data out of the US indicated inflation was starting to moderate. Key inputs oil and gas were coming off their highs despite the continuance of the Ukraine conflict. Markets rallied on the assumption that inflation would not be as high as thought earlier, and therefore central banks would be able to slow and moderate the future path of rate rises.

Throughout July and most of August stock markets around the world started to climb, both the Australian and US stock markets were up by more than 10% over the period. But this turned out to be a "bear market rally" – a sharp, short-term rebound in share prices amid a longer-term bear market decline.

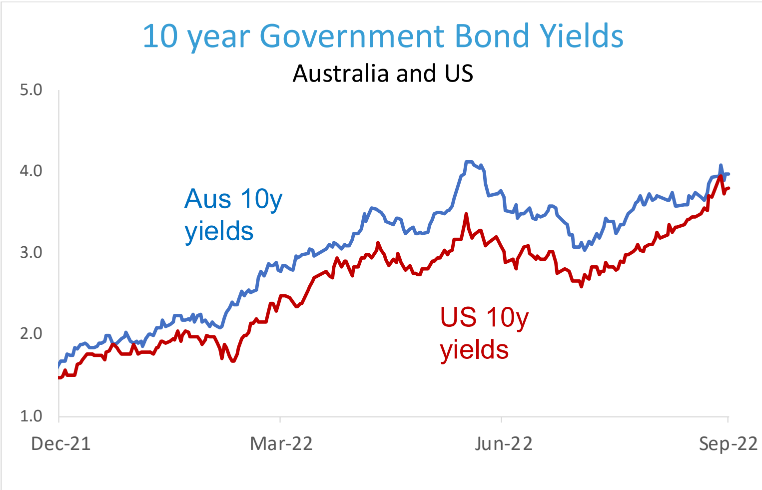
A VOLATILE YEAR IN MARKETS

The stock market "bear rally" ended on August 26th when at the Economic Policy Symposium Fed Chairman Powell said that "restoring price stability will likely require maintaining a restrictive policy stance for some time," re-iterating the Fed's stance to combat inflation. It may have taken nine months, but the Fed's message is now being received loud and clear.



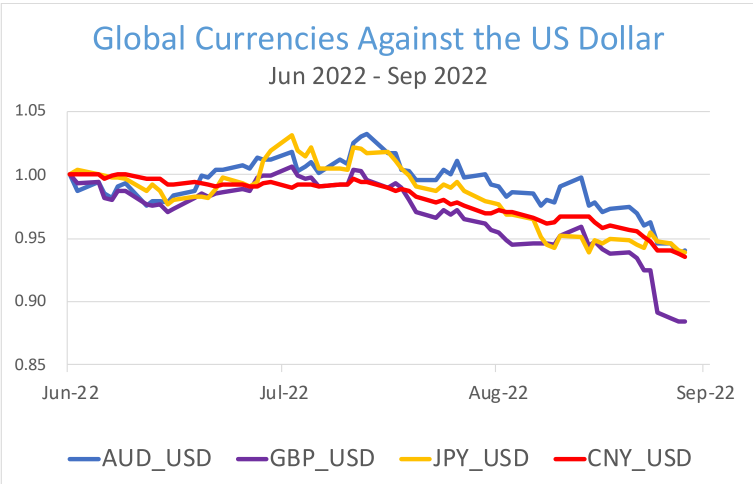
BOND PAIN CONTINUES

Hard hit bond investors finally saw some relief during the bear rally as yields declined between June and mid-July, before inflation expectations again lifted yields. By mid-September underlying inflation had accelerated, resulting in a third 75bps rate hike by the Federal Reserve. The yield on 10-year US Treasuries briefly hit 4% for the first time in 14 years.



USD CURRENCY SURGES

The Federal Reserve's determination to crush inflation at home by raising interest rates is pumping up the value of the US dollar, inflicting pain in other countries – pushing up prices from imports, ballooning the size of debt re-payments and increasing the risk of a deep recession. By quarter end the British pound had touched a record low against the US dollar.



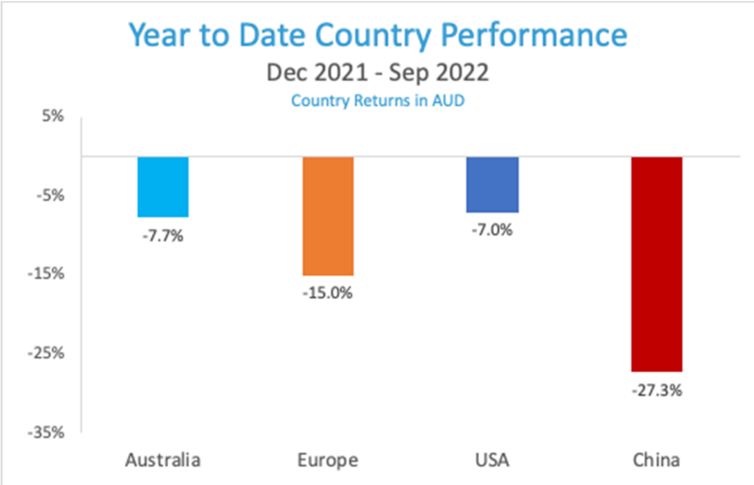
Market Overview

	YtD	3 Months	1 Year	3 Year	5 Year	10 Year
Cash	0.5%	0.4%	0.5%	0.4%	0.9%	1.7%
Australian Bonds	-10.0%	-0.6%	-11.4%	-3.4%	0.8%	2.3%
Global Bonds	-12.8%	-3.8%	-12.8%	-3.6%	-0.2%	2.4%
Australian Equity	-9.6%	0.4%	-7.7%	2.7%	6.8%	8.4%
Developed Markets	-15.8%	0.3%	-9.8%	6.3%	9.6%	13.6%
Developed Markets (hedged)	-23.5%	-5.2%	-17.5%	4.0%	5.3%	10.0%
Emerging Markets	-17.6%	-5.4%	-19.2%	-0.5%	2.2%	6.0%
Australian REITS	-28.7%	-6.7%	-21.5%	-5.3%	2.6%	7.7%
Global REITs	-20.0%	-4.9%	-10.7%	-3.7%	4.2%	8.7%

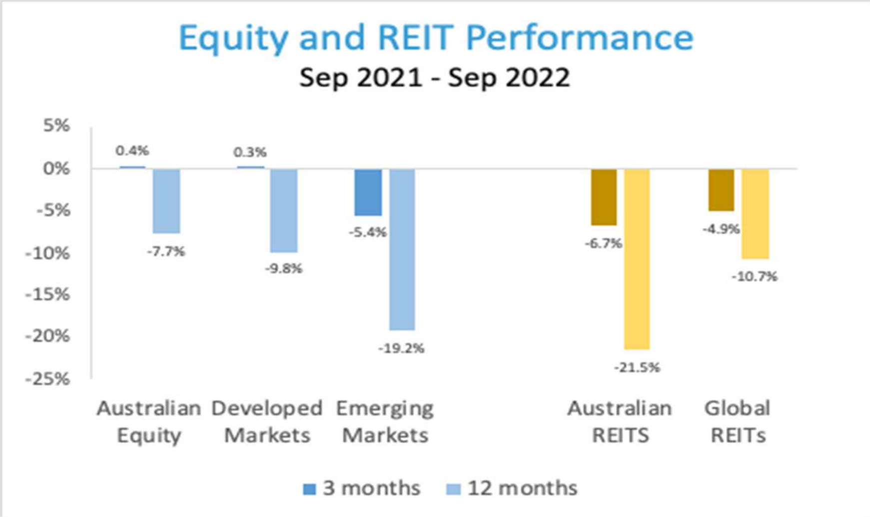
- Australian and Global Bonds have significantly underperformed cash. This has been the worst 12 months in modern history for bond investors.
- The Australian Equity Market returned 0.04% for the quarter and -7.7% for the year. All Sectors except Energy were negative over the year.
- The biggest influence on Developed Markets is the US, which makes up around 65% of the MSCI World Index, and then Europe which makes up a further 15%.
- The biggest detractor in Emerging Markets was China, which makes up around 30% of the EM index, and is down 18% for the quarter (in AUD).
- Australian and Global REIT's have been hit particularly hard by the re-pricing around interest rates and have been the worst performing asset class over the last year.

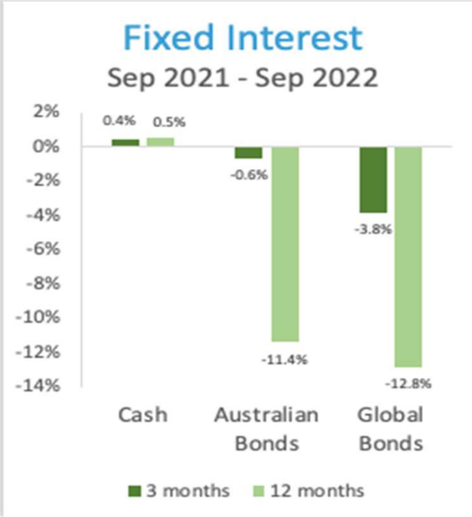
MAJOR MARKETS ARE ALL NEGATIVE YEAR TO DATE

Markets around the world have been hit by rising inflation, tightening monetary policies, the strong USD, and the ongoing uncertainty from the conflict in Ukraine. Chinese stocks have been hit hard as the Covid-Zero policy and property market slump took a toll on the nation's economy, and Sino-American tensions over Taiwan and Russia weighed on the market.



Index data sources: Bloomberg AusBond Bank Bill Index,
Bloomberg AusBond Composite 0+ Yr Index, Bloomberg Barclays Global Aggregate Bond Index (hedged to AUD),
S&P/ASX 200 Index (Total Return), MSCI World ex Australia Index (net div., AUD), MSCI Emerging Markets Index (net div., AUD),
S&P/ASX 200 A-REIT Index (Total Return), S&P Global REIT Index (net div., AUD)

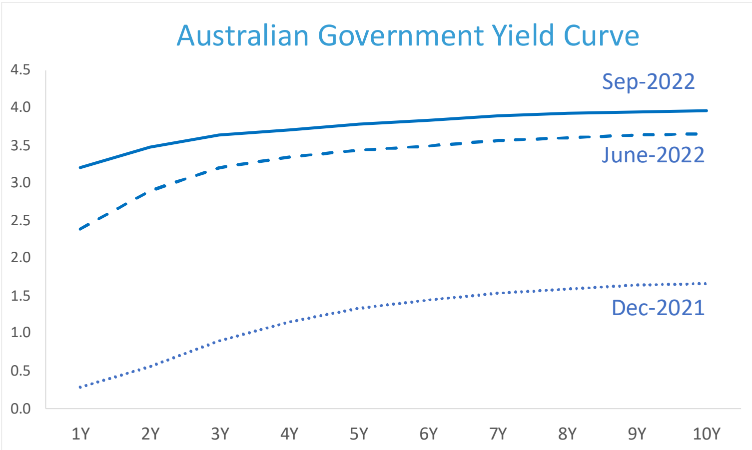




Yield Curves

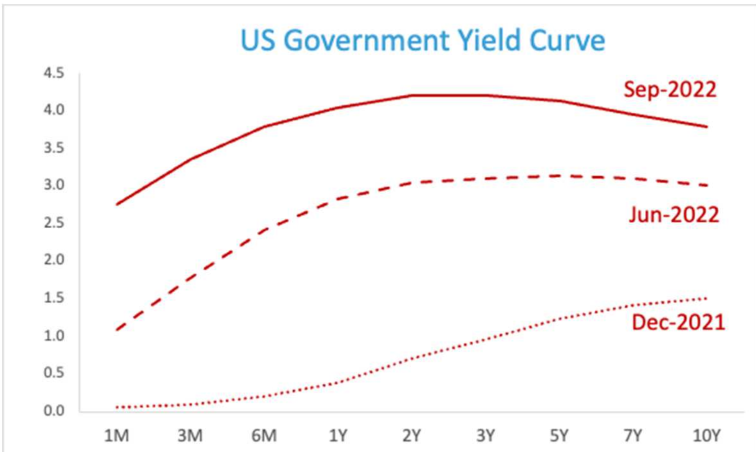
AUSTRALIA

The RBA raised the cash rate by 50bps to 2.35% during its September meeting but delivered a surprise in early October by lifting the cash rate by 25bp to 2.6%. At quarter end the yield on the 10-year government bond rose above 4%, hovering around its highest level since early 2014, amid the prospect of surging inflation and rising borrowing costs.



UNITED STATES

The 10y – 2y spread has increased over the last quarter. Yield curve inversion has been seen as an indicator of a coming recession in past cycles. Recent comments from the Fed have confirmed the central bank's commitment to bring inflation back to its 2% – 3% target, and Fed members forecast that rates will reach 4.4% by the end of this year.



Source for yield curves: www.investing.com

Sector Performance

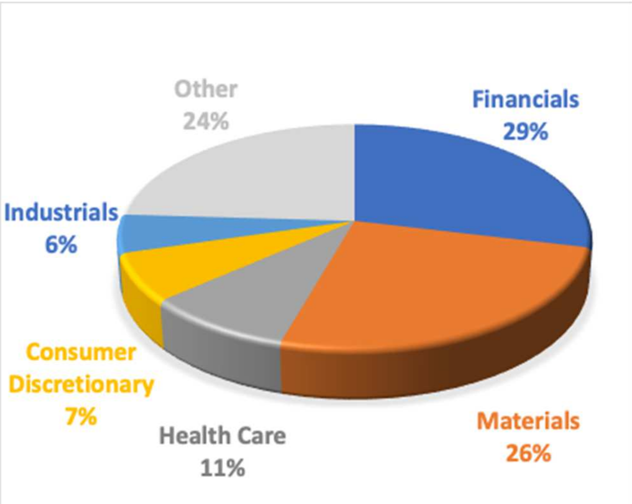
AUSTRALIA

As in other markets, the IT sector had the biggest fall; down 39.3% for the year. However, this sector makes up only 3.6% of the ASX.

Consumer Discretionary and Real Estate also had big falls over the year, as they are directly affected by interest rates. Energy and Utilities were the only positive sectors, as one of the key drivers of inflation has been higher fuel prices.

Sector	3 months	12 months
ASX 200	0.4%	-7.7%
Communication Services	0.9%	-10.1%
Consumer Discretionary	-0.7%	-23.5%
Consumer Staple	-3.0%	-6.7%
Energy	5.9%	26.1%
Financials	1.5%	-10.5%
Health Care	3.3%	-8.9%
Industrials	-5.5%	-8.3%
Information Technology	2.9%	-39.3%
Materials	1.2%	10.5%
Real Estate	-6.2%	-21.4%
Utilities	-12.5%	13.1%

Five sectors make up 75% of the Australian market, with the two largest constituting 55%. The chart below shows the 12-month performance of the major sectors.



Sector	Weight
Financials	28.8%
Materials	25.7%
Health Care	9.1%
Consumer Disc	6.9%
Real Estate	6.7%
Industrials	5.5%
Consumer Staples	4.8%
Communication Services	3.9%
Information Technology	3.6%
Energy	3.8%
Utilities	1.3%

Source: S&P Global, FE Analytics

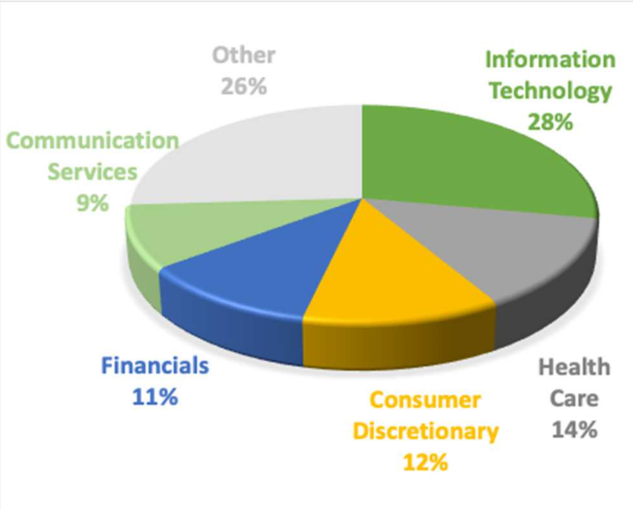
UNITED STATES

The S&P 500 is more diversified in sector weights. Nonetheless, Information Technology and Communication Services make up 37% of the index. These are home to the high P/E tech stocks, and as such have been the major detractors to the US market.

The best performing sectors were Consumer Staples, Energy and Utilities. Energy is up +40% for the last 12 months.

Sector	3 months	12 months
S&P 500	-4.9%	-15.5%
Communication Services	-12.7%	-39.1%
Consumer Discretionary	4.4%	-20.9%
Consumer Staple	-6.6%	-0.1%
Energy	2.4%	45.7%
Financials	-3.1%	-17.7%
Health Care	-5.2%	-3.4%
Industrials	-4.7%	-13.9%
Information Technology	-6.2%	-20.0%
Materials	-7.1%	-12.2%
Real Estate	-11.0%	-16.4%
Utilities	-6.0%	5.6%

Five sectors make up 75% of the US market, with Tech companies constituting around 37%. The chart below shows the 12-month performance of the major sectors.



Sector	Weight
Information Technology	28.0%
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Financials	11.1%
Communication Services	9.4%
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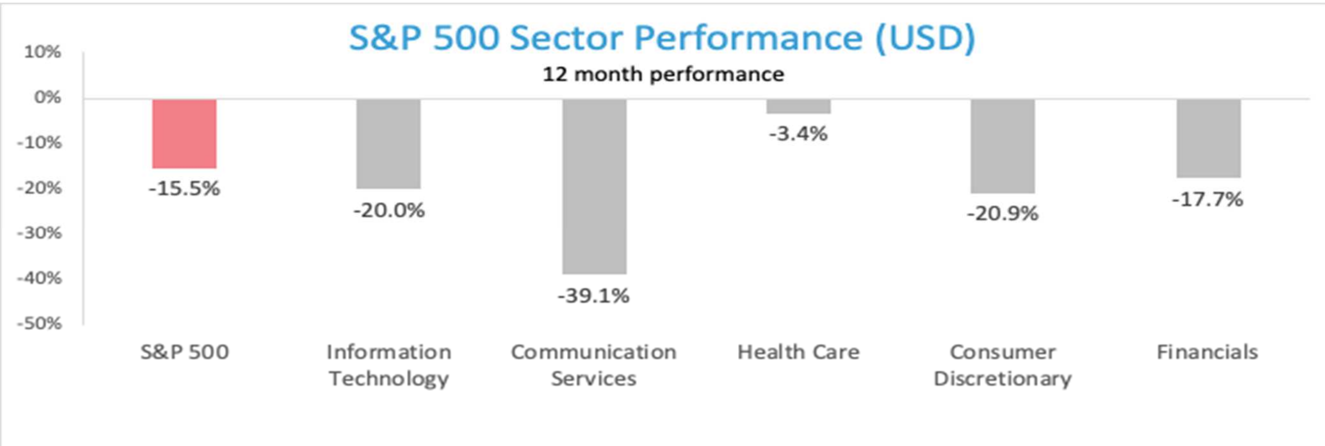
Energy	3.9%
Materials	2.6%
Utilities	2.7%



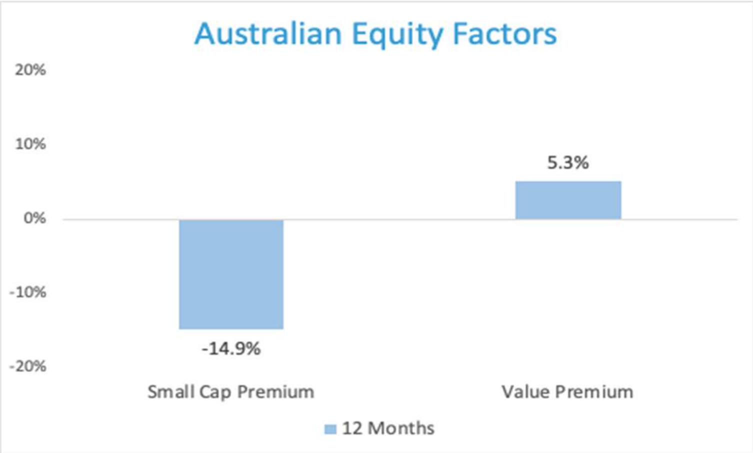
Source: S&P Global, FE Analytics

Equity Factors - Small and Value Premium

	YtD	3 Months	1 Year	3 Year	5 Year	10 Year
Australian Market	-9.6%	0.4%	-7.7%	2.7%	6.8%	8.4%
Australian Small	-24.1%	-0.5%	-22.6%	-0.8%	4.1%	4.6%
Australian Value	-6.2%	0.3%	-5.6%	2.6%	6.5%	9.0%
Australian Growth	-14.2%	1.2%	-10.9%	4.0%	8.4%	8.2%
Global Market	-15.8%	0.3%	-9.8%	6.3%	9.6%	13.6%
Global Small	-17.0%	1.2%	-15.8%	4.3%	6.5%	12.9%
Global Value	-8.0%	-0.8%	-1.9%	3.4%	6.4%	11.5%
Global Growth	-23.7%	1.6%	-18.0%	8.2%	12.3%	15.3%

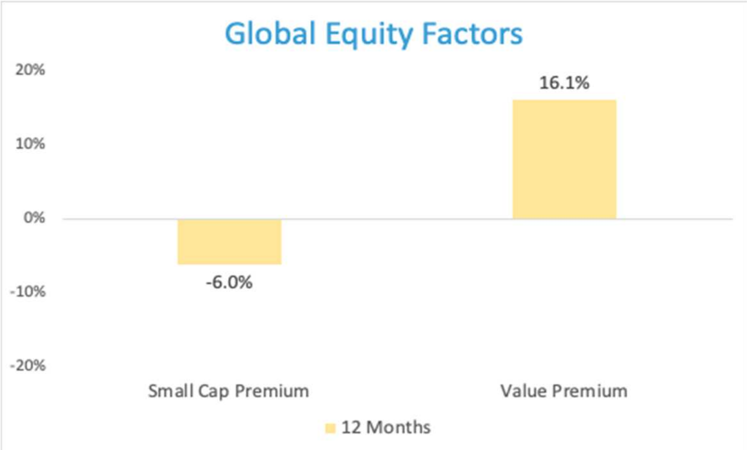
Australian Factors

Factors are very volatile over short time periods. Looking over the course of the last 12 months, value stocks out-performed growth stocks by more than 5%, as lower P/E companies on average did better than higher P/E companies (typically in IT). However smaller companies have under-performed large caps by nearly 15%.



Global Factors

The story is much the same in developed markets, where the rout in high P/E tech stocks has resulted in an extraordinary value premium of more than16% for the previous 12 months. As in Australia, global small companies have underperformed global large caps, but not as severely.



Value premium = Value Index – Growth Index
Small premium = Small Index – Market Index

S&P/ASX 200 Index (Total Return)
S&P/ASX Small Ordinaries Index (Total Return)
S&P Australia BMI Value Index (gross div., AUD)
S&P Australia BMI Growth Index (gross div., AUD)

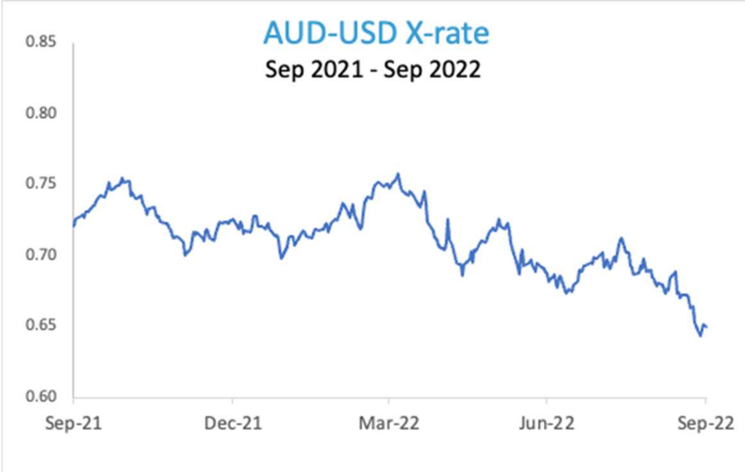
MSCI World ex Australia Index (net div., AUD)
MSCI World ex Australia Small Cap Index (net div., AUD)
MSCI World ex Australia Value Index (net div., AUD)
MSCI World ex Australia Growth Index (net div., AUD)

Currency and Commodities

EXCHANGE RATE

The Australian dollar dropped to $0.65, its lowest levels in over two years, weighed down by the USD strength and general risk-off sentiment.

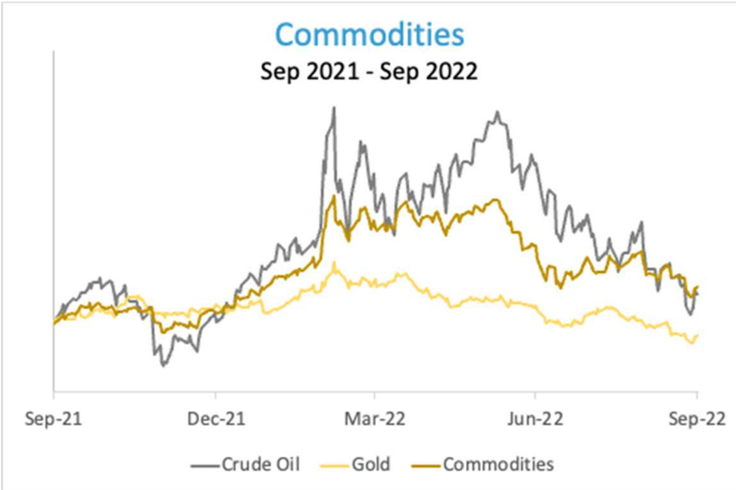
For an Australian investor, an un-hedged position in global equities returned 8% better than a hedged position over the last 12 months



COMMODITIES

Gold is failing its safe-haven image weighed down by a strong dollar and elevated Treasury yields and is down near -10% for the quarter.

Crude Oil is down by more than 25% for the quarter amid concerns over a global recession and weaker energy demand, while a surging dollar is adding to the bearish sentiment.



Source: www.investing.com

Please contact us on +613 99350970 or email admin@warrhunt.com.au if we can be of assistance.