**Current Market View - Investment Markets**

The global share markets retreated in local currency terms over September 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 was 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 30th September 2023

Historically bonds have had an important role to play in the 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 had been attracted 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.*

Over the next month markets typically experience lessvolatility 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 Volatility Index (VIX) which measures the implied volatility of the S&P/ASX 200 VIX for the next 30 days has spiked higher to **12.48** as of 16th October 2023 after finishing September 2023 around 11.65. **A mild pull back in share prices would not** surprise given the increasing volatility mostly impacted by the global political situation (Ukraine and Israel) and the elevated **price of oil** which has inflationary side effects and is being influenced by the conflict.

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 September 2023 unchanged 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 September 20/21, 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 the 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 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 high immigration levels, commodity markets and the strong level of employment with unemployment sitting at 3.7% in August 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 3rd of October 2023 by leaving the **cash rate unchanged at 4.10%** much to the relief of the broader economy and mortgage holders.

Despite the political conflict, 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 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 30th September 2023:**



Source data: Lonsec as of 30th September 2023

The developed markets asset classes finished down for the month (apart from cash) across the asset classes covered. The AUD/USD finished slightly lower (-0.42%) in the month which benefitted unhedged holdings.

**Asset Class Performance**

Strong upside momentum continues as markets look to for growth.



Data Source: Lonsec as of 30th September 2023 & Fox Asset Management

**Investment Climate**

The underlying investment climate has switched to **“hold with a selective buy on dips”** in the short term as investors consider the recent impacts of the 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 will be closely watched for a buying opportunity.

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 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. The People’s Bank of China has stepped up its effort to support the economic recovery via a large 289B yuan cash injection via the medium-term lending facility and 134B yuan of short-term liquidity through open market operations.

**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 30th September 2023:**

Global markets ended September in negative territory as expectations for further interest rate rises underpinned the softening in share prices. The situation in Russia/Ukraine conflict remains unchanged however the latest conflict between Israel and Humas 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 20-21 September 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 31/01 October/November 2023**. Most officials see US interest rates ending at 5%-5.5%.

**Investor Focus**

For Australia, investors focussed on the following issues:

* The Israel-Humas 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 growth rate to 0.80% in the second quarter of 2023 down from 2.2% previously.
* Inflation remains stubbornly high at 6.0% although easing from 7.0% in the first quarter of 2023 which infers higher interest rates for longer.
* 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 30th September 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 (0.6458 down from 0.6485) which had a positive impact of (+0.42%) 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 September/October 2023 in response to the political conflict in Israel and ongoing in the 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 30th September 2023

In AUD terms, the global share markets posted one month return of (-3.97%). The US posted returns of (-4.44%), Asia ex Japan (-2.34%), Japan (-1.63%), the UK (-0.49%), Europe (-3.62%) and the Emerging Markets (-2.24%).

**Australian Shares**

Australian shares posted negative results as commodity markets experienced mixed results and interest rates pushed higher. Shares finished down (-2.84%) for the month and (-0.77%) 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$120.79 per tonne at the end of September 2023 with a monthly gain of (+10.83%) and gains of (+7.30%) for the previous three months. Oil (WTI) closed sharply higher at US$90.79 a barrel at the end of September 2023 resulting in gains of (+11.22%) for the month and up (+28.52%) 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 30th September 2023

Over the last month, Energy was the best performing sector posting gains of (+1.58%). Real Estate Investment Trusts (REITS) was the worst performing sector finishing (-8.58%) for the month.



Source data: Lonsec as of 30th September 2023

## Debt Market Returns

Bonds and Fixed Interest markets finished mixed as global bond prices retreated (up in yield) as the continued bias of central bank tightening in some countries continued to worry investors. In Australia, the short-dated 2-year Government bonds trading at 4.16% on the 17th of October 2023 and longer dated 10-year bonds trading at 4.54%. 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 (-2.67%) and Australian Bonds ended down (-0.29%) for the month of September 2023 and down (-3.36%) and down (-3.23%) respectively for the previous three months.

The RBA held the **target cash rate at 4.10%** following the 3rd of October 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 Michelle Bullock)”.

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 20-21 September 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 (4.579%) for the month up in yield (+0.473%) from the previous month close of (4.106%).

The Australian Government 10-year bonds finished higher in yield in September 2023 at (4.474%) up in yield (+0.436%) from (4.038%) price in August 2023.



Source data: Lonsec as of 30th September 2023

## Currency

The $A closed lower at AUD/USD 0.6458 at the end of September 2023 which benefitted investors who held offshore assets unhedged (+0.42%) over the month and (+2.59%) 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 at 3.7% in September 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. 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.

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**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 43 basis points in yield. Investors are nervous post the latest political conflict in Israel as they were seeing positive signs emerging post the end of the tightening cycle as Central banks kept the target cash rates on hold in many countries.

Pressure is still building for further interest rate rises as inflation remains elevated with the catch cry, **higher for longer** is repeated voiced by analysts.

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 September 2023 in AUD terms helped by the weakening AUD/USD exchange rate which added (+0.42%) to the performance results. Inflation (higher oil prices) 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. The People's Bank of China (PBOC) have invoked quantitative easing to rekindle growth in their economy. Recent moves to add liquidity to the short- and medium-term debt markets is helping their cause. The main problems facing growth prospects is the property sector and the global slowdown subduing expansion.

Despite the uncertain geopolitical situation with the Russia-Ukraine, Israel-Humas conflict and interest rate concerns, we expect the **medium-term outlook to reflect better opportunities for investors**. Short-term, we expect the last quarter of 2023 to see further consolidation on the interest rate front and growth emerging towards the latter months of 2023 as seasonal factors kick in and retail sales get a boost.

**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’s hope the situation is 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 17/10/2023. 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.