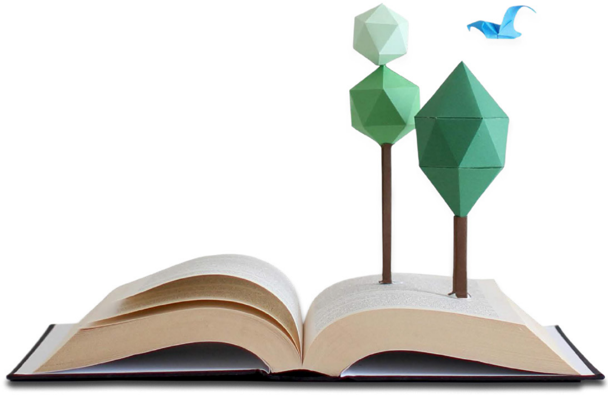
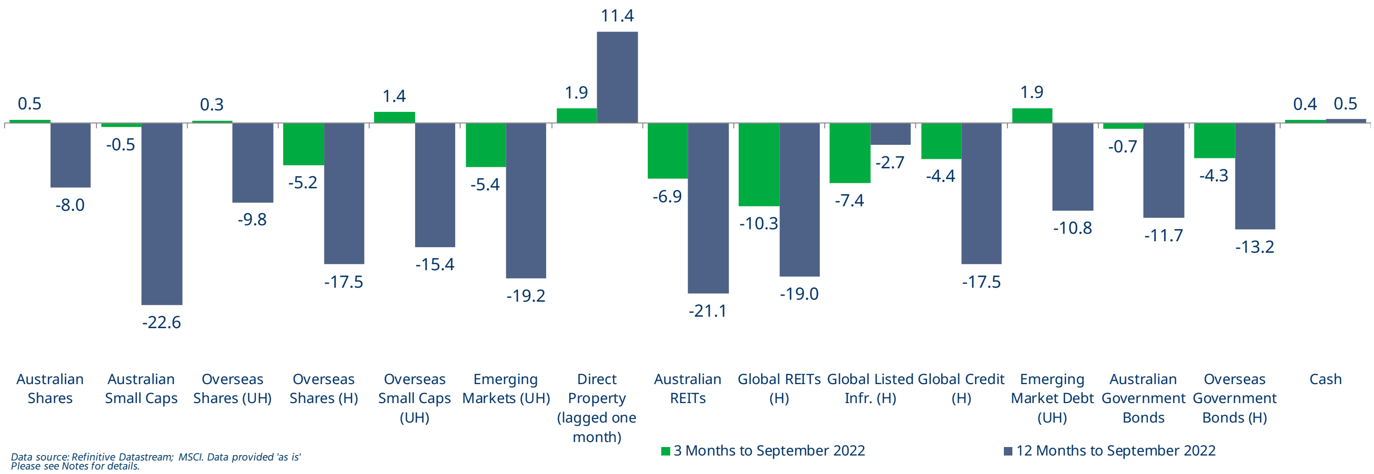
Q3 2022

Market and economic conditions



Selected market indicators commentary

Asset class returns as at September quarter 2022



The third quarter of 2022 began with a strong rally in July, however was followed by a moderate decline in August and a broad based selloff in September. Federal Reserve chair Jerome Powell reasserted that monetary policy will be tighter for longer if needed, during his speech at Jackson Hole. Economic data continued to deteriorate over the quarter with most countries reporting higher than expected inflation and labour markets remained tight.

Hedged Developed Market Overseas Shares returned -5.2% over the quarter as investor sentiment continued to deteriorate, conversely unhedged overseas shares posted a 0.3% gain given the continued US dollar strength. Equity market volatility returned to the heights seen in early June. However, Australian shares saw a modest increase of 0.5%.

Emerging market equities underperformed their global counterparts, as slowing growth hurt exporting nations. China's economic growth prospects were hit by the downturn in its housing market and ongoing Covid restrictions.

Hedged Overseas Government Bonds returned -4.3% over the quarter as major developed bond yields rose sharply across all months. Discouraging inflation readings across the developed world made it likely that monetary tightening will continue for the foreseeable future. Australian government bonds fared slightly better posting a 0.7% decline for the quarter. The UK went through a major government bond (gilt) sell-off after its government announced a budget that markets deemed fiscally unsound.

Australian shares outperformed hedged overseas shares over the quarter with the ASX 300 gaining 0.5%. The S&P/ASX Small Ordinaries declined 0.5%, whilst the S&P/ASX mid 50 was the best performing Australian index, gaining 5.2%. The strongest performing sector for the second consecutive quarter was Energy (5.8%) followed by Healthcare (3.2%), whilst the worst performing sectors were Utilities (-12.5%) and Real Estate (-6.4%). Pilbara Minerals was the top contributor (99.1%), whilst BHP was the largest negative contributor (-3.7%).

Significant Developments

- During its October 2022 meeting, the Reserve Bank of Australia (RBA) decided to increase the current target cash rate by 25 basis points to 2.6% per annum and the interest rate on exchange settlement balances from 2.25% to 2.5%. The Board is committed to returning inflation to the 2–3% range. As is the case in most countries, inflation in Australia is too high. Global factors explain much of this high inflation, but strong domestic demand relative to the ability of the economy to meet that demand is also playing a role. A further increase in inflation is expected over the months ahead, before a decline back towards the 2–3% range. The expected moderation in inflation next year reflects the ongoing resolution of global supply-side problems, recent declines in some commodity prices and the impact of rising interest rates. The Bank's central forecast is for CPI inflation to be around 7.75% over 2022, a little above 4% over 2023 and around 3% over 2024. The Australian economy is continuing to grow solidly and national income is being boosted by a record level of the terms of trade. The labour market is very tight and many firms are having difficulty hiring workers. The unemployment rate in August was 3.5%. Wages growth is continuing to pick up from the low rates of recent years, although it remains lower than in other advanced economies. Price stability is a prerequisite for a strong economy and a sustained period of full employment. It is seeking to do this while keeping the economy on an even keel. One source of uncertainty is the outlook for the global economy, which has deteriorated recently. Higher inflation and higher interest rates are putting pressure on household budgets, with the full effects of higher interest rates yet to be felt in mortgage payments. Consumer confidence has also fallen and housing prices are declining after the earlier large increases. Working in the other direction, people are finding jobs, gaining more hours of work and receiving higher wages. The increase in interest rates will help achieve a more sustainable balance of demand and supply in the Australian economy.

  The Board expects to increase interest rates further over the months ahead. The size and timing of future interest rate increases will be guided by the incoming data and the Board's assessment of the outlook for inflation and the labour market.

- Australian seasonally adjusted employment increased by 33,900 in August, below expectations for an increase of 35,000 and above the prior month's decrease of 40,900. The unemployment increased in August to 3.5%, above expectations of 3.4%.The participation increased by 66.6%, in line with expectations. Part time jobs decreased by 25,300 and full time jobs increased by 58,800.
- The CoreLogic House price index indicated Australian residential house prices declined by -1.4% MoM to September. Australian building approvals increased by 28.1% month-on-month to August, compared to the decreased of -18.2% (revised) for July.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 50.9 in September, below consensus for 52 and below the 52.8 recorded in August. Of the 9 manufacturing industries, Nonmetallic Mineral Products and Machinery were the two industries that reported the highest growth. There were seven industries that recorded contraction in September compared to August. The ISM Services Index recorded 56.7 in September, above consensus for 56 and below the 56.9 recorded in August. Of the 15 services industries, the top performers were Mining and Other Services. The three industries reporting a decrease in the month of September were Accommodation & Food Services; Arts, Entertainment & Recreation and Transportation & Warehousing.
- US Non-Farm Payrolls increased by 263,000 in September, below the 315,000 increase recorded for August. The unemployment rate decreased to 3.5% over September, below expectations of 3.7%.
- US GDP third estimate for Q2 2022 is -0.6% quarter on quarter (QoQ) annualised, which was in line with expectations.
- US headline consumer price index (CPI) increased to 0.4% MoM and increased to 8.2% YoY in September.
- The Caixin Manufacturing PMI in China recorded 48.1 in September, below expectations of 49.5, as output and demand were dampened by COVID-19 containment measures.
- Chinese GDP increased 0.4% YoY for Q2 2022, below expectations for 1.2%. Seasonally adjusted GDP decreased 2.6% QoQ for Q2 2022, below expectations for -2.0%.

- The preliminary estimate of the European Core CPI recorded 4.8% over the year to September, above expectations of 4.7%. The unemployment rate remained the same over the month at 7.3% in September 2022.
- The Eurozone composite PMI decreased to 48.1 in September, below expectations for 48.2.
- The final estimate recorded for Q1 2022 Eurozone seasonally adjusted GDP is 0.8% QoQ and 4.1% YoY.

Australian Equities

Australian shares were positive over Q3 2022 as the S&P/ASX 300 Index returned 0.5% for the period. The S&P/ASX Mid 50 Accumulation Index was the strongest performer for the quarter returning 5.2%, while the S&P/ASX Small Ordinaries was the weakest performer, returning -0.5%.

The best performing sectors were Energy (5.8%) and Healthcare (3.2%), while the weakest performing sectors were Utilities (-12.5%) and Real Estate (-6.4%). The largest positive contributors to the return of the index were Pilbara Minerals, CSL and Whitehaven Coal with absolute returns of 99.1%, 6.2% and 87.6% respectively. On the other hand, the most significant detractors from performance were BHP, Transurban and Macquarie Group with absolute returns of -3.7%, -13.5% and -6.3% respectively.

Global Equities

The broad MSCI World ex Australia Accumulation Index increased 0.3% in unhedged terms and decreased -5.2% in hedged terms over the quarter, as the AUD weakened against most major currencies over the period. The strongest performing sectors were Consumer Discretionary (7.3%) and Energy (5.5%), while Communication Services (-7.0%) and Real Estate (-5.5%) were the worst performers. Other global shares indices produced mixed results as the MSCI Small Caps Total Return Index returned 1.3% and the MSCI Emerging Markets Accumulation Index returned -5.4% over the quarter.

Over the September quarter, the NASDAQ (-4.1%), the S&P 500 Composite Index (-4.9%) and the Dow Jones Industrial Average decreased (-6.2%), all in USD terms. European markets experienced negative returns, as the FTSE 100 (United Kingdom) (-2.7%), the CAC 40 (France) (-2.5%) and the DAX 30 (Germany) (-5.2%) decreased, all in local currency terms. Equity returns were mixed across Asia as the S&P BSE 500 (India) (10.9%) increased, while the SSE Composite (China) (-11.0%), Hang Seng (Hong Kong) (-20.1%) and the TOPIX (Japan) (-0.8%) decreased, all in local currency terms.

Real Assets

Domestic listed property experienced poor performance over the quarter and returned -6.9%. Global REIT's returned -10.3% (in AUD hedged terms) over the September quarter. The Australian unlisted property sector (NAV) increased 1.9% over the quarter and the FTSE Global Core Infrastructure 50/50 Index returned -7.4% for the quarter in hedged AUD terms.

Fixed Interest

Global sovereign bonds produced broadly negative returns over the September quarter as ten-year bond yields increased in the US (83bps to 3.80%), Germany (83bps to 2.20%), UK (202bps to 4.23%) and Japan (2bps to 0.25%). Two-year bond yields increased in the US (131bps to 4.26%), Germany (121bps to 1.74%), the UK (241bps to 4.28%) and Japan (1bp to -0.05%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index returned -3.8% and the FTSE World Government Bond (ex-Australia) Index decreased by 4.3% over the September quarter, both on a fully hedged basis.

Domestically, the Australian 10-year bond yield (24bps to 3.90%), five-year bond yield (33bps to 3.69%) and two-year bond yield (52bps to 3.51%) all increased. The Bloomberg Ausbond indices returned broadly negative results over the quarter, with the Bloomberg Ausbond Bank Bill producing the highest quarterly return, returning 0.4%, and the weakest being the Bloomberg Ausbond Inflation, returning -1.9%.

Currency Markets

The Australian Dollar (AUD) depreciated against most major developed market currencies over the September quarter, finishing at US$0.64. The AUD depreciated against the USD (-6.5%), the Japanese Yen (-0.4%) and the Euro (-0.2%), while appreciating against the Pound Sterling (1.7%). On a trade-weighted basis, the local currency depreciated by 0.5% over the quarter.

Commodities

The S&P GSCI Commodity Total Return Index decreased by 4.1% over the quarter. Gold prices finished the quarter at US$1,674.06 per ounce, decreasing by 7.4%. Meanwhile, Iron Ore prices decreased by 20% to US$98.0 per metric tonne over the period and Oil decreased by 22.8% to US$88.69 per barrel.

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Chart Constituents

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Net Index: Total Return (Net Dividends Reinvested).*
- *Total Return: Total Return Index with Gross Dividends.*
- *Where a lag exists, the performance period start and end dates are shifted accordingly.*

Asset class	Benchmark	Data type
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
Overseas Shares (UH)	MSCI World ex Australia	Net Index
Overseas Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
Overseas Small Caps (UH)	MSCI World Small Cap	Total Return
Emerging Markets (UH)	MSCI Emerging Markets	Net Index
Direct Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian REITs	S&P/ASX 300: Industry Group: A-REIT	Total Return
Global REITs (H)	FTSE EPRA/NAREIT Developed Hedged	Total Return
Global Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Total Return
Global Credit (H)	Bloomberg Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
Overseas Government Bonds (H)	FTSE WGBI Non Australia	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

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- For higher volatility investments, losses on realisation may be high because their value may fall suddenly and substantially.
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