Quarterly Market Update – 30 September 2023

Higher for Longer

Much of the support for equities over the year has been driven by the equity market's belief that the 'terminal rate' for this cycle of interest rates has been reached, and that the central banks would start cutting rates as soon as the end of this year. Contributing to this narrative was data showing inflation continuing to decline and a better-than-expected earnings season.

However, as the end of quarter approached, stocks came off their highs and bond yields continued to rise as both the Federal Reserve in the US and the RBA emphasised that rates would remain higher for longer. The message is now coming in loud and clear that the central banks are not planning on a rapid policy pivot as many were expecting.

The Australian stock market is up 13.5 per cent for the previous 12 months, but much of that performance came from the last quarter of last year and the first quarter of this year. In the September quarter, the ASX 200 Index is down by nearly 1 per cent. The IT sector is down by nearly 6 per cent for the quarter as the expectation of higher rates affects the growth stocks.

Developed Markets are up 17 per cent for the 12 months, driven by the large US technology stocks. But as the "higher for longer" narrative takes hold, these technology stocks have borne the brunt of selling, with the S&P 500 Information Technology Index down by more than 10 per cent from its July high.

For bond investors, the pain is likely to continue as traders are expecting further yield increases as the "higher for longer" message seeps in. Complicating the global fight against inflation is the unwelcome surge in oil prices, and the fact that economies remain resilient.

Against the backdrop of continued rate increases, the bond market continues to signal that the US will end up in recession, along with the Eurozone, which will also markedly slow Australia's economic activity. China's economic slowdown after the post-pandemic rebound is also contributing to the gloom about next year's prospects.

However, as we have seen throughout the year, economic predictions have very little bearing on what markets will do over the next quarter, or the next year.

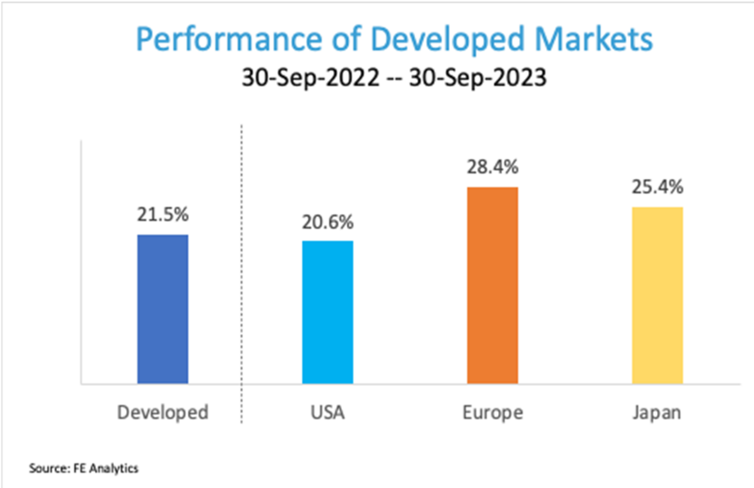
Equity and Bond Market Overview

ASX FLAT FOR THE QUARTER

The Australian stock market, represented by the S&P/ASX 200 index has traded flat for the quarter, as surging oil prices, inflationary risks and rallying government bond yields continued to pressure equity markets globally. Furthermore, retail cooled faster than expected in August. The market is up over 12 per cent for the 12 months, but most of these gains came from the last quarter of 2022.

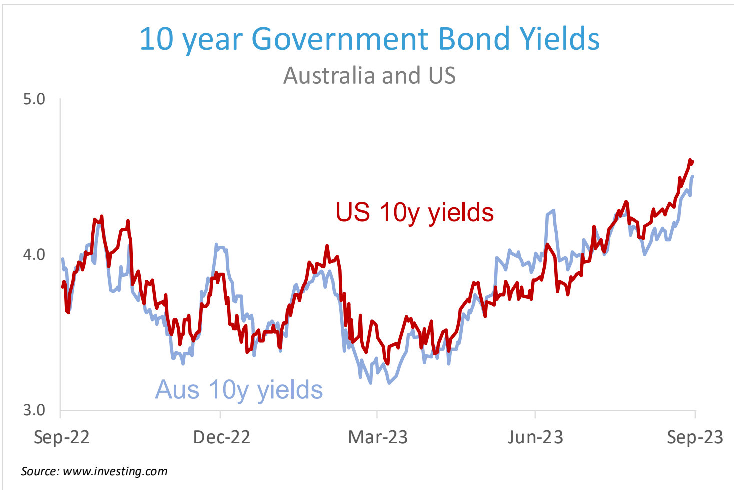
DEVELOPED MARKETS HAVE IGNORED HIGHER RATES

This stock market rally in the first half of 2023 was built on the back of technology stocks, as investors bet on resilient consumers and hype surrounding AI. However, continued emphasis by central banks that rates will stay higher for longer has sapped some of the risk appetite for equities. Like Australia, most developed markets are trading flat for this quarter.



YIELDS KEEP RISING ON CONTINUING HIGH INFLATION

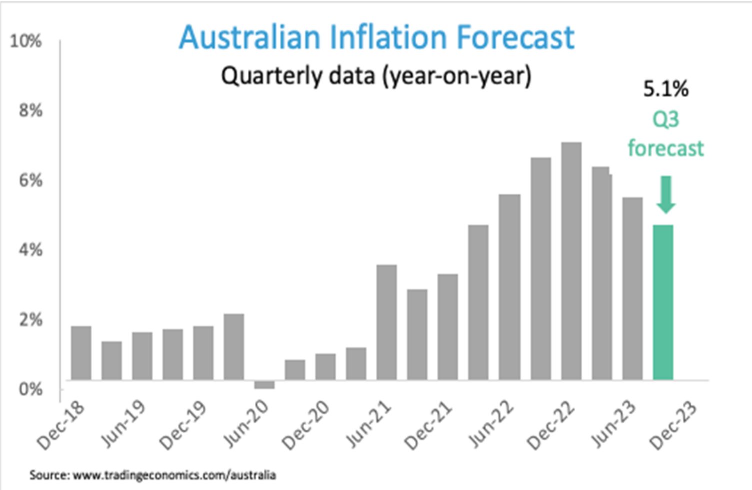
Australia's 10-year government bond yield hit its strongest levels since December 2013 and tracked a rally in global bond yields amid expectations that major central banks will keep interest rates higher for longer. Despite recently pausing rate increases, both the RBA and US Federal Reserve have indicated that continuing inflation may support the case for future rate increases.



Economic Review and Forecasts

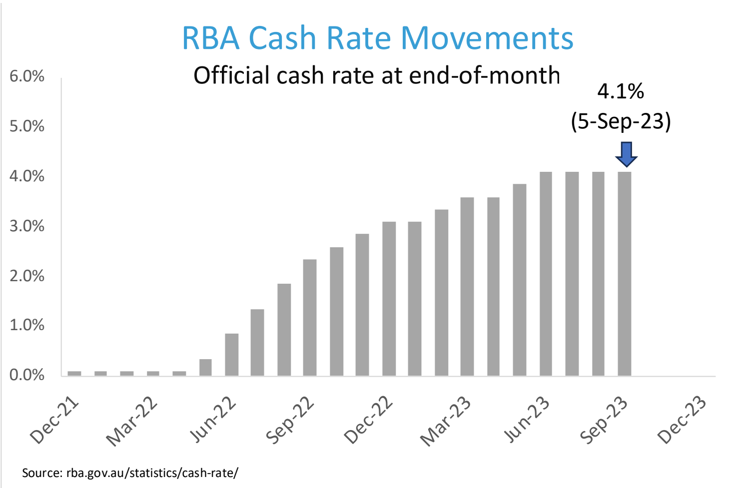
INFLATION CONTINUES TO FALL BUT REMAINS ABOVE TARGET.

The Consumer Price Index (CPI) indicator rose 5.2 per cent in the 12 months to August 2023, according to the latest data from the Australian Bureau of Statistics, which is up from 4.9 per cent in July. The RBA reiterated concerns that services price inflation was surprisingly persistent, keeping expectations of higher interest rates alive.



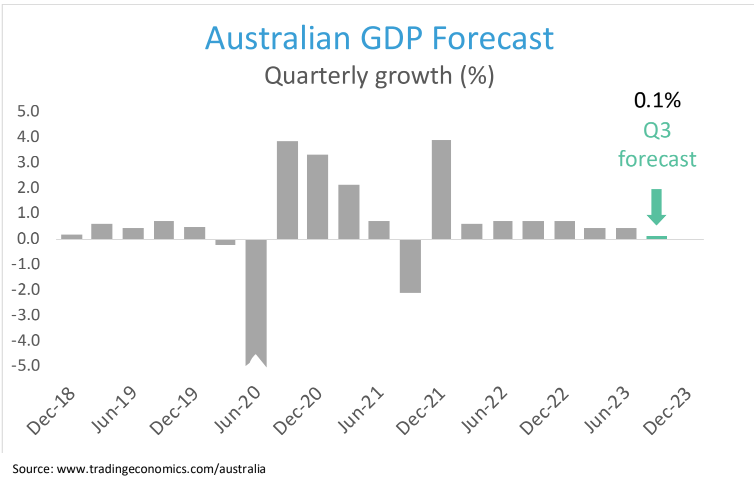
INTEREST RATES HIKES MAY NOT BE OVER JUST YET.

As inflation continues its downward trend, the RBA remains in a wait and see mode and has kept interest rates at 4.1 per cent for the last four meetings. The RBA continues to signal that some further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe, but that will continue to depend upon the data and the evolving assessment of risks.



AUSTRALIA REMAINS ON TRACK FOR A SOFT LANDING.

The Australian economy expanded by a soft 0.4 per cent growth in the June quarter. Underneath the aggregate economic figures are contrasting trends that will both please and concern the RBA. Consumer spending is weakening and helping reduce inflation, but wages are picking up while labour productivity continues to decline, pushing up the cost of producing goods and services.



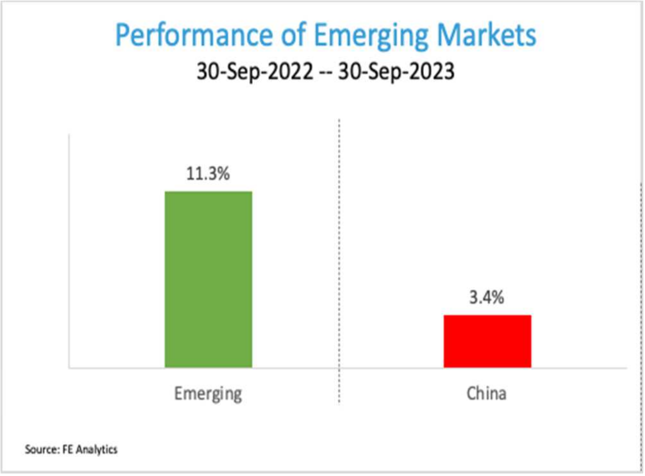
Market Returns

Asset Class	Year to Date	3 Months	1 Year	3 Year	5 Year	10 Year
Cash	2.8%	1.1%	3.6%	1.4%	1.3%	1.7%
Australian Bonds	1.2%	-0.3%	1.6%	-3.9%	0.3%	2.3%
Global Bonds	-0.3%	-2.4%	0.3%	-4.6%	-0.3%	2.2%
Australian Equity	3.7%	-0.8%	13.5%	11.0%	6.7%	7.4%
Developed Markets	17.0%	-0.4%	21.6%	11.9%	9.8%	12.5%
Developed Markets (hedged)	11.6%	-2.7%	19.6%	8.3%	6.7%	9.6%
Emerging Markets	7.0%	0.1%	11.3%	1.8%	2.9%	5.9%
Australian REITS	0.9%	-2.9%	12.5%	4.7%	2.5%	7.3%
Global REITs	0.3%	-3.6%	1.6%	5.8%	2.3%	7.0%

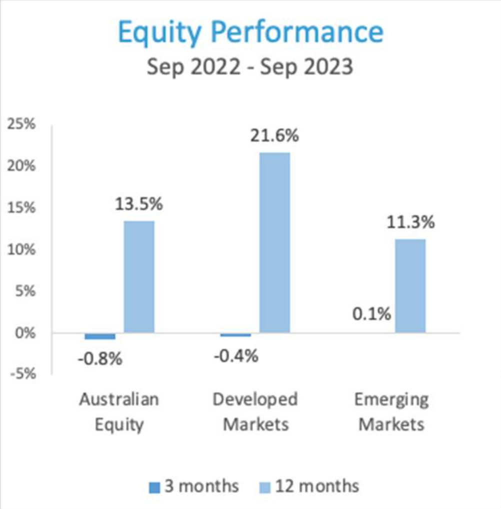
- Despite the fastest rate rises in a generation, equity markets have rallied over the last 12 months, even though much of the performance has been driven by a handful of large tech stocks in the US on hype around artificial intelligence.
- That support has fallen away in the last few weeks of the quarter, as central banks see rates staying higher for longer and flagging consumer confidence triggering a sell-off, with tech stocks falling by more than 10 per cent.
- Most equity markets have now fallen back to levels seen at the start of the quarter.
- Inflation remains sticky and even resurgent, thanks in part to a 30 per cent rise in oil prices since late June, which has seen bond yields continue to rise on the expectation of more rate rises ahead.
- However, the higher income from bonds is off setting the rise in yields, and bonds have delivered positive returns over the last 12 months.
- Emerging Markets continue to lag developed markets, principally because of the poor performance of China and the effect of a strong US dollar.
- REITs are now more correlated to the broader risk market than has been the case since the pandemic.

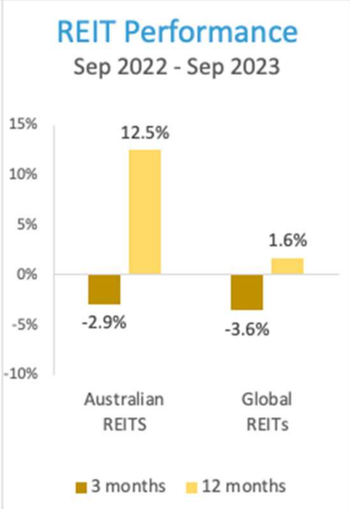
CHINA DRAGS DOWN THE EMERGING MARKETS

The world's second-largest economy is facing a host of problems – including slow growth, high youth unemployment and a property sector debt crisis that has rattled global markets. The US credit rating agency Fitch said last month that China's slowdown was "casting a shadow over global growth prospects" and downgraded its forecast for the entire world in 2024.



Market Returns

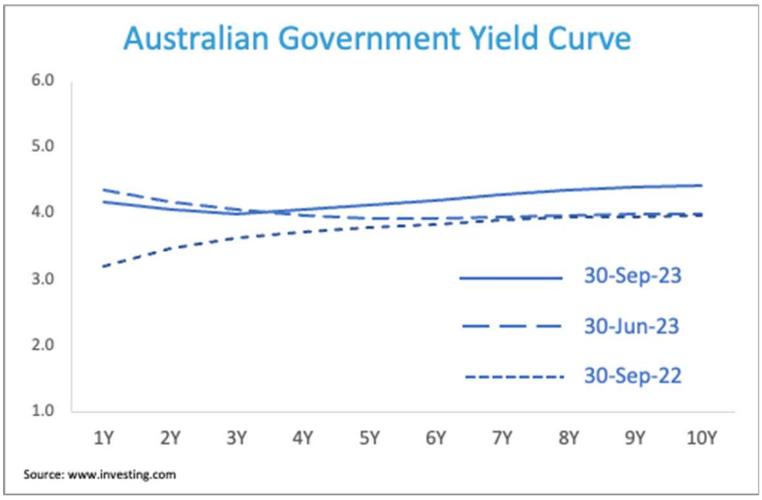




Yield Curves

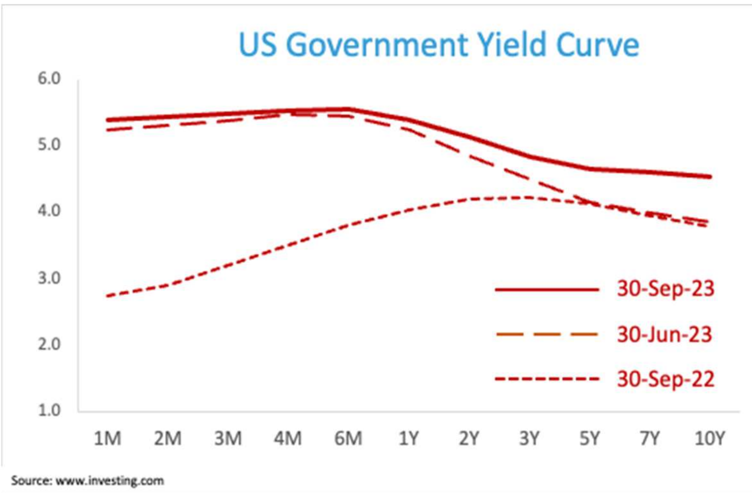
AUSTRALIA

Short end yields came down slightly over the quarter as the market continued to assess inflation data and whether the RBA would keep rates on hold for a prolonged period. However longer yields rose, with the 10-year government bond yield rising above 4.4 per cent, hitting its strongest levels since December 2013 amid expectations that rates would stay higher for longer.



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. Most economists now favour the soft-landing scenario as more likely, although some still see a hard landing as inevitable as the Fed signals there are one or two more rate increases to come.



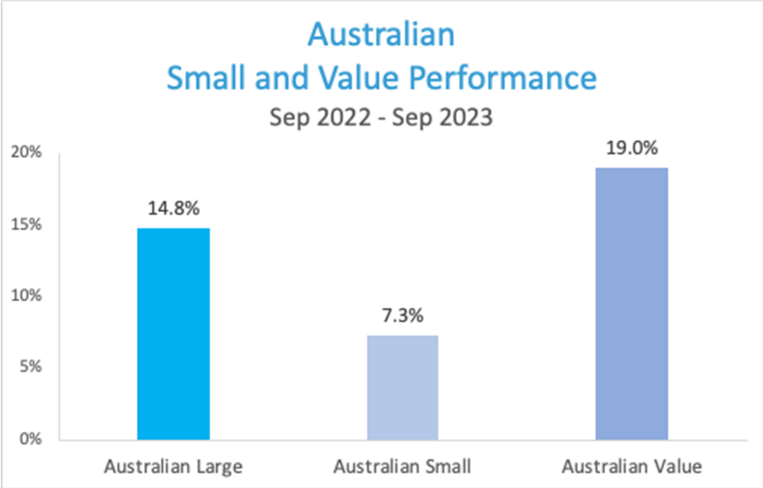
Equity Factors – Small and Value Premium

Asset Class	Year to Date	3 Months	1 Year	3 Year	5 Year	10 Year
Australian Large	4.7%	-0.3%	14.8%	12.1%	6.9%	7.3%
Australian Growth	5.0%	-2.0%	10.9%	5.0%	5.1%	7.7%
Australian Small	0.2%	-1.3%	7.3%	6.9%	5.5%	7.0%
Australian Value	4.6%	1.4%	19.0%	18.7%	8.0%	6.5%
Global Large	17.0%	-0.4%	21.6%	11.9%	9.8%	12.5%
Global Growth	27.5%	-1.9%	26.4%	9.1%	12.1%	14.8%
Global Small	8.5%	-1.4%	13.8%	10.1%	5.5%	10.4%
Global Value	7.3%	1.2%	16.6%	14.2%	6.8%	9.8%

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

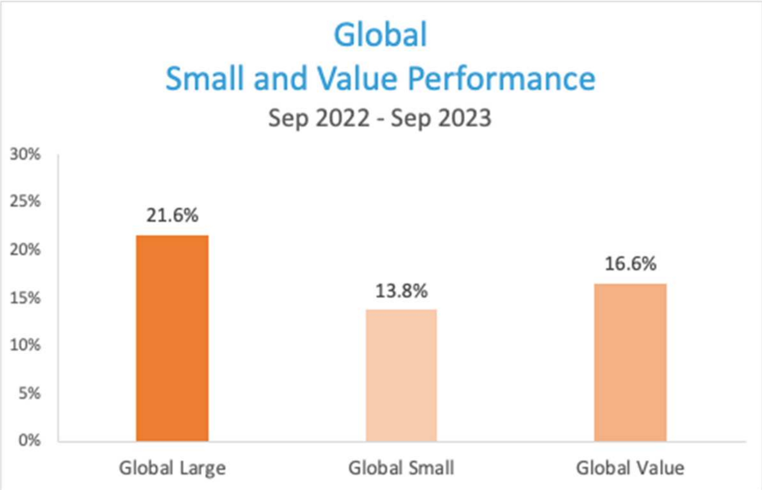
AUSTRALIAN FACTORS

Factors are very volatile over short time periods. Looking over the course of the last 12 months, value stocks out-performed growth stocks by 9.5 per cent, as lower relative price companies on average did better than higher relative price companies. However, smaller companies continue to under-perform the broader market.



GLOBAL FACTORS

The global markets are dominated by the US, which accounts for approximately 70% of the MSCI World Index. The biggest driver of US returns in the last year has been the large growth tech stocks, resulting in value and small cap stocks underperforming the broader market. However, the MSCI World ex-USA index has delivered a value premium.



Source for yield curves: www.investing.com

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