The Monthly Market Report

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Asset Class Returns October 2023

Asset Classes	Month % chge	3 Month % chge	6 month % chge	FYTD%	YTD %	1 year % chge	3yr return pa	5yr return pa	10yr return pa
Australian Shares (ASX 200 Accumulation)	-3.78	-7.19	-5.30	-4.52	-0.21	2.95	8.88	7.18	6.60
Global Shares (MSCI World ex Aust-net(USD))	-2.86	-9.26	-1.44	-6.22	8.19	10.62	8.18	8.33	7.67
Global Shares (MSCI World ex Aust ,net, AUD)	-0.98	-3.42	2.87	-1.41	15.88	11.72	11.98	10.80	12.10
MSCI World ex Australia 100% hedged to AUD Index (Net)	-2.70	-8.11	-0.43	-5.50	8.39	8.34	8.31	7.44	8.76
Australian Property (S&P/ASX 200 - Property Trusts (TR)m)	-5.83	-11.97	-10.24	-8.60	-5.00	-3.62	2.73	1.90	6.41
Global REITs (FTSE EPRA Nareit DEV HEDGED IN AUD L - TOT RETURN IND)	-4.50	-12.26	-10.47	-9.45	-8.58	-7.73	0.70	-1.93	2.55
Australian Cash (Bloomberg AusBond Bank Bill Index)	0.33	1.04	2.02	1.42	3.14	3.66	1.47	1.31	1.75
Australian Bonds (Bloomberg AusBond Composite 0+ yr Index)	-1.85	-2.63	-5.20	-2.13	-0.65	-1.18	-4.61	-0.13	2.11
Global Bonds (Barclays Global Aggregate (AUD Hedged))	-0.83	-2.90	-3.65	-2.96	-0.95	0.07	-4.82	-0.36	1.97

Sub Asset classes	Month % chge	3 Month % chge	6 month % chge	FYTD%	YTD %	1 year % chge	3yr return pa	5yr return pa	10yr return pa
MSCI All Country ex Aust(net, AUD)	-1.13	-3.81	2.36	-1.50	14.34	11.60	10.80	10.19	11.42
US Shares (S&P 500 Total Return Index)	-2.10	-8.25	1.39	-5.31	10.69	10.14	10.36	11.01	11.18
Australian Small Caps (ASX Small Ords Accum (Ex 100))	-5.45	-10.45	-10.28	-7.28	-6.05	-5.10	0.52	2.55	4.26
Global Small Caps (MSCI Small Cap Index (USD, net))	-6.14	-14.45	-7.27	-10.25	-3.39	-0.96	4.02	3.96	5.30
Global Small Caps ex-Aust (MSCI World Small Caps ex Aust (NI) AUD)	-4.41	-9.86	-3.21	-6.18	3.50	0.40	7.83	6.29	9.72
Global Emerging (MSCI Emerging Markets (USD))	-3.89	-12.16	-4.78	-6.70	-2.14	10.80	-3.67	1.59	1.19
Global Emerging (MSCI Emerging Markets (AUD, net))	-2.03	-6.52	-0.62	-1.91	4.82	11.90	-0.29	3.91	5.34
Global Infrastructure (FTSE Global Core Infrastructure 50/50 Index - AUD Hedged NR)	-1.59	-10.10	-11.50	-8.82	-10.00	-7.22	2.24	2.69	5.84
Global Credit (Barclays Global Aggregate Credit (AUD Hedged))	-1.18	-3.49	-4.17	-3.12	-1.05	2.23	-5.31	-0.08	2.29
Global High Yield (Barclays Global Aggregate High Yield TR Hedged AUD)	-1.02	-2.31	0.44	-0.86	3.00	7.05	-0.75	0.91	3.53
Australian Govt Bonds (Bloomberg AusBond Infl Govt 0+ yr Index (d))	-1.35	-2.84	-4.91	-1.95	1.90	1.56	-2.13	1.57	3.11
Treasury Yields (Bloomberg Treasury Index)	-1.85	-3.11	-6.18	-2.63	-1.59	-2.54	-5.29	-0.37	1.92
Australian Credit (Bloomberg AusBond Credit Bond Index (d))	-0.77	-0.37	-1.13	0.47	2.73	3.47	-1.70	1.41	3.04
Australian Floating Rate Bonds (Bloomberg AusBond Credit FRN 0+ Yr Index)	0.37	1.21	2.44	1.68	4.06	4.86	1.95	2.11	2.63
AUD-USD (m)	-1.73	-5.03	-3.99	-4.28	-6.33	-1.15	-3.42	-2.18	-3.94
Trade Weighted Index of AUD (AUD TWI(m))	-1.47	-1.79	0.67	-2.43	-1.95	-1.79	0.39	-0.56	-1.79
US Broad Dollar Index -- Nominal, Monthly	1.46	4.49	3.76	3.50	1.39	-2.75	2.29	1.53	2.97

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1. Markets

GLOBAL DEVELOPED EQUITIES

- Global equity markets dropped a further 2.9% per cent in October taking the year to date return to 8.2 per cent. Bond yields continued to climb, undermining valuations while the Israel-Hamas conflict added to uncertainty and risk aversion.
- Bond yields moved up to 5 per cent in the US, a rise of more than 100 basis points since June. While markets seem content that the peak Fed funds rate is in they have unwound expectations of easing in 2024. As a result, the yield curve has suffered a bear market flattening, that is, rising long term bond yields and steady shorter dated bond yields. Against the backdrop of a resilient economy in the face of 500 basis points of policy tightening and a burgeoning fiscal deficit and treasury issuance program, the so-called "term premium", the reward investors receive for holding long term fixed rates of return, has lifted from around -75 basis points in June to 0.5 per cent. All asset prices, particularly for those with higher leverage and long "duration", have suffered.
- While bond yields have presented headwinds to equity market valuations, the earnings picture has been better than expected. Based on FactSet data, US earnings look set to grow in Q3 by around 3-4 per cent, the first rise since Q3 2022. Earnings have been strongest in communication services, consumer discretionary and financials while energy, materials and healthcare lagged. Consensus expects earnings growth of more than 10 per cent for the next year.
- Of course, the tragic developments in the Israel-Hamas conflict became the focus in early October. The initial market response, higher oil prices, a safe-haven bid for bonds and a stronger USD, was as expected but given the situation has not escalated to a broader regional conflict, it has not, as yet, had a sustained impact on markets. The situation, however, is fluid and unpredictable.
- In other major developments, the Bank of Japan (BoJ) moved a step closer toward ending Yield Curve Control (YCC) and exiting negative interest rate policies. In late October, the BoJ raised the reference rate, or target bond yield to zero +/- 100 basis points, but importantly, with no commitment to defend this limit with bond purchases.
- Although the rapid decline in inflation to date has led to calls that the tightening cycle is close to over, the resilient economy continues to undermine expectations for easing in 2024 and 2025. Markets expect the Fed funds rate to be 4.65 per cent by end-2024, more than 50 basis points higher than what was anticipated in June. The 4.9 per cent September quarter GDP result was a key reason for the change in projections.
- On the inflation front, September saw another rise in headline CPI, largely due to higher energy costs. The core measures, particularly over the past six months, suggest core inflation is back below 3 per cent. Inflation also appears to be falling faster than anticipated in Europe (2.9 per cent in October) while in the UK inflation is now around 6.6 per cent.
- Across regions, the US was the best performing major region, down 2.3 per cent while Japan was down 4.5 per cent. Europe ex-UK was off 3.6 per cent. The Hamas attacks and subsequent response from Israel prompted a 12.6 per cent decline in the MSCI Israel index. For the year to date, Italy and Denmark have been the major winners while Hong Kong, New Zealand and Israel have lagged considerably.
- On a factor basis Quality outperformed as expected in a rising bond yield/ uncertain growth environment, down just 1.7 per cent while Value stocks lagged, down 3.4 per cent. For the year to date, Growth stocks have rallied 17.9 per cent, Quality 15.7 per cent while Value, Momentum and High Dividend stocks are down 1-2 per cent. In terms of sectors, banks, consumer discretionary, energy and healthcare were down during October while insurance benefited from higher bond yields. For the year, IT and communications services are up close to 30 per cent while healthcare and banks are down 6 per cent and 3.9 per cent, respectively.

AUSTRALIAN EQUITIES

- The Australian equity market lost 3.8 per cent in the month and is now down marginally for the year to date. As was the case globally, the theme was higher bond yields and a contraction in PE multiples. However, unlike the US market, the earnings outlook for Australia is very subdued with consensus EPS growth for the next 12 months around -1 per cent.
- Healthcare stocks continue to be sold down, the sector off a further 7.1 per cent to be down 14.7 per cent in 2023. The financials sector was 3.7 per cent lower while REITs were down 5.7 per cent, largely on higher real bond yields. For the year REITs are down 5 per cent while financials are slightly negative.
- In terms of data, the NAB survey shows that business conditions, while softer, are still well above average levels. The labour market remains tight, despite some softening in jobs growth. The focus for markets was on inflation where a higher than expected September quarter result prompted markets to price in another rate hike as soon as November. The September quarter CPI showed inflation of 1.2 per cent for both headline and core inflation, slightly above expectations. With the annual core inflation rate at 5.4 per cent (down from 6 per cent), it will be very difficult to reach the RBA's earlier forecast of 3.9 per cent by end-2023 (last three quarters 1.2%, 1% and 1.2% per cent.
- The RBA chose not to lift rates at the September and October meetings as it gave itself more time to assess the impact of the four percentage points of interest rate hikes delivered since May 2022. Market pricing implied a high probability of one more move to 4.35 per cent (subsequently delivered) with the possibility of another by June 2024.

EMERGING MARKETS

- Emerging markets declined 3.9 per cent in USD terms in October. For the year to date, emerging markets are down 2.1 per cent, lagging global developed equities by around 10 per cent.
- The Chinese equity market continued to struggle under the weight of a weak property market and a muted policy response. The MSCI China index fell a further 4.3 per cent for the month, taking the loss this year to -11.2 per cent. During the month the Chinese authorities announced plans to support the equity market and approved a 1 trillion yuan sovereign bond issue (around 0.8 per cent of GDP) partly to fund infrastructure spending in 2024. In terms of economic data, China's GDP expanded by a better than expected 4.9 per cent in the September quarter while retail sales also exceeded expectations. PMI readings for October, however, were back below the critical 50 level.
- Korean equities were down 7 per cent and Taiwan 1.7 per cent, leaving the MSCI Asia index off 4 per cent. MSCI Latin America was down 4.8 per cent with Mexico down more than 6 per cent. MSCI Europe was held up by strong performance from Poland.
- Emerging markets appear to be cheap relative to developed markets but still require a catalyst for outperformance, perhaps in the way of a more dovish Fed and a weaker USD, or in terms of additional Chinese stimulus.

REITS AND INFRASTRUCTURE

- The ongoing lift in real yields hit infrastructure and REITs harder than most equity sectors during September and October. Although REITs had already discounted sizeable declines in property valuations, the 65 basis point surge in real yields since August saw the sector decline a further 5.8 per cent in October after dropping 8.6 per cent in September. For the year to date, REITs are down 5 per cent.
- Meanwhile GREITs were down a further 4.5 per cent, taking the loss this year to 8.6 per cent.
- Global infrastructure was down 1.6 per cent in October after losing 4.2 per cent in September and 4.7 per cent in August, reflecting the 100 basis point lift in US 10 year TIPs yields since July.

GLOBAL FIXED INTEREST

- Global bond yields continued their march higher in October with the US 10-year yield ending the month at 4.88 per after briefly touching 5 per cent during the month. Yields have risen more than 120 basis points since the end of June. The Barclays Global Aggregate (AUD hedged) index dropped a further 0.8 per cent in October and since peaking at the end of 2020, the index has declined almost 15 per cent.
- The rise in bond yields occurred against the backdrop of a resilient economy. Despite 500 basis points of policy tightening the US economy expanded at a 4.9 per cent annualised pace in the September quarter, underpinned by strong consumer spending. And although the headline inflation rate has declined to 3.7 per cent and core inflation looks headed towards 3-3.5 per cent in early 2024 the bond market has instead focussed on the burgeoning fiscal deficit and rising treasury issuance program. The "term premium", the reward investors receive for holding long term fixed rates of return, has lifted from around -75 basis points in June to 0.5 per cent.
- Although the rapid decline in inflation to date has led to calls that the tightening cycle is over, the resilient economy continues to undermine expectations for easing in 2024 and 2025. Markets expect the Fed funds rate to be 4.65 per cent by end-2024, more than 50 basis points higher than what was anticipated in June.
- In other major developments, the Bank of Japan (BoJ) moved another step toward ending Yield Curve Control (YCC), raising the reference rate, or target bond yield to zero +/- 100 basis points, but with no commitment to defend this limit with bond purchases. With global bond yields sharply higher the BoJ acknowledged that its decision in July to defend the 1 per cent level was untenable. The view is that with inflation and wages growth in the order of 3 per cent and the yen weakening beyond 150 to the USD, the BoJ will abandon YCC before moving to take short rates into positive territory.
- Inflation also appears to be falling faster than anticipated in Europe (2.9 per cent in October) while in the UK inflation is now around 6.6 per cent. With the European economy stagnating, the ECB is expected to join the Fed and the BoE and hold rates steady.
- Meanwhile, yields on US 10 year TIPs pushed out to 2.46 per cent, a level considered "cheap" relative to longer term trend real GDP growth of less than 2 per cent.
- US credit spreads widened to 442 basis points in October, up from 403 basis points as the "higher for longer" interest rate outlook raised concerns over corporate re-financing risks. Investment grade spreads moved out slightly. However, with yields close to over 9 per cent for US high yield and 6.25 per cent for investment grade, the corporate bond sector is once again in the sights of income investors.

AUSTRALIAN FIXED INTEREST

- Australian bond yields sold off more aggressively than their US and global counterparts, touching 4.95 per cent at the end of October, up from 4.5 per cent. While US 2-year yields were relatively steady at 5.06 per cent, Australian 2-year yields adjusted 35 basis points upwards to 4.46 per cent as markets priced in another RBA tightening in November following the higher than expected September quarter CPI result.
- The September quarter CPI rose 1.2 per cent for both headline and core inflation, above expectations. With the annual core inflation rate at 5.4 per cent (down from 6 per cent), it seems the RBA's earlier forecast of 3.9 per cent by end-2023 will not be achieved.

- In early November, the RBA lifted the cash rate to 4.35 per cent, the first rise in four months, with new RBA governor Michele Bullock noting "Inflation in Australia has passed its peak but is still too high and is proving more persistent than expected a few months ago." Markets now expect Australian cash rates to be broadly in line with US Fed funds in 2025 (around 4.5 per cent), providing the AUD with support over the past few weeks.

- In other data, Australia's unemployment rate dropped to 3.6 per cent in September from 3.7 per cent as the workforce participation rate declined. The underemployment rate lifted to 6.4 per cent, compared with the 5.8 per cent low, perhaps an early sign that the labour market is beginning to soften. Meanwhile the NAB business conditions index remains above average.

COMMODITIES

- The price of Brent crude declined sharply in early October on the back of weak demand before the Hamas attack on Israel and concerns over an escalation in the crisis pushed oil to US$93.26 a barrel on October 19. However, with the crisis remaining contained for now, oil prices drifted off over the remainder of the month, ending at US$87.42 a barrel. Underscoring the potential economic impact of the crisis, the Middle East supplies almost a third of the world's oil and 20 per cent of the world's oil is shipped through the Strait of Hormuz.
- Rising geopolitical risk underpinned a 7 per cent lift in the price of gold to US1997.6 an ounce. This performance was all the more extraordinary considering the relentless rise in real yields.
- Finally, the price of iron ore managed to rise to US$122 a tonne, partly in response to better than expected Chinese growth data and stimulus plans.

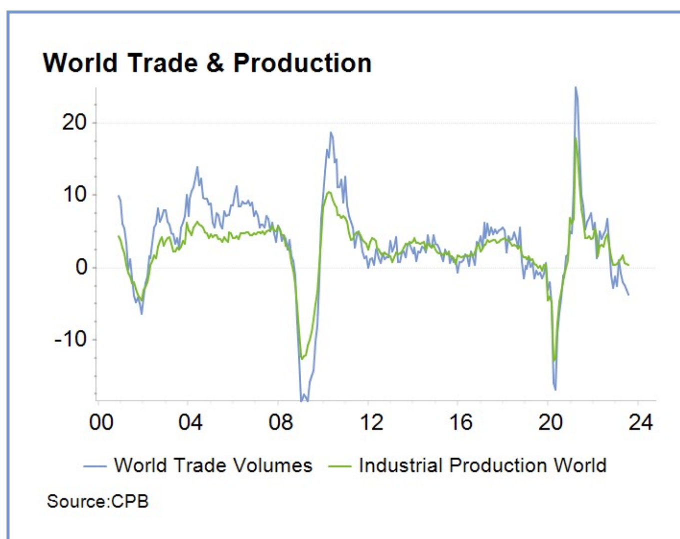
CURRENCY

- After declining towards 62 cents under the weight of "higher for long" interest rates in the US, the AUD ended the month with some upside momentum as markets priced in a Melbourne Cup Day tightening which in turn reflected the higher than expected September quarter inflation data.
- The yen continued to decline as the BoJ refrained from totally abandoning its Yield Curve Contral program. While it did relax the "cap" on 10 year yields, Japanese rates remain well below global rates, adding to further downside pressure on the yen, ending the month at 151.7 to the USD. Meanwhile the Euro was steady at 1.06.

2. Key Economic Releases

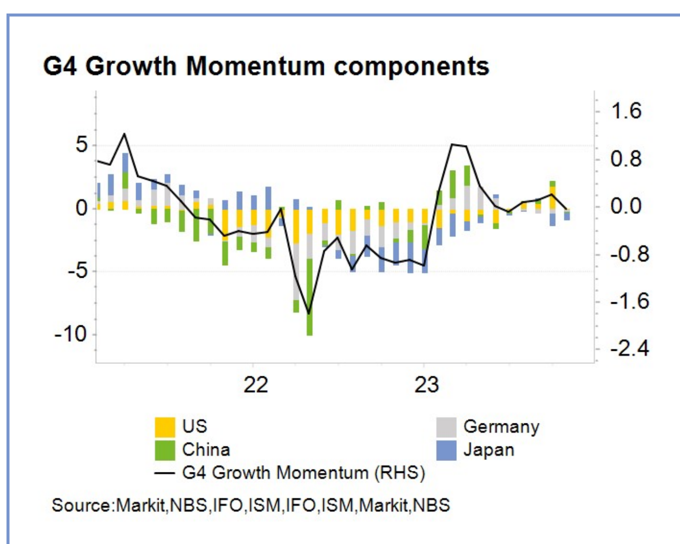
GLOBAL TRADE TURNING DOWN

- World trade volumes contracted by 3.8 per cent over the year to August, a new low for this cycle. Global industrial production was up just 0.4 per cent. Overall trade growth relative to output growth continues to decline, one measure of de-globalisation.



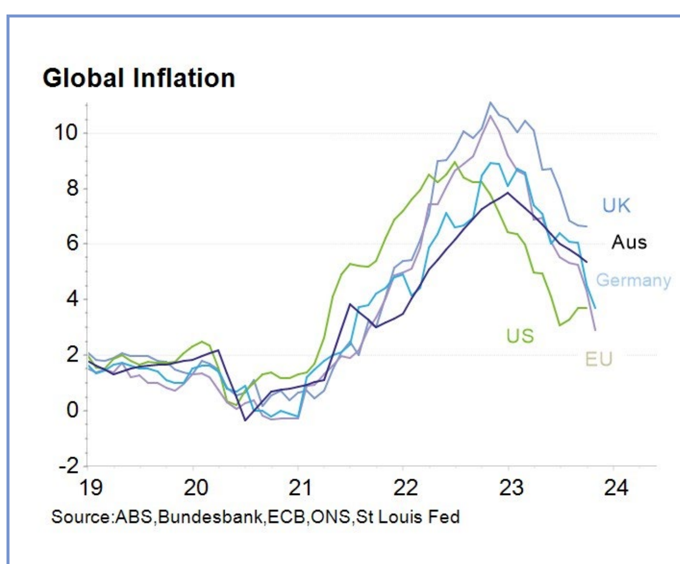
GLOBAL GROWTH MOMENTUM FLAT

- The US ISM manufacturing dropped to 46.7, towards the bottom end of the 46.3 to 49 range of the past year. New orders eased to 45.5. The European manufacturing PMI was 43.1, Japan 48.7 and China 49.5.
- Our measure of G4 growth momentum was flat, suggesting a potential stabilisation in the global output cycle.



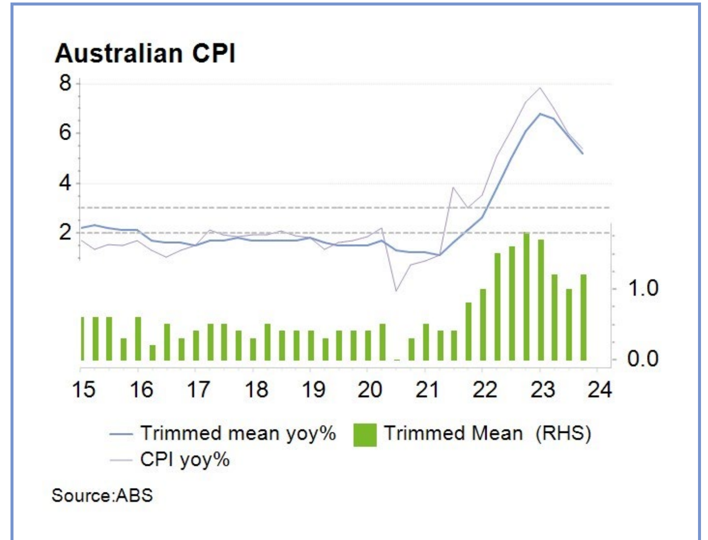
GLOBAL INFLATION

- US inflation rose slightly to 3.7 per cent in September. In Europe the CPI dropped sharply to 2.9 per cent, with Germany at 3.7 per cent. UK inflation remains stubbornly high at 6.6 per cent with Australia also relatively high at 5.4 per cent.



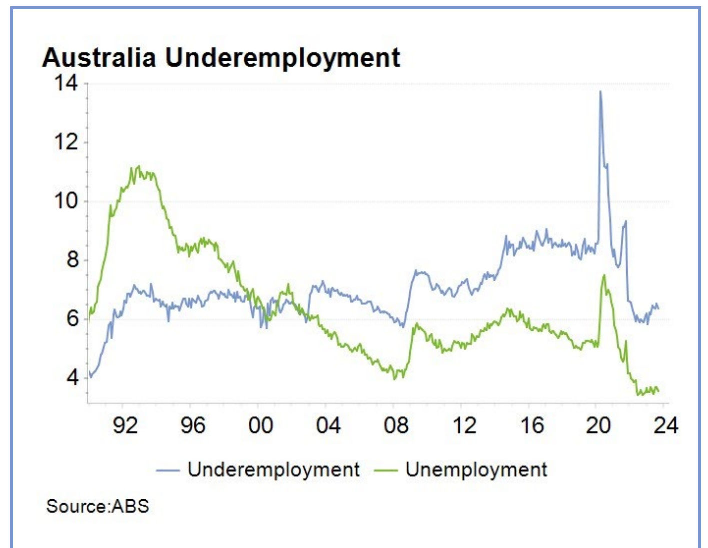
AUSTRALIAN INFLATION

- The September quarter CPI rose 1.2 per cent for both headline and core inflation, slightly above expectations. With the annual core inflation rate at 5.4 per cent (down from 6 per cent), it will be very difficult to reach the RBA's earlier forecast of 3.9 per cent by end-2023 (last three quarters 1.2%, 1% and 1.2% per cent).



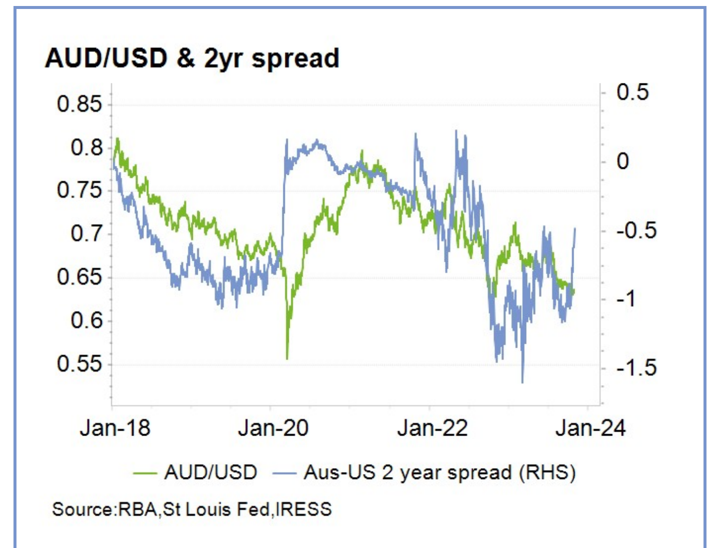
LABOUR MARKET EASING?

- Australia's unemployment rate dropped to 3.6 per cent in September from 3.7 per cent as the workforce participation rate declined. The underemployment rate lifted to 6.4 per cent, compared with the 5.8 per cent low, perhaps an early sign that the labour market is beginning to soften.



INTEREST RATE DIFFERENTIALS SUPPORTING AUD

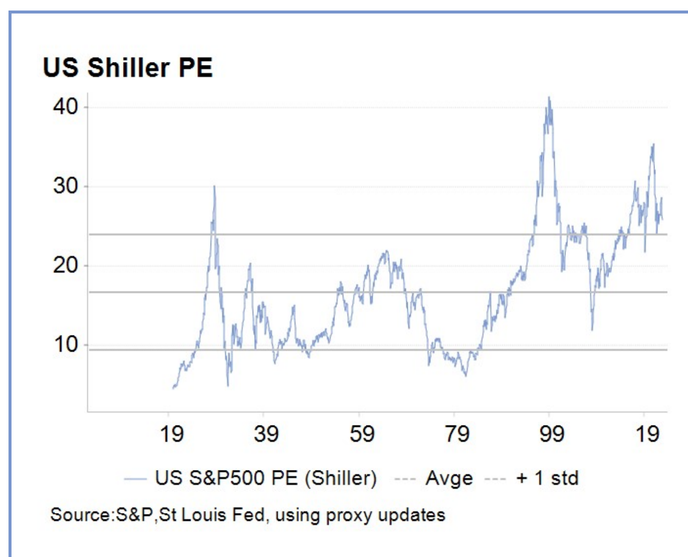
- The AUD has risen over the past week, partly reflecting the narrowing of interest rate differentials to the US. The 2-year spread was -100 basis points in mid-October, improving to -50 basis points at present. While markets are thinking the Fed may be done, the higher than expected Australian CPI suggests a rate hike domestically next week (subsequently delivered).



3. Valuations: Overseas

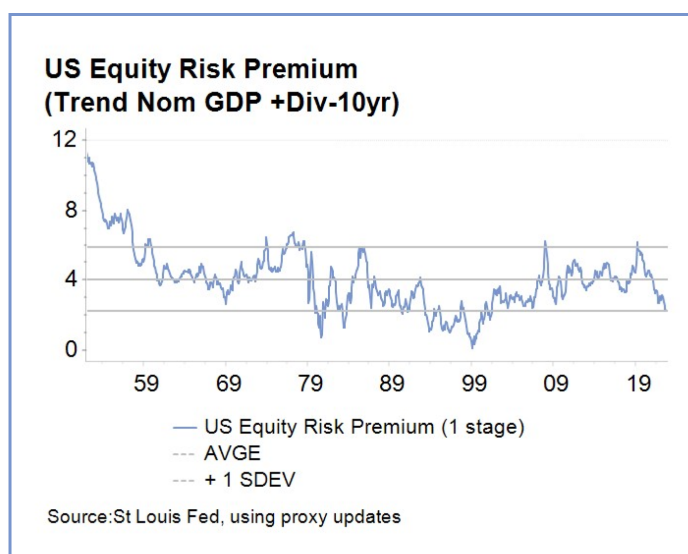
LONG TERM CYCLICALLY ADJUSTED PE

- The long term cyclically adjusted P/E is sitting at 26 times, well down from 37 times in late 2021 but is still well above average levels (17.5) and the low inflation regime average of around 23 times. The high inflation average is close to 15 times.



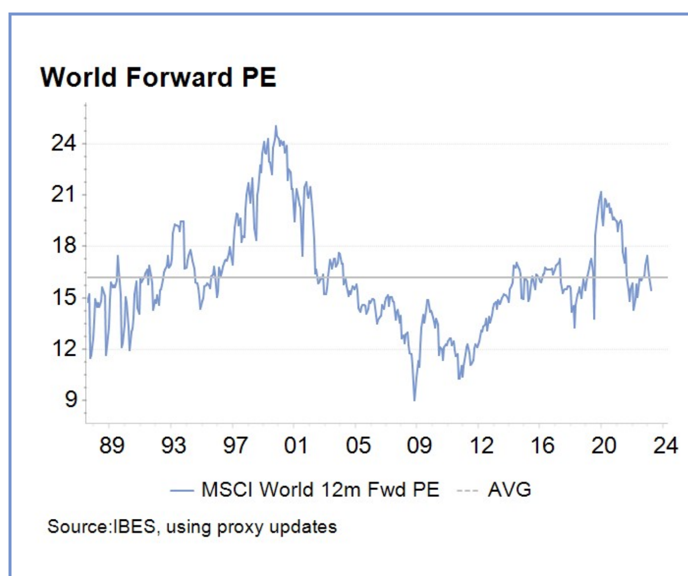
US EQUITY RISK PREMIUM

- The US Equity risk premium based on a simple (GDP plus dividend less bond yield) model, sits at just over 2 per cent at present, the 15th percentile.
- Previously, from such levels, returns over the following year from bonds and equities have been broadly similar (around 10-12 per cent) over the subsequent 1 and 2 year periods. Obviously, bonds achieved this with much lower volatility.



WORLD FORWARD PE

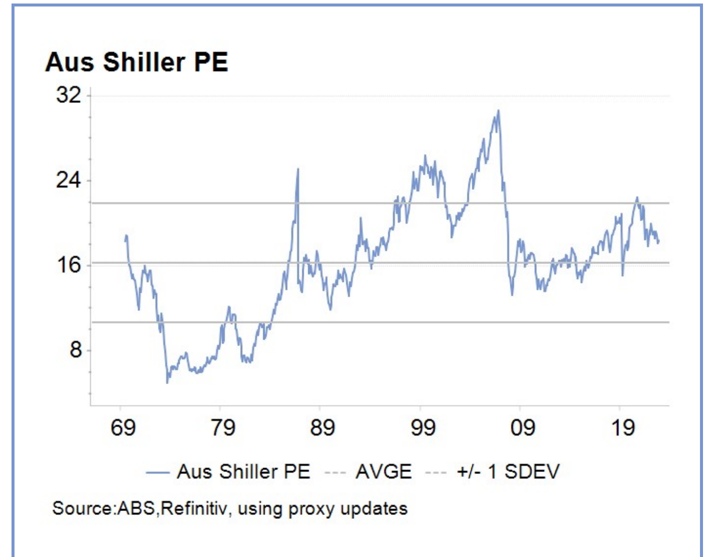
- Developed markets 12 month forward PE sits at 15.5 times, below the average of 16.2.



4. Valuations: Australia

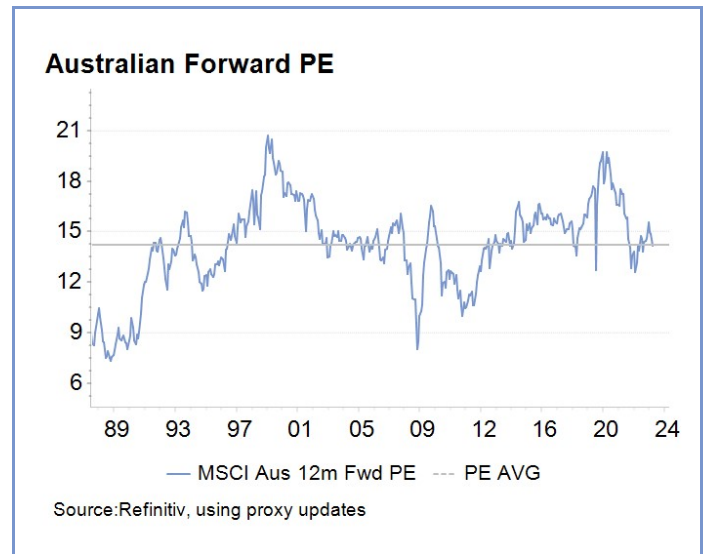
AUSTRALIAN LONGER-TERM VALUATIONS

- Using a Shiller method for calculating PE's the market is at 18 times (compared with the average of 16).



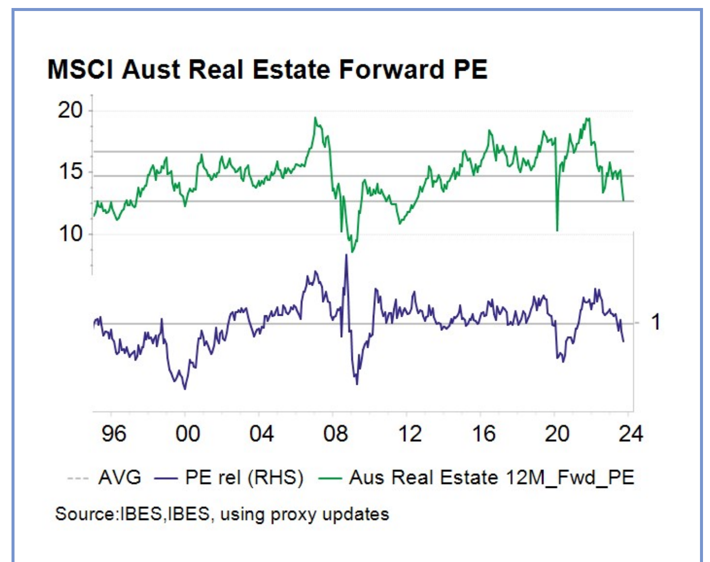
AUSTRALIAN PE

- The Australian PE sits at 14.1 times, in line with the long-term average of 14 but well down on the recent 20 times in 2020.



A-REITS

- The 12-month forward PE on AREITs sits at 13.9 times, a 7 per cent discount to the broader market.



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