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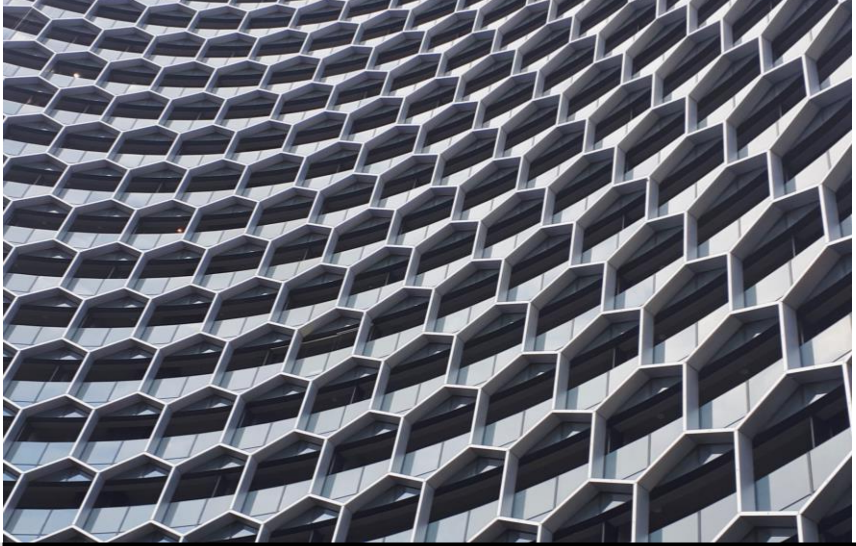
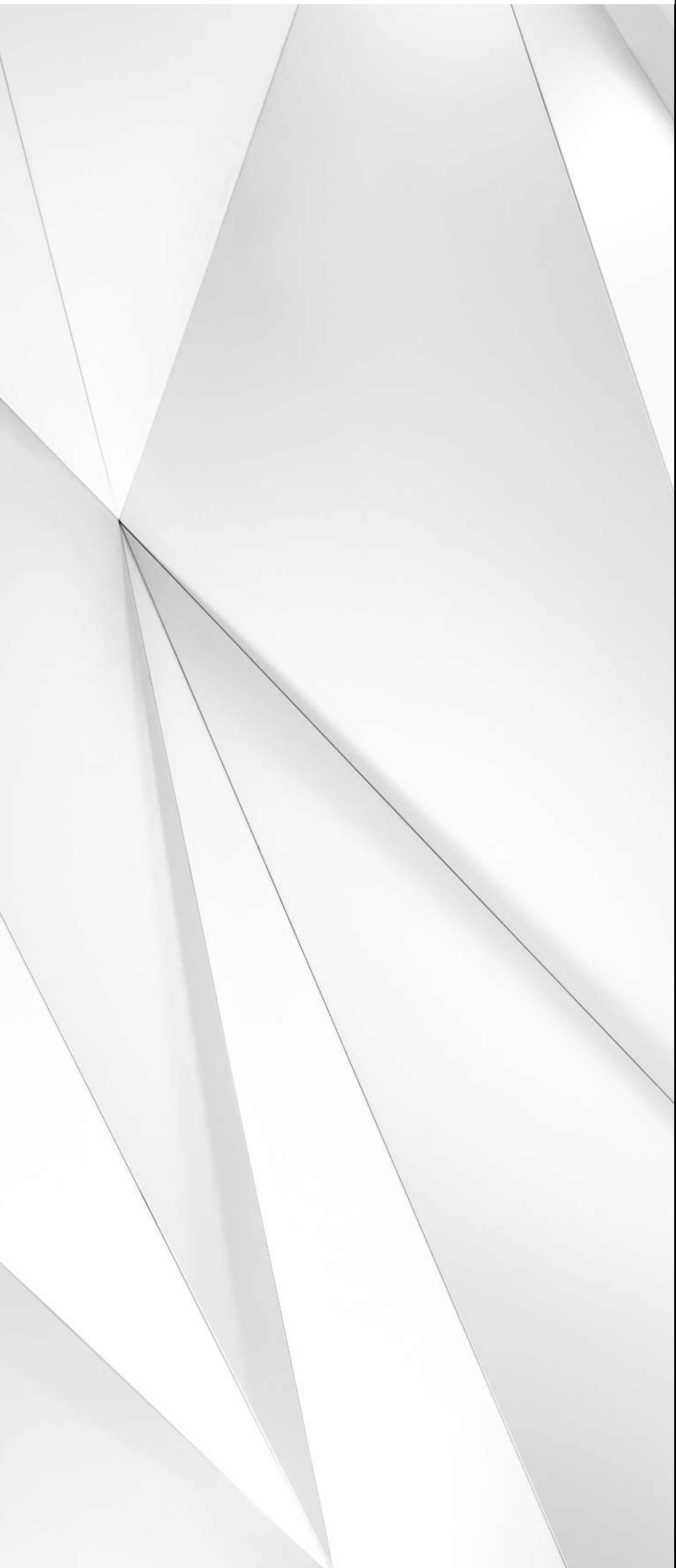


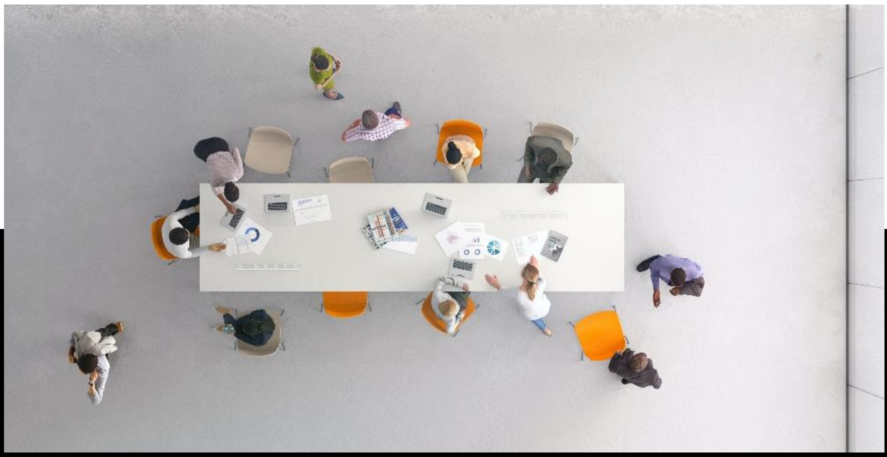


Investment & Economic Snapshot

September 2023

Smarter Investment Solutions

Highlights

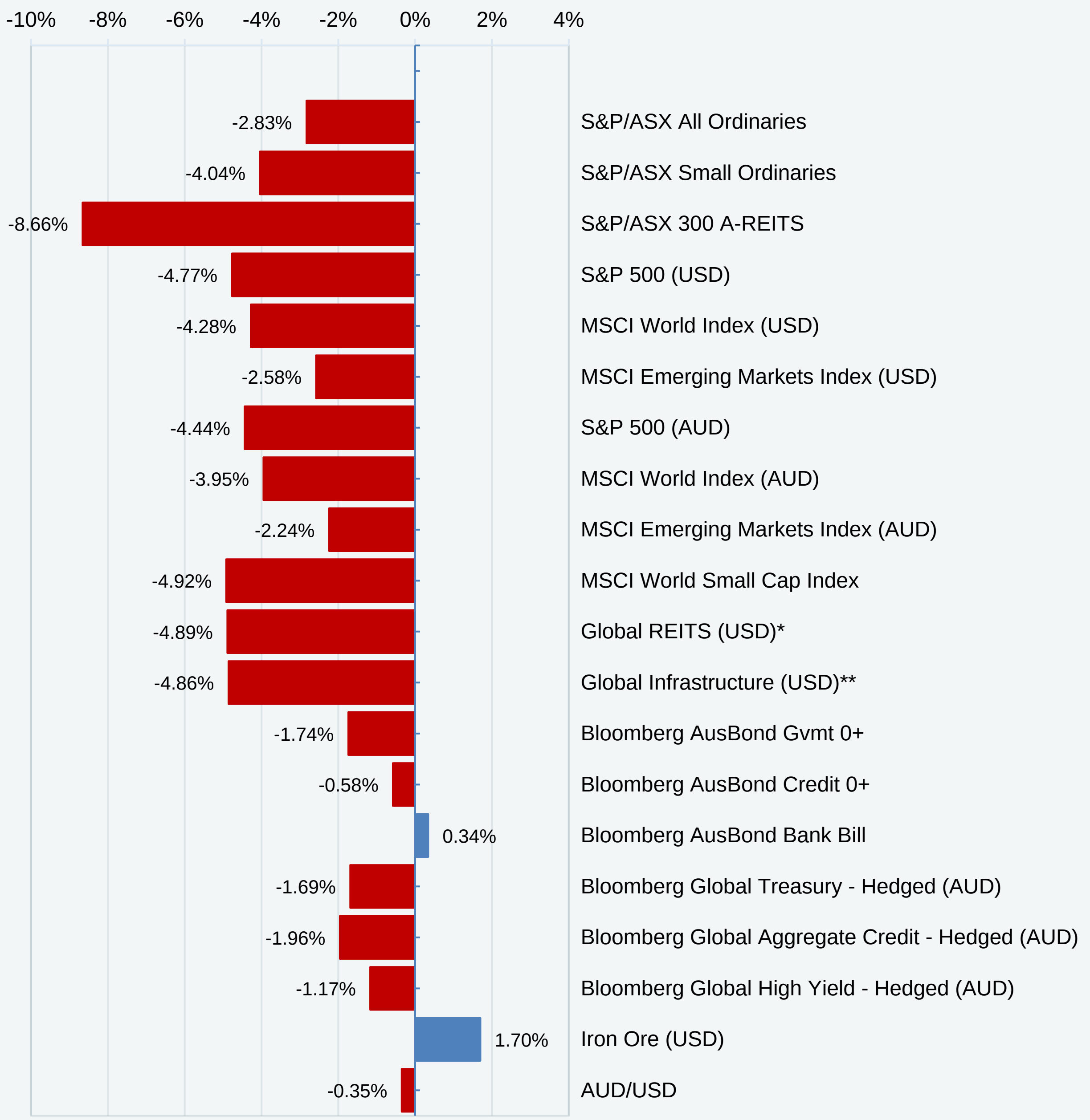


- September's reputation for being a poor month for markets came to bear, leading to a widespread sell off in equities, bonds, real estate, and listed infrastructure.

- In a recent meeting, the US Federal Reserve held the funds rate steady and made only minor changes to its policy statement. However, significant shifts in economic and interest rate projections, especially the "higher (interest rates) for longer" outlook, rattled markets, resulting in unexpected losses across various investment sectors as investors grew cautious.

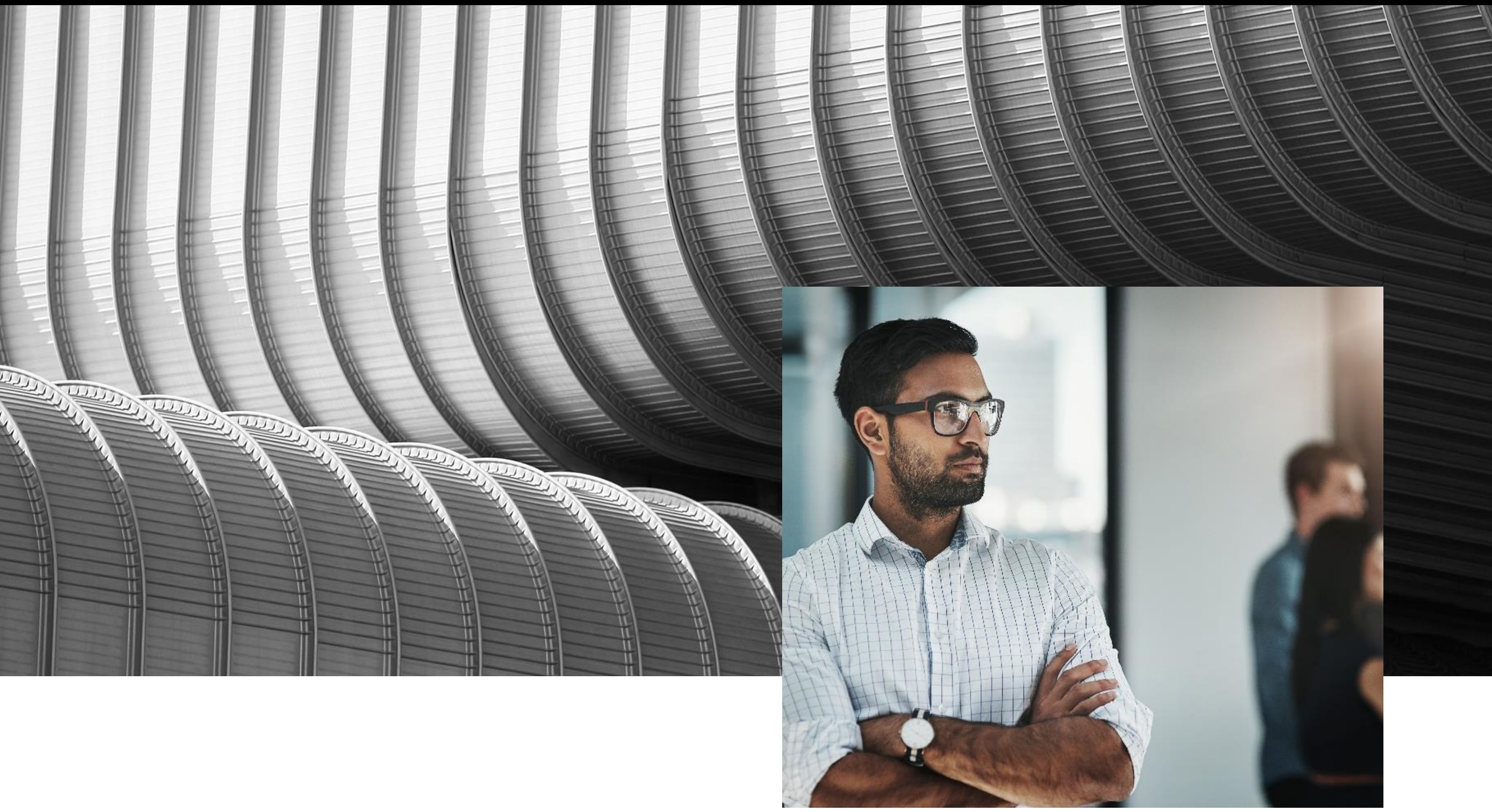
- The Reserve Bank of Australia (RBA), led by newly appointed Governor Michele Bullock, unsurprisingly kept interest rates unchanged this month. The RBA expressed concerns about inflation and acknowledged the prevailing economic uncertainty, keeping the door open to a further increase in rates if circumstances force their hand.

Selected Market Returns September 2023



Sources: *Refinitiv G-7 Diversified REIT Index, **FTSE Global Core Infrastructure 50/50 Index

Key developments in September



Financial markets.

In the past month, almost all major financial assets experienced negative returns as market participants adjusted their expectations regarding interest rates, inflation, and the previously anticipated soft landing scenario.

The prevailing market narrative of "higher interest rates for a longer period" took centre stage, influenced by the recent Federal Reserve meeting. While the Fed decided to maintain the status quo on rates for the time being, substantial adjustments were made to economic and interest rate projections. Official forecasts now indicate another 25 basis point rate hike by year-end, with a consensus emerging that anticipations of rate cuts in 2024 have diminished. That said, the recent increase in long-term US bond rates, which is the equivalent of an official interest rate rise, may mean less need for the central bank to tighten again.

This evolving narrative had a notable impact across asset classes. US stocks, in particular, faced a significant decline over the September quarter after a robust first half of the year, with the S&P 500 ending the quarter down -3.3%. Virtually all S&P 500 sectors, with energy a notable exception, ended the quarter in negative territory.

Bond markets too were affected by the recent rise in Treasury yields. The US 10 year bond yield climbed 76.4 basis points higher to settle at a fresh high of 4.57%. Bond proxies such as listed real estate and infrastructure were not spared either, feeling the impact of a widespread sell-off. We note that Government debt, considered relatively risk-free, now offers higher relative yields versus equities if held to term.

Interestingly, oil prices rose 8.6% in September and a remarkable 28.5% over the quarter. Industrial metal prices, led by iron ore, also defied expectations, rising 5.3% in Q3, despite the lack of compelling evidence for a substantial Chinese economic recovery.

The global shift towards risk aversion boosted the performance of the counter-cyclical US dollar, which also benefited from the relative resilience of the US economy underpinned by a robust labour market.

Economic developments.

This month, the US Federal Reserve made a number of notable and interesting revisions to its economic forecasts including:

- The median forecast for real GDP growth in 2023 and 2024 was significantly raised, indicating a stronger outlook for economic expansion.
- In line with this improved growth perspective, the Fed lowered its median unemployment rate projection for this year from 4.1% to 3.8% and for the following year from 4.5% to 4.1%.
- Regarding inflation, the Fed's median forecast for core inflation in 2023 has been revised down from 3.9% to 3.7%, while the 2024 forecast remains unchanged.
- Importantly, the Fed's median interest rate projection for 2023 remains steady, but there is a substantial increase in the projection for 2024. Most members of the Federal Reserve anticipate one more 25 basis point rate hike before the end of this year, with a reduced likelihood of rate cuts in the following year compared to previous expectations.

US job openings unexpectedly rise.

In August, job openings in the United States surpassed expectations, surging to 9.6 million, well above the consensus estimate of 8.8 million. This increase was accompanied by a revision for July, which was adjusted from 8.8 million to 8.9 million job openings. Consequently, the job openings rate climbed from 5.4% to 5.8%, underscoring the continued strength and resilience of the US labour market. This robust labour market performance carries implications for inflationary pressures.

Inflation continues to surprise on the upside.

The Citi US Inflation Surprise Index (which shows how economic data compares with consensus analyst expectations) has been on the rise for the past two months, rebounding from a three-year low it reached in July. However, it's essential to emphasize that the index remains in negative territory, indicating that inflation data is still coming in lower than initially anticipated. While the current trend is a positive development, there is a concern that if this recent upward momentum continues to accelerate, it could trigger the emergence of a second wave of inflation. This inflation surprise trend is not limited to the United States; several other advanced economies, including Canada, Japan, New Zealand, Switzerland, and Australia, have also seen their inflation surprise indices increase in recent assessments.

Michele Bullock takes over Philip Lowe at the RBA.

After the RBA decided to maintain the cash rate at 4.1% for the fourth consecutive month, newly appointed Governor Michele Bullock expressed concerns about inflation, particularly in sectors such as services, fuel, and rent prices. Notably, in August, Australian headline CPI inflation rose from 4.9% year-on-year to 5.2% year-on-year due to increased energy costs, while core CPI inflation slowed from 5.6% year-on-year to 5.3% year-on-year. In response to these inflationary pressures, the RBA has left the door open for the possibility of another interest rate increase, suggesting that "further tightening of monetary policy may be necessary to ensure that inflation returns to target within a reasonable timeframe".

Timing of the Bank of Japan’s next move.

This month, the Bank of Japan (BoJ) made a unanimous decision to maintain the policy rate at -0.1% and continue with its Yield Curve Control (YCC) programme, which specifically targets 10-year Japanese Government Bond (JGB) yields.

It's worth highlighting that during the BoJ's previous meeting in July, significant adjustments were made to the longstanding YCC programme. These changes introduced greater flexibility and allowed for higher yields on 10-year bonds. This modification has sparked speculation that Japan might be moving towards a tighter monetary policy stance in 2024. The end of YCC, if it were to happen, could have huge market implications, ranging from a stronger Japanese Yen, weaker Japanese equity prices, and perhaps a massive reversal of financial flows from the rest of the world back to Japan, as Japanese investors find safer and more attractive yield in domestic risk-free assets. Watch this space.

Outlook

The current financial landscape is marked by persistently high interest rates, which are a source of concern for both businesses and households, as they contend with the highest borrowing costs in 15 years. Additionally, there are unmistakable signs of a global economic slowdown, with Europe experiencing a contractionary phase in both its manufacturing and services sectors. This slowdown reflects a broader global trend, indicating a potential economic deceleration. Muddying the waters further is the fact that this economic weakness comes at a time of ongoing geopolitical concerns including the ongoing war between Russia and Ukraine and more recently, the alarming conflict between Israel and Hamas.

Given this challenging backdrop, it is advisable to continue to adopt a risk-off investment strategy. This involves reducing exposure to equities and credit to mitigate the impact of market volatility. Maintaining a neutral cash position provides flexibility in navigating uncertain conditions.

Furthermore, a preference for government bonds is warranted, given their potential for stability and gains during a recession. It's worth noting that the duration is a critical factor, as expectations suggest limited further upward movement in 10-year US Treasury yields, making government bonds an attractive option for investors seeking stability and potential returns.

Major market indicators

	30-Sep-23	31-Aug-23	31-Jul-23	Qtr change	1 year change
Interest Rates (at close of period)					
Aus 90 day Bank Bills	4.13%	4.15%	4.30%	-12.0	+137.0
Aus 10yr Bond	4.21%	4.13%	4.03%	+29.0	+46.4
US 90 day T Bill	5.32%	5.32%	5.28%	+15.0	+210.0
US 10 yr Bond	4.57%	4.10%	3.95%	+76.4	+76.9
Currency (against the AUD)					
US Dollar	0.645	0.648	0.674	-3.04%	0.38%
British Pound	0.528	0.510	0.520	0.65%	-9.44%
Euro	0.611	0.594	0.607	0.11%	-7.74%
Japanese Yen	96.06	94.34	95.57	-0.04%	3.77%
Trade-Weighted Index	61.10	60.60	61.30	-0.97%	-0.65%
Equity Markets					
Australian All Ordinaries	-2.8%	-0.7%	3.0%	-0.7%	13.1%
MSCI Australia Value (AUD)	-1.6%	-0.8%	3.8%	1.4%	17.8%
MSCI Australia Growth (AUD)	-3.9%	0.5%	1.5%	-1.9%	11.0%
S&P 500 (USD)	-4.8%	-1.6%	3.2%	-3.3%	21.6%
MSCI US Value (USD)	-3.6%	-2.5%	3.6%	-2.6%	12.8%
MSCI US Growth (USD)	-5.6%	-1.0%	3.3%	-3.4%	29.8%
MSCI World (USD)	-4.3%	-2.3%	3.4%	-3.4%	22.6%
Nikkei (YEN)	-1.6%	-1.6%	0.0%	-3.3%	25.4%
CSI 300 (CNY)	-2.0%	-6.0%	5.4%	-2.9%	-0.5%
FTSE 100 (GBP)	2.4%	-2.5%	2.3%	2.2%	14.7%
DAX (EUR)	-3.5%	-3.0%	1.9%	-4.7%	27.0%
Euro 100 (EUR)	-2.3%	-3.1%	2.1%	-3.3%	22.4%
MSCI Emerging Markets (USD)	-2.6%	-6.1%	6.3%	-2.8%	12.2%
Commodities					
Iron Ore (USD)	1.7%	5.8%	-2.2%	5.3%	23.7%
Crude Oil WTI U$/BBL	8.6%	2.2%	15.8%	28.5%	13.6%
Gold Bullion $/t oz	-4.4%	-1.3%	2.7%	-3.1%	10.9%

Source: Quilla and Refinitv

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