# Current Market View

**Investment Markets**

The global share markets delivered mixed results in local currency terms as investor optimism for a soft landing in the US gained momentum despite rising bond yields. US reporting companies have predominantly revealed **stronger than expected results**, which shows that company revenues and profits have not been collapsing as much as many analysts feared.

Over the next month markets typically experience **increased volatility** as investors assimilate the results of the reporting season and consider the current economic backdrop to make strategic plans for the year ahead. This year may be different as the US Cboe Volatility Index (VIX) which measures the implied volatility of the S&P500 (SPX) for the next 30 days has drifted lower to **12.82** as of 15th September 2023 after finishing August 2023 around 13.57. **A mild pull back in share prices would not** surprise given the upcoming Central Bank meetingsscheduled forlater in September 2023.

Expectations for further interest rate hikes remains high while inflation continues to be sticky. The latest inflation print in the US has revealed **3.7% in August 2023 up from 3.2% last month.** This may lead to further interest rate moves by theUS Federal Reserve Bank (the Fed) **following July 2023 move to lift the US target cash rate to 5.25% to 5.50%.**

The issues at the forefront of investors thoughts included:

* Global growth – for our region China is the focus with property developers in the spotlight. The ramifications are that if China stumbles then Australia will be impacted given, they are our biggest trading partner.
* Inflation now showing signs of abating but remaining sticky and above the target ranges of Central banks . The impact of monetary policy changes typically takes 12 to 18 months to be felt and so markets are watching the economic data closely for signals that will challenge growth.
* Bond markets and their response to the latest inflation print and Central bank cash rate changes. Further rate rises should be limited but debt markets are nervous.
* Share market valuations are challenging along with economic indicators flagging downside risks; however, **investors are encouraged to hold their resolve** and navigate this period of uncertainty and expect better conditions to prevail in the latter part of this year.

Locally the domestic house prices continued to stabilise and drift higher after the brunt of the interest rate rises as confidence returned to some stressed market sectors. This year will be challenging however, the broader economy is weathering the storm very well given the mixed support from commodity markets and the strong level of employment with unemployment sitting at 3.5% in June 2023.

The latest inflation print for the first quarter of 2023 in Australia was 6.0% which was down from the 7.0% in the second quarter of 2023 but still elevated. The next update is due out on the 25th of October 2023 which should provide a better guidance on how we are tracking. The RBA took a breather from their tightening bias for Monetary Policy at this month’s board meeting on the 5th of September 2023 by leaving the **cash rate unchanged at 4.10%** much to the relief of the broader economy and mortgage holders.

The Russia-Ukraine conflict continues to be a background factor along with the China re-opening which is showing improvement in the supply chain issues with manufactured goods now recovering but demand is slowing.

The fundamentals are still supportive of longer-term recovery but not without short-term downside risk. Investors have adjusted their risk appetite to **“optimistic”** short term and medium term as they await the next round of inflation data and Central Bank activity however, the signals are getting better and **opportunistic buying** is still on the agenda despite the economic data indicating a slowdown is likely to occur at some future point but the severity is now seen as limited. We are looking for a **soft landing** for Australia.

For Australia, the economic data is improving slowly but the main influence on our market is from offshore, especially China. China is experiencing issues relating to the opening up post the Covid lockdowns and while the level of activity has picked up, the global demand for manufactured goods is now easing. Property developers remain a concern for debt holders.

Despite being a major exporter of oil, gas, wheat, and other related materials left in short supply following the start of the Russia/Ukraine conflict, we are not immune to the global inflation or the price pressures from supply chain bottlenecks impacting food, energy, and manufactured goods. Wages growth, subdued historically, is now gaining pace which will fuel inflation down the track.

**The following total returns across the asset classes are as of 31st August 2023:**



Source data: Lonsec as of 31st August 2023

The developed markets asset classes finished the month mostly positive across the asset classes covered. The AUD/USD finished slightly higher (+0.78%) in the month which hurt unhedged holdings.

**Asset Class Performance**

Strong upside momentum continues as markets look to for growth.



Data Source: Lonsec as of 31st August 2023 & Fox Asset Management

**Investment Climate**

The underlying investment climate has switched to **optimistic** in the short term as investors consider the recent minor changes to cash rates and in some cases the “pivot” on the interest rate front which is helping support this recent uptrend. Consumption is showing signs of a slowdown which will impact demand in the short-term and while it will take some time to settle, the world will pull through this period of uncertainty supported by the deep pockets of Central Banks.

The **medium-term view remains positive** for returns overall although headwinds will prevail as the interest rate expectations and the Russia/Ukraine conflict remain. While companies appear to have had a reasonable six months from an earnings perspective, they are concerned with the potential for a slowdown in growth next year given the situation with inflation and Russia. The reopening-up of China is encouraging investors to look at Asia for growth again but progress in getting back to normal is slow as domestic issues with property developers make markets nervous.

**Longer term investors remain** **cautiously** **optimistic** for a goldilocks period ahead. Global Central Banks continue to indicate a resolve to get inflation under control however, the economic data is showing signs of an easing in inflation but core inflation remains elevated.

**The following commentary is based on month-end closing prices as of 31st August 2023:**

Global markets ended August mixed as expectations for further interest rate rises underpinned the softening in share prices outside the US. The situation in Russia/Ukraine conflict remains unchanged however optimism is rising for the supply chain issues involving China following the resumption of most manufacturing businesses post the Covid-19 lockdowns. Unfortunately, a resolution to the problems in Europe is a way off currently however, the underlying economies are emerging after such an extended period of uncertainty.

As mentioned, the Fed raised the target cash rates to **5.25% - 5.50%** at the 25-26 July 2023 FOMC meeting.

Other measures agreed to at the Fed meeting include:

* In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals.
* The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

**The next Fed meeting is scheduled for 19-20 September 2023**. Most officials see US interest rates ending at 5%-5.5%.

**Investor Focus**

For Australia, investors focussed on the following issues:

* China growth prospects – the latest news regarding property developers’ losses and the slowdown in the GDP growth rate to 0.80% in June 2023 down from 2.2% previously.
* Company reporting season ended mixed with 32.7% beating forecast earnings, 37.9% in line and 29.4% missing guidance.
* Inflation remains stubbornly high at 6.0% although easing from 7.0% in the first quarter of 2023.
* The bearish tone of the short-term Interest rates is distracting opportunistic buyers in sectors like tech and some quality growth stocks.
* The Russian and Ukraine conflict and the impact on supply of energy, food, goods, and services globally remains a background factor.

## Asset Class Returns

Returns across the various asset classes ended mixed over the month:



Source data: Lonsec as of 31st August 2023

## Global Share Returns

For share markets, the focus remains on **inflation** and the level of commitment by Central Banks to stem the rise which is showing signs of easing across most of the developed world. Unhedged global shares gained with the USD/AUD weakening (0.6485 down from 0.6682) which had a positive impact of (+2.95%) on AUD returns over the month for unhedged investors.

The markets are looking to stabilise and regain a level of confidence. Markets are looking for the Central Banks to **“pivot”** now and freeze future interest rates increases which may signal that inflation has indeed peaked and is now closer to being tamed. Unfortunately, inflation and strong employment numbers are holding this back.

The **volatility in markets eased** over August/September 2023 in response to the company reporting results despite the US lead to on the target cash rate and the developments in China. Most investors are content to **stay invested and ride out the storm** and add to their holdings opportunistically.



Source data: Lonsec as of 31st August 2023

In AUD terms, the global share markets posted one month return of (+1.65%). The US posted returns of (+2.39%), Asia ex Japan (-2.27%), Japan (+1.53%), the UK (-0.12%), Europe (-0.07%) and the Emerging Markets (-2.33%).

**Australian Shares**

Australian shares posted negative results as commodity markets experienced mixed results and interest rates pushing higher. Shares finished down (-0.73%) for the month and (+3.93%) over the last three months. The focus for investors was:

* Consumer confidence post the recent interest rate increases.
* Mortgage stress and the impact on domestic house prices and banks.
* Inflation and the welcome response by the RBA to hold the target cash rate at 4.10%.
* Rising longer term interest rates and the impact on share price valuations.
* Political uncertainty with the Russia/Ukraine conflict disrupting the flow of money, trade and the related cost to companies that deal with Russia given the restrictions now imposed.
* China’s slowing growth, property developers’ debt problems and the impact on Australia’s trade.

Commodity markets ended mixed with Iron Ore closing at US$108.99 per tonne at the end of August 2023 with a monthly loss of (-3.09%) however gains of (+3.73%) for the previous three months. Oil (WTI) closed slightly lower at US$81.63 a barrel at the end of August 2023 resulting in a loss of (-0.21%) for the month and up (+19.89%) over the last three months. China remains our main export market followed by Japan.

## Australian Industry Returns

Industry sectors posted mixed results for August 2023. The industry sector performance results for the last month were:



Source data: Lonsec as of 31st August 2023

Over the last month, Consumer Discretionary was the best performing sector posting gains of (+5.74%) followed by Real Estate Investment Trusts (REITS) with a gain of (+2.26%).

Utilities was the worst performing sector finishing (-3.85%) for the month.



Source data: Lonsec as of 31st August 2023

## Debt Market Returns

Bonds and Fixed Interest markets finished mixed as global bond prices retreated (up in yield) as the central bank tightening in some countries continued to worry investors. In Australia, the short-dated 2-year Government bonds trading at 3.83% on the 15th of September 2023 and longer dated 10-year bonds trading at 4.09%. Inflation fears along with the continuation of Quantitative Tightening (QT) by Central Banks, remain the main factors impacting the overall trend in bond prices.

Global Bonds ended down (-0.29 %) and Australian Bonds ended up (+0.74%) for the month of August 2023 and down (-1.05%) and down (-0.71%) respectively for the previous three months.

The RBA held the **target cash rate at 4.10%** following the 5th of September 2023 board meeting and stated that:

“There are significant uncertainties around the outlook. Services price inflation has been surprisingly persistent overseas and the same could occur in Australia. There are also uncertainties regarding the lags in the effect of monetary policy and how firms’ pricing decisions and wages respond to the slower growth in the economy at a time when the labour market remains tight. The outlook for household consumption also remains uncertain, with many households experiencing a painful squeeze on their finances, while some are benefiting from rising housing prices, substantial savings buffers, and higher interest income. And globally, there is increased uncertainty around the outlook for the Chinese economy due to ongoing stresses in the property market.

**Some further tightening of monetary policy may be required** to ensure that inflation returns to target in a reasonable timeframe, but that will depend upon the data and the evolving assessment of risks. In making its decisions, the Board will continue to pay close attention to developments in the global economy, trends in household spending, and the outlook for inflation and the labour market. The Board remains resolute in its determination to return inflation to target and will do what is necessary to achieve that. (RBA statement by Phillip Lowe)” .

The US Federal Reserve Bank (the Fed) continued the QT measures by raising the target range for **federal funds to 5.25% to 5.50%** on the 25-26th of July 2023 meeting. In addition, the Committee would continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities.

The US 10-year Government bonds closed at (4.106%) for the month up in yield (+0.139%) from the previous month close of (3.967%).

The Australian Government 10-year bonds finished higher in yield in August 2023 at (4.038%) up in yield (+0.006%) from (4.032%) price in July 2023.



Source data: Lonsec as of 31st August 2023

## Currency

The $A closed lower at AUD/USD 0.6485 at the end of August 2023 which benefitted investors who held offshore assets unhedged (+2.95%) over the month and (+0.15%) over the last three months.

**Currency example for unhedged USD investors:**



**Note**

* The AUD/USD has weakened -3.76% over the 12-month period.
* The S&P500 price index in USD has strengthened +7.75% over the same period.
* The AUD valuation (gain) reflects a benefit of +11.96% showing the currency impact (+4.21%).

In this example, holding unhedged international assets such as USD in a client’s portfolio results in currency gains of (+4.21%). The hedged or unhedged decision has ramifications on the performance of the offshore assets depending upon the direction of the AUD against all currencies not just the USD in this example.

When the AUD/USD exchange rate falls, this benefits investors who hold offshore assets in USD or other currencies. Holding any offshore assets in the local currency will be subject to the strength or weakness of the AUD as investors sell AUD to purchase the other currency so valuations will be subject to the fluctuations of the AUD against that currency.



Currency forecasters see the AUD/USD range between 0.6250 and 0.7250 cents in the medium term and most likely to trade within the 0.5500 to 0.7500 range in the longer term.

## Australian Economy

Australia’s latest GDP data for the second quarter of 2023 revealed an **annual growth rate of 2.1%** which was down from the first quarter of 2023 of 2.3%. Unemployment was unchanged to 3.7% in August 2023 from 3.7% in July 2023. The **core Inflation rate fell to 5.9%** in the second quarter of 2023 which is above the Reserve Bank’s targeted 2% to 3% target range. As mentioned, the **annual inflation rate eased to 6.0%** in the second quarter of 2023 down from 7.0% in the first quarter 2023. The next update on inflation data is due 25th October 2023.

 

## Current Market View

### Domestic View

The Australian share market suffered from the mixed corporate earnings results and a softening in prices (higher yields) in the longer dated bonds. **Investors are becoming increasingly bullish** but care is recommended over the next month to gauge the response to the next moves by the Central Banks. Pressure is still building for further interest rate rises as inflation remains elevated.

Investors are gaining a better understanding of what industries and which countries are navigating the geopolitical events, inflation, and volatility in the share and bond markets. The disruption to the supply of goods and services is abating however, this may be more demand driven as consumers tighten their belts.

More aggressive investors are taking advantage of any pullback in markets to buy oversold companies in some industries and entering selective risk-on trades. This activity is likely to be in response to conservative earnings guidance being met and future guidance being marginally positive.

The overall investment feeling for shares in the short-term is “selectively buy on dips” however, be **cautiously optimistic** **over the long run** as interest rates search for equilibrium.

### Global View

Global markets crept higher over August 2023 in AUD terms helped by the weakening AUD/USD exchange rate which added (+2.95%) to the performance results. Inflation and the potential for systematic failure remains the key focus although mitigated by the relative stabilisation of both equity and debt markets of late. For China, the world encouraged by the direction of their policy towards the re-opening of their economy and is looking for growth to emerge. The People's Bank of China (PBOC) have invoked quantitative easing to rekindle growth in their economy. Recent moves to lower the reserve requirement ratio for banks by 0.25% is helping their cause. The main problems facing growth prospects is the property sector and the global slowdown subduing expansion.

Company reporting season in the US was received well with a high number of companies achieving or exceeding guidance. Investors are encouraged by the improving outlook despite the recession talk.

Despite the uncertain geopolitical situation with the Russia/Ukraine conflict and interest rate concerns, we expect the **medium-term outlook to reflect better opportunities for investors**. Short-term, we expect the second half of 2023 to see further consolidation on the interest rate front and growth to start emerging towards the latter months of 2023.

**Where to From Here?**

**For Australia**, what is happening in the global markets is directly impacting our markets as there is alignment in trade terms but the fallout remains mitigated given our agricultural and resource assets. **All eyes are focussed on China** and any sign of a slowdown in growth expectations. Property development consumes a lot of our natural resources such as iron ore and coal so **any problem with demand from these industries will have an impact**. Offshore investors understand the downside mitigation stemming from the support agriculture and resource sectors provide for Australia which has sheltered, to a degree, our main share market.

The concern regarding Central Banks maintaining their quantitative tightening bias and further interest rate increases may lead to a **potential overshoot** resulting in a forced recession. The recent move by the Fed and the potential move coming up is now overshadowing share valuations and recession expectations.

The latest rhetoric from Central Banks still maintains their resolve that they will continue with the shift higher in their target cash interest rates to stem inflation. We may not have reached a point where they can wait and see what the impact on demand and consumer activity has been, before making any unnecessary future interest rate changes.

Markets have already weathered tough conditions and there is economic evidence pointing to a potential global recession in the US and Europe down the track however, it is worth noting that **markets are forward looking**, so it is likely they will **find a bottom and consolidate** before starting to recover again. Fingers crossed that this latest monetary policy moves in the US and in other countries, will lead to a moderation in prices and the start of a more stable growth platform going forward. Going forward, we expect to see **a continued broader consolidation in markets** from which the world can begin to launch a recovery trend.

**Footnote**

This market update written by Graham Fox for and on behalf of HNW Planning on 15/09/2023. Graham Fox is an external asset consultant and consults to the HNW Investment Committee. Graham has enjoyed a career in financial services covering several private, corporate and investment banking institutions including, Genesys Wealth Advisers (research), Standard & Poor’s Australia (fund ratings), Westpac Private Bank (research, strategy and product), Gold Link Capital (sales and marketing), Challenger Financial Services Group (COO asset management), Deutsche Funds Management (head of treasury), Canadian Imperial Bank of Commerce (regional head of FX), Banque Nationale de Paris, (F/X) and Commercial Bank of Australia (International and Treasury). Graham references material made available from HNW Planning’s' contracted research houses including Lonsec and Morningstar.