Quarterly Market Update – 30 June 2023

Calm Before the Storm?

An eerie calm has fallen over markets in recent weeks, as the banking stresses of early March fade into the background. Market measures of risk, such as volatility, have retreated, while global equity markets have rebounded strongly, buoyed by a resurgence in technology stocks.

In Australia, 2023 has started very positively for the ASX 200 Index and it is up 4.5% year to date. This is despite continuing rate increases from the Reserve Bank, and at the end of the second quarter the consensus view is that there will still be another two rate hikes before the terminal rate is reached.

In the US, the S&P 500 Index has gained 13% this year, recouping the 2022 downturn since the Fed kicked off its cycle of rate hikes last March. The index is also up 22% from its October closing trough, leaving it above the threshold of what's considered a bull market. However, nearly all the gains have come from the big stocks in the Nasdaq 100 Index, which is poised for its best opening six months ever, with a surge of 36% erasing last year's 33% slump.

The bond market has been focused on the growing risk of still higher rates and the US yield curve continues to suggest a recession is imminent. A surprisingly resilient economy gives warning that the job of beating inflation is far from over as data shows that while inflation is coming off its highs, the economy is still growing at a faster-than-expected pace. Central banks in Australia and the northern hemisphere are expected to continue to raise official cash rates despite the increasing risk of recession.

Equity and bond markets are sending mixed messages. The equity market believes that the terminal rate for this cycle of tightening is close, and that as inflation continues to decline the economy will gradually slow to a soft landing. Bond markets also believe the terminal rate is close, but the inverted yield curves in Australia and the US suggest that a hard landing may be in store. There remains uncertainty about the lagged effects of tightening so far and the extent of credit tightening in the US resulting from banking stresses earlier in the year.

The exuberant equity market and low volatility may just be the calm before the storm.

Equity and Bond Market Overview

ASX IGNORES HIGHER RATES

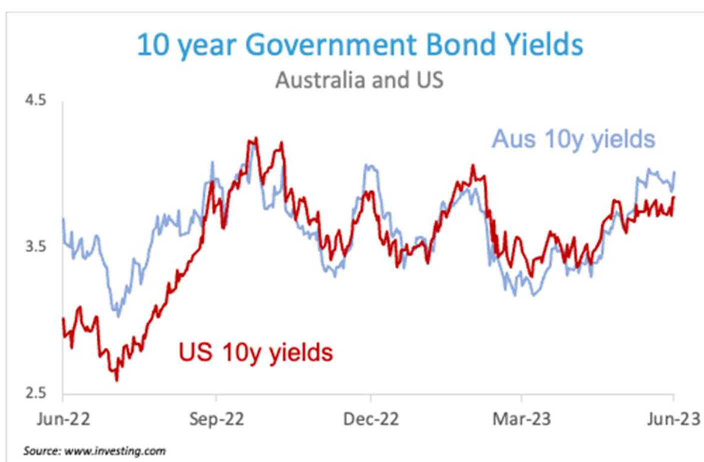
The Australian stock market, represented by the S&P/ASX 200 index is up 14.8% over the last 12 months. In that period the cash rate has increased from 0.85% to 4.1% and is now at its highest level since April 2012. However, the S&P/ASX Volatility Index – a measure of expected volatility over the next 30 days – remains at its lowest levels since the end of 2021.

GAINS ACROSS DEVELOPED MARKETS YEAR TO DATE

Global equities have rallied over the last 6 months, with the MSCI World ex Australia Index returning 17.5% since the start of the year. The recovery in global risk assets has, however, been quite narrow and heavily concentrated in a small number of US tech stocks. The Emerging Markets are lagging, pulled down by the stalled recovery in China.

THE BOND MARKET VERSUS THE CENTRAL BANKS

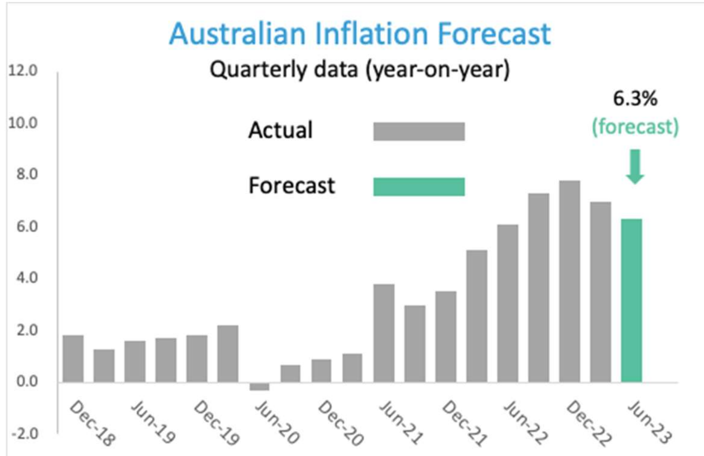
Global government bond yields have been rising over the quarter, as stubbornly high inflation pushes central banks to continue to increase interest rates. Despite the global bond index having a 3% gain in the first quarter, increasing yields are delaying the promise of a strong rebound for bonds after last year's historic negative 12% return.



Economic Review and Forecasts

INFALTION HAS BEEN FALLING SINCE OCTOBER 2022…

The annual inflation rate in Australia dropped to 7.0% in Q1 of 2023 from an over 30-year high of 7.8% in the previous period. The headline figure of the monthly Consumer Price Index (CPI) for May 2023 signalled a large deceleration of inflation, though underlying measures were less encouraging. The inflation rate in Australia is forecast to be 6.30% for Q2 2023.



Source: www.tradingeconomics.com/australia/

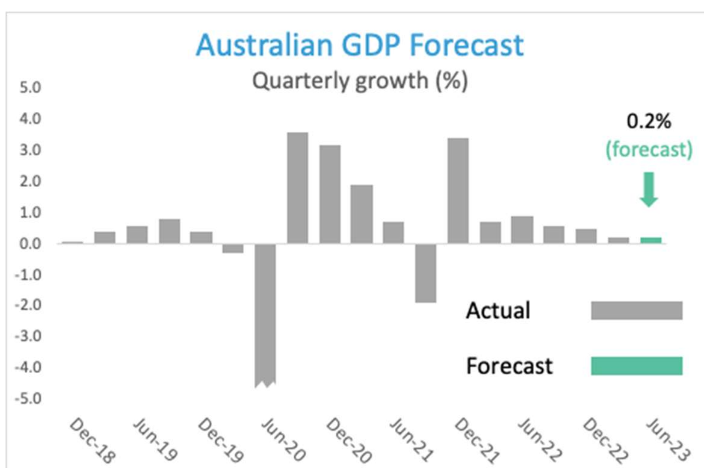
…BUT INTEREST RATES HIKES ARE NOT OVER YET.

While inflation is falling, it is not falling fast enough to prevent central banks in Australia and elsewhere from continuing to raise interest rates, despite an increasing risk of recession. The RBA raised the cash rate for the 12th time in early June to 4.1% and indicated further increases are likely to suppress still elevated price pressures.

Source: www.rba.gov.au

THE AUSTRALIAN ECONOMY IS HEALTHY BUT SLOWING.

The Australian economy expanded 0.2% quarter-on-quarter in Q1 of 2023. This was the sixth consecutive period of economic growth but the softest pace in the sequence, as household consumption rose the least due to persistent cost pressures and elevated interest rates. The GDP Growth Rate is expected to be much the same at 0.20% for the June quarter.



Source: www.tradingeconomics.com/australia/

Market Returns

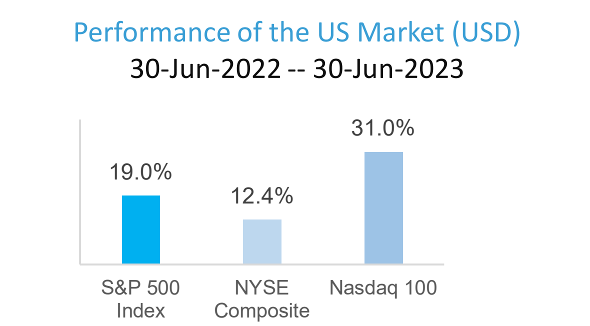
Asset Class	Year to Date	3 Months	1 Year	3 Year	5 Year	10 Year
Cash	1.7%	0.9%	2.9%	1.0%	1.2%	1.7%
Australian Bonds	1.5%	-2.9%	1.2%	-3.5%	0.5%	2.4%
Global Bonds	2.1%	-0.3%	-1.2%	-3.6%	0.2%	2.5%
Australian Equity	4.5%	1.0%	14.8%	11.1%	7.2%	8.6%
Developed Markets	17.5%	7.6%	22.6%	13.5%	11.5%	13.2%
Developed Markets (hedged)	14.7%	7.1%	16.6%	11.5%	8.3%	10.6%
Emerging Markets	6.9%	1.5%	5.1%	3.5%	3.1%	6.3%
Australian REITS	3.9%	3.4%	8.1%	8.1%	3.5%	7.7%
Global REITs	4.0%	1.3%	0.2%	6.5%	3.5%	7.2%

Cash	Bloomberg AusBond Bank Bill Index	Global Bonds	Bloomberg Global Aggregate Bond Index (hedged to AUD)
Australian Bonds	Bloomberg AusBond Composite 0+ Yr Index	Developed Markets	MSCI World ex Australia Index (net div., AUD)
Australian Equity	S&P/ASX 200 Index (Total Return)	Emerging Markets	MSCI Emerging Markets Index (net div., AUD)
Australian REITS	S&P/ASX 200 A-REIT Index (Total Return)	Global REITs	S&P Global REIT Index (net div., AUD)

- In the last quarter Australian and Global Bonds have underperformed cash, as yields have inched higher as traders raise their estimates of the terminal rate
- Despite low volatility, the Australian equity market has been relatively flat over the quarter, although the 12-month return is a healthy 14.6%
- The Developed Markets are the best performing asset class in the quarter, mainly due to the rebound in the Nasdaq-listed tech stocks
- The strong USD resulted in the depreciation of the AUD, so that a hedged exposure to global shares underperformed an unhedged exposure
- The high USD and the slower than expected recovery in China post the pandemic lockdowns is weighing on the Emerging Markets
- Australian and Global REIT's have been hit particularly hard by rising interest rates and have underperformed the broader equity market over the last year

GAINS IN THE US MARKET ARE ALL FROM 7 STOCKS

The largest US tech names – the "Magnificent Seven" - are up around 50% year to date, while the rest of the US equity market is flat. Excitement around AI has helped push AI-related tech stocks to all-time highs and driven the S&P 500 into a bull market. The stock of semiconductor company Nvidia is up 192% for the year.

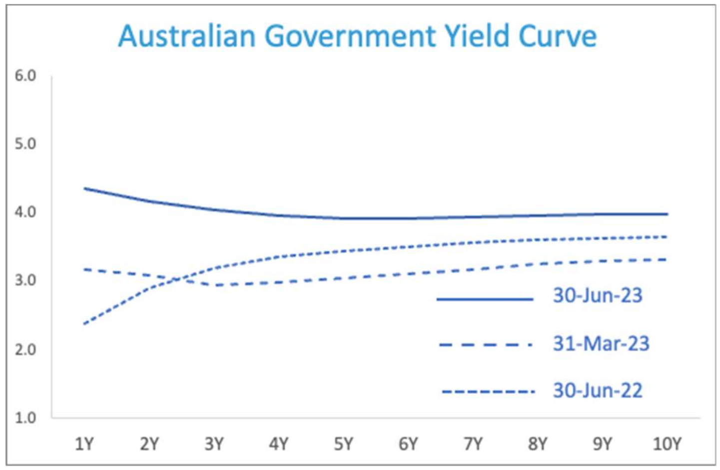


Source: www.investing.com

Yield Curves

AUSTRALIA

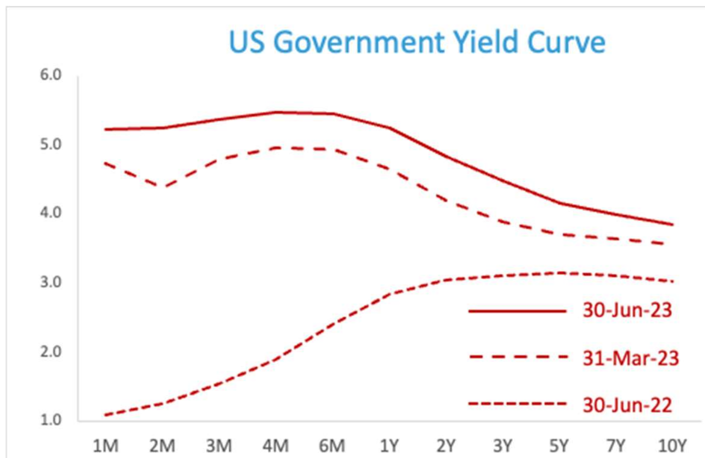
Australia's yield curve inverted for the first time since the financial crisis as traders increasingly priced in the risk of a recession. Australia's economy is caught between slowing growth and elevated inflation, which complicates the central bank's efforts to contain the latter. Borrowing costs are now at their highest in ten years, and this has been the fastest tightening cycle since 1989.



UNITED STATES

The US yield curve remains inverted despite the slowing of inflation and the economy remaining resilient in the face of higher interest rates. Economists are now divided on whether the US will have the long anticipated hard-landing, or whether a soft landing is now more likely. However, the Fed has signalled more rate rises are to come.

Source for yield curves: www.investing.com



Equity Factors - Small and Value Premium

Asset Class	Year to Date	3 Months	1 Year	3 Year	5 Year	10 Year
Australian Large	5.0%	0.9%	14.9%	11.8%	7.2%	8.4%
Australian Growth	7.1%	2.3%	12.7%	6.1%	5.7%	9.0%
Australian Small	1.5%	1.7%	12.4%	9.3%	6.1%	8.6%
Australian Value	3.2%	-0.4%	17.3%	16.8%	8.0%	7.2%
Global Large	17.5%	7.6%	22.6%	13.5%	11.5%	13.2%
Global Growth	30.0%	11.3%	30.9%	12.5%	14.3%	15.7%
Global Small	10.0%	3.9%	16.8%	11.8%	6.7%	11.5%
Global Value	6.0%	3.8%	14.3%	13.7%	7.9%	10.2%

Source: FE Analytics. See below for MSCI indices used to define Large, Small, Value and Growth

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

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 4.7%, as lower relative price companies on average did better than higher relative price companies. However, smaller companies have under-performed the broader market by 2.5%.

GLOBAL FACTORS

The US makes up around 65% of developed markets, and the extraordinary performance of the large growth tech stocks in the Nasdaq has resulted in global growth stocks significantly outperforming global value stocks, and global large caps outperforming global small caps.

Please contact us on +61 3 9935 0970 or email admin@warrhunt.com.au if we can be of assistance.