# Current Market View

**Investment Markets**

The global share markets ended lower in local currency terms over October 2023 as global interest rates shifted sharply higher which inferred lower share valuations. Investor optimism waned in the face of the prospect of **higher for longer inflation** which may mean Central Banks will have to do more tightening or hold rates higher for longer than currently factored into the share prices supporting company valuations.

The higher level of interest rates is attracting **capital flows from the equity markets to the debt** **markets** as portfolio investment strategy is now reverting towards a more traditional approach to risk where equities and bonds shoulder respective return expectations over the medium to longer term.



Source data: Lonsec as of 31st October 2023

Historically bonds have had a key role to play in a multi-asset portfolio approach. The recent sell off in the bond markets saw capital losses impacting returns however, with yields in the corporate markets at or near the 5% level for short-dated maturities, this is proving attractive for the risk adverse investor. From the chart above, you can gain an understanding of why investors over the past year have tilted towards shares over bonds given the higher risk resulting in higher returns in most cases.

*The risk measure is simply the one-year annualised standard deviation of the monthly total return time series for each category. The total return is the share or bond price movement monthly including any cash dividends and coupons payable.*

The US volatility (VIX) pushed higher closing at **18.14** as of 31st October 2023 after finishing September 2023 at 17.52. It is currently trading at 14.17 as at close of business 11th November 2023. Looks like the market is consolidating at the lower levels.

After themild pull back in share pricesexperienced over October 2023**,** we are hopeful that the markets will now settle and consolidate after the impact of the global political situation (Ukraine and Israel) and the elevated **price of oil** which has inflationary side effects and influenced by the conflict. Oil prices have pulled back a little which will help inflation measures.

Expectations for further interest rate hikes is abating as the recent inflation numbers reflect an easing bias. The latest inflation print in the US has revealed **3.2% in October 2023 down from 3.7% last month.** TheUS Federal Reserve Bank (the Fed) **left the target cash rate unchanged at 5.25% to 5.50%** at the 31st / 1st October/November 2023, meeting.

The issues at the forefront of investors thoughts included:

* Political conflict – the outbreak of war in the middle east for Israel and Humas along with Ukraine and Russia has unsettled investors. While not panicking, the underlying impact of these events put doubt into expectations for any economic recovery.
* 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 however stubbornly 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 and early 2024.

Locally the domestic house prices continued to stabilise and drift higher after the brunt of the interest rate rises as confidence returned to stressed market sectors. This year will be challenging however, the broader economy is weathering the storm very well given the mixed support from high immigration levels, commodity markets and the strong level of employment with unemployment sitting at 3.7% in October 2023.

The latest inflation print for the third quarter of 2023 in Australia was 5.4% which was down from the 6.0% in the second quarter of 2023 but still elevated. The RBA responded to the persistent elevated level with a much-anticipated tightening bias for Monetary Policy at this month’s board meeting on the 7th of November 2023 by increasing the **cash rate to 4.35% from 4.10%**.

Despite the political conflict and volatile interest rate markets, the investment fundamentals are still supportive of longer-term recovery but not without short-term downside risk. Investors have adjusted their risk appetite to **“hold-with a selective buy on dips”** short term and **“cautiously optimistic”** 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, we are a long way from the conflict zone and the economic data is improving slowly but the main influence on our market is from offshore, especially China. China is experiencing issues relating to Property developers which is holding back the improving underlying market conditions. Retail sales were up 7.6% in October 2023 reflecting a mild economic rebound.

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 October 2023:**



Source data: Lonsec as of 31st October 2023

The developed markets asset classes finished down for the month (apart from cash). The AUD/USD finished sharply lower (-1.73%) in the month which benefitted unhedged holdings.

**Asset Class Performance**



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

**Investment Climate**

The underlying investment climate remains **“hold with a selective buy on dips”** in the short term as investors consider the recent impacts of the rising interest rates and the European and middle east conflict. The risk is that the conflict may escalate and involve neighbours which could then inflame the situation. While this situation continues, investors will be nervous however and fall in asset prices closely watched for a buying opportunity as a high percentage of **negative factors already discounted in the market prices.**

Consumption is showing signs of a slowdown which will impact demand in the short-term and while it will take time to settle, the world will pull through this period of uncertainty supported by the deep pockets of Central Banks and strong allies of the conflicted countries.

The **medium-term view remains positive** for returns overall although headwinds will prevail as the interest rate expectations, recent Israel and Palestine conflict and the existing 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, Israel, 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 October 2023:**

Global markets ended October in negative territory as expectations for further interest rate rises and the global political situation underpinned the softening in share prices. The situation in Russia/Ukraine conflict remains unchanged however the latest conflict between Israel and Hamas has prompted a nervous wait for investors. Unfortunately, a resolution to the regional conflict is a way off currently however, the underlying economies elsewhere are emerging with a more growth orientated momentum after such an extended period of uncertainty.

As mentioned, the Fed left the target cash rates at **5.25% - 5.50%** at the 31/01 October/November 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 12/13 December 2023**. Most officials see US interest rates ending at 5%-5.5%.

**Investor Focus**

For Australia, investors focussed on the following issues:

* The Israel-Hamas conflict and the implication for global security, oil prices and inflation.
* China growth prospects – the PBOC efforts to boost the economic growth by adding liquidity to the market to offset the property developers’ losses and the slowdown in the GDP annual growth rate to 4.9% in the third quarter of 2023 down from 6.3% previously.
* Inflation remains stubbornly high at 5.4% although easing from 6.0% in the second quarter of 2023 which although heading in the right direction, infers higher interest rates for longer.
* The bearish tone of the short-term Interest rates is distracting opportunistic buyers in sectors like tech and 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 October 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 the developed world. Unfortunately, **higher inflation means higher interest rates** in the current environment. Unhedged global shares gained with the USD/AUD weakening (0.6346 down from 0.6458) which had a positive impact of (+1.73%) on AUD returns over the month for unhedged investors.

The markets are looking to stabilise and regain a level of confidence. Investors 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 ramped up** over October 2023 in response to the rising interest rates, political conflict in Israel and ongoing problems in Ukraine region. Most investors are content to **stay invested and ride out the storm** and add to their holdings opportunistically.



Source data: Lonsec as of 31st October 2023

In AUD terms, the global share markets posted one month return of (-0.95%). The US posted returns of (-0.21%), Asia ex Japan (-2.22%), Japan (-2.65%), the UK (-2.31%), Europe (-1.86%) and the Emerging Markets (-2.01%).

**Australian Shares**

Australian shares posted negative results as commodity markets experienced mixed results and interest rates pushed higher. Shares finished down (-3.78%) for the month and (-7.20%) over the last three months. The focus for investors was:

* **Global conflict** and the impact on the economy.
* **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.
* China’s slowing growth, **property developers’** debt problems and the impact on Australia’s trade.

Commodity markets ended stronger with Iron Ore closing at US$118.91 per tonne at the end of October 2023 with a monthly loss of (-1.56%) and gains of (+5.74%) for the previous three months. Oil (WTI) closed sharply lower at US$81.02 a barrel at the end of October 2023 resulting in losses of (-10.76%) for the month and up (-0.95%) 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 December 2023

Over the last month, Utilities was the best performing sector posting gains of (+1.68%).

Information Technology was the worst performing sector finishing (-7.55%) for the month.



Source data: Lonsec as of 31st October 2023

## Debt Market Returns

Bonds and Fixed Interest markets finished lower as global bond prices retreated (up in yield) as the continued bias of central bank tightening in the developed countries continued to worry investors. In Australia, the short-dated 2-year Government bonds trading at 4.27% on the 16th of November 2023 and longer dated 10-year bonds trading at 4.53%. Inflation fears along with the continuation of Quantitative Tightening (QT) by global Central Banks, remain the main factors impacting the overall trend in bond prices.

Global Bonds ended down (-0.73%) and Australian Bonds ended down (-2.64%) for the month of October 2023 and down (-4.29%) and down (-5.20%) respectively for the previous three months.

The RBA increased the **target cash rate by 0.25% to 4.35%** following the 7th of November 2023 board meeting and stated that:

*“Whether further tightening of monetary policy is required to ensure that inflation returns to target in a reasonable timeframe* ***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 domestic demand, 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 outcome.” Michelle Bullock, Governor, RBA Monetary Policy Board meeting, 7th November 2023.*

The US Federal Reserve Bank (the Fed) paused their monetary policy tightening measures by holding the target range for **federal funds to 5.25% to 5.50%** on the 31/01 October/November 2023 meeting. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities.

The US 10-year Government bonds closed at (4.926%) for the month up in yield (+0.347%) from the previous month close of (4.579%).

The Australian Government 10-year bonds finished higher in yield in October 2023 at (4.918%) up in yield (+0.444) from (4.474%) price in September 2023.



Source data: Lonsec as of 31st October 2023

## Currency

The $A closed lower at AUD/USD 0.6346 at the end of October 2023 which benefitted investors who held offshore assets unhedged (+1.73%) over the month and (+5.03%) 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 slipped to 3.7% in October 2023 from 3.6%. The **core Inflation rate fell to 5.2%** in the third quarter of 2023 which is above the Reserve Bank’s targeted 2% to 3% target range. The **annual inflation rate eased to 5.4%** in the third quarter of 2023 down from 6.0% in the second quarter 2023.

##

## Current Market View

### Domestic View

The Australian share market suffered from softening company valuations reflected in the share prices after the long bond market rose sharply by forty-four basis points in yield. Investors are nervous post the latest political conflict in Israel as they were expecting positive economic signals post the end of the tightening cycle as Central banks kept the target cash rates on hold in developed countries.

Pressure was building for further interest rate rises as inflation remains elevated with the catch cry, **higher for longer** is repeatedly voiced by analysts however, after the latest inflation numbers indicated lower inflation in several countries, **markets responded with renewed optimism**.

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 “**hold - selectively buy on dips**” however, be **cautiously optimistic** **over the long run** as interest rates search for equilibrium.

### Global View

Global markets retreated over October 2023 in AUD terms helped by the weakening AUD/USD exchange rate which added (+1.73%) to the performance results. Inflation, interest rates and the political uncertainty remain the key focus. 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.

Despite the uncertain geopolitical situation with the Russia-Ukraine, Israel-Hamas conflict, and interest rate concerns, we expect the **medium-term outlook to reflect better opportunities for investors**. Short-term, we expect the last few months of 2023 to see further consolidation on the interest rate front and growth emerging towards the end of 2023 and early 2024. **From November to January markets have historically performed** well so fingers crossed history repeats itself.

**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 the **Middle East political unrest.** Let us hope the situation will be contained and a solution that ceases further aggression and violence is forthcoming.

Immigration along with agriculture and the resource sector is providing a support mechanism for Australia which has sheltered, to a degree, our economy, and our share market.

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 some economic evidence pointing to a potential mild 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. There is quite a lot of this negativity already factored into the current share prices which is limiting further downside risks.

Fingers crossed that this latest monetary policy moves in the US and in other developed countries, will lead to a moderation in prices and the start of a more stable growth platform.

**Footnote**

This market update written by Graham Fox for and on behalf of HNW Planning on 16/11/2023. 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.