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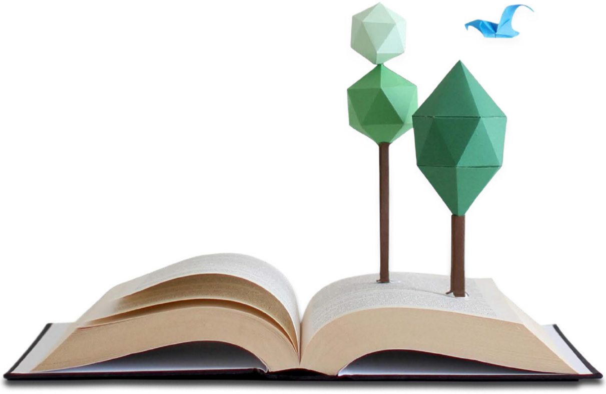
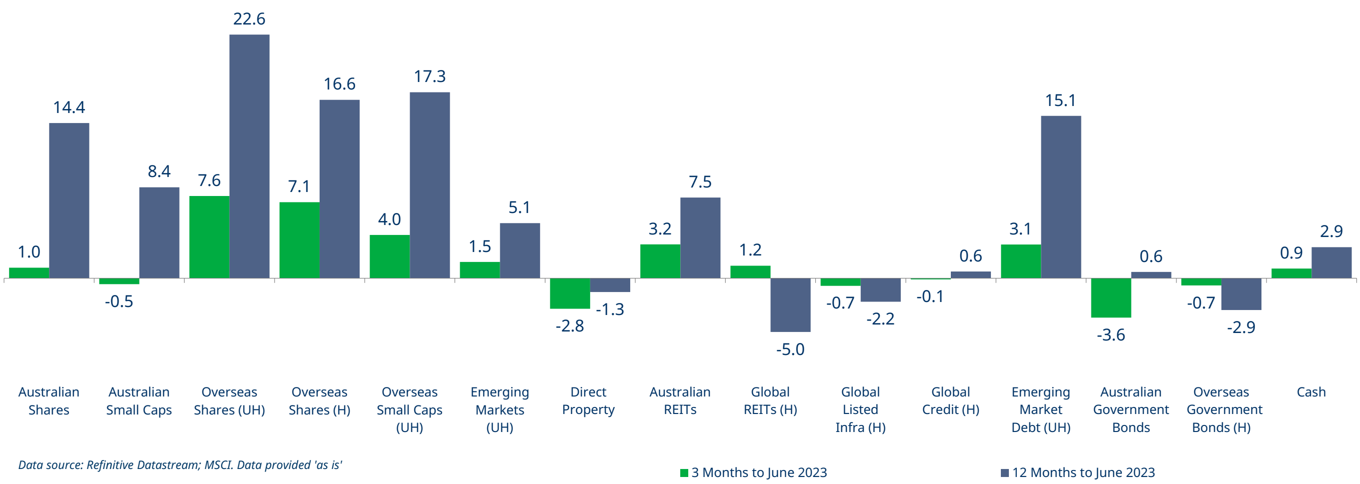
Q2 2023

Market and economic conditions



Selected market indicators commentary

Asset class returns as at June quarter 2023



Data source: Refinitive Datastream; MSCI. Data provided 'as is'

Please see Notes for details.

Market Recap

The second quarter of 2023 was positive for growth assets and generally flat to slightly negative for fixed income.

Globally, inflation continued to ease, although at different rates depending on the country or region. However, major central banks continued to raise rates over the quarter, though notably, the US Federal Reserve kept rates on hold at its June meeting. Looking forward, with the global economy continuing to show resilience despite tighter credit conditions, markets appear to be more optimistic. Growth assets, in particular, are reflecting this optimism and are pricing in an increased likelihood of a "soft landing".

Hedged Developed Market Overseas Shares returned 7.1% over the June quarter as inflationary expectations receded, and Unhedged Overseas shares outperformed, adding 7.6%. Australian Shares posted a modest gain of 1.0% over Q2 as sector performance was mixed. Materials (-2.6%) and Healthcare (-3.1%) sectors were the most significant detractors, offset by gains in Information Technology (18.5%) and Financial (3.1%) sectors. Emerging market equities returned 1.5%, lagging behind developed markets, as the tailwinds expected from China's post-covid reopening have disappointed so far. Brazil was a top performer (15.9%), given its early monetary policy intervention and apparent success with fighting inflation.

Hedged Overseas Government Bonds returned -0.7% as bond yields moved higher over the quarter. The period was marked by the machinations and subsequent resolution of US Debt ceiling negotiations, leading to a substantial drop in market volatility. High yield outperformed investment grade bonds as fixed interest markets are also pricing in a more optimistic "soft landing" scenario. Over the quarter, US inflation expectations were mostly unchanged with the 10-year inflation breakeven rate ending June at 2.2%.

Significant Developments

- Australian seasonally adjusted employment increased by 75,900 in May, well above 17,500 expectations and countered the prior month's decrease of 4,300. The unemployment rate dropped to 3.6% (expectations were 3.7%) with the participation rate increasing to 66.9% (66.7% was the consensus estimate). Part-time jobs increased by 14,300 and full-time jobs increased by a healthy 61,700.
- The CoreLogic House price index indicated Australian residential house prices increased by 1.2% month-on-month (MoM) to June. Australian building approvals were up 20.6% (MoM) to May, compared to the revised figure of -6.8% for April.
- The US Institute for Supply Management (ISM) Manufacturing Index recorded 46.0 in June, below consensus for 47.1 and lower than the 46.9 recorded in May. The eighth consecutive reading below 50, the line that marks the difference between expansion and contraction. On a positive note, ISM Services Index recorded 53.9 in June (consensus was 51.2) and above the 50.3 recorded in May. This was the sixth month of expansion and was highlighted by 15 service industries reporting growth versus only three industries flagging contraction.
- US Non-Farm Payrolls increased by 209,000 in June, below the 306,000 increase recorded for May. US unemployment rate ticked 0.1% lower to 3.6% over June, in line with expectations.
- The third estimate for Q1 2023 US GDP (released late June by the US Bureau of Economic Analysis) was 2.0% quarter on quarter (QoQ, annualised), above expectations of 1.4% and solid increase from the original estimate of 1.1%.
- US headline consumer price index (CPI) increased 0.2% MoM (and marginally up from 0.1% MoM in May) and was 3.0% on a YoY basis (4.1% YoY in May).
- China's Caixin Manufacturing PMI recorded 50.5 in June, above expectations of 50, as there was a modest rise in manufacturing production over the month.
- Chinese GDP on a seasonally adjusted basis increased 0.8% QoQ, surpassing the 0.5% expectations, though a sharp drop from 2.2% in Q2 2023. On a YoY basis, this translated to 6.3% (vs. 4.5% for Q1 2023) as its Covid lockdown-impacted Q2 2022 quarter rolled off.
- Key European Area data indicated a technical recession with two consecutive quarters of negative 0.1% GDP growth after a revision to the Q4 2022 number. Expectations for Q1 2023 were +0.1% and revisions may yet see a flat to positive number.
- The preliminary estimate of 5.4% for European Core CPI over the year to June was slightly below expectations of 5.5% and only marginally below the cycle peak of 5.7% (March 2023).
- Euro Area unemployment rate remained static at 6.5% in May, a record low for the region.
- The Eurozone composite PMI dropped to 49.9 in June, below 50.3 expectations and has now ticked into contractionary territory. Both Manufacturing and Services PMIs for the region have fallen away with respective readings of 43.4 and 52.0.

Market Outlook

Looking ahead, we expect weak growth for the next few quarters for most of the developed world as central banks maintain a restrictive policy setting to temper inflation. We however do not believe that a hard landing is likely given the health of the household and corporate balance sheet. The one key bright spot remains China in our view where, despite disappointing economic performance recently, we expect policy to remain supportive and for economic conditions to improve.

In Australia, whilst economic conditions have held up well, we continue to believe that the risks to economic growth remains to the downside with the rise in mortgage rates and its impact on consumption the main likely driver. Meanwhile, we maintain our view for inflation to moderate this year, albeit the risks are for core inflation to decline more slowly than rapidly given the pressures in labour and residential rental markets, and consequently, we believe that the risks are that RBA maintains its cash rate higher for longer as they seek to manage these risks.

From an asset class perspective, we maintain a neutral view on global equities whilst persisting with a cautious bias given market pricing relative to potential downside macroeconomic risk. We also maintain a neutral view on Australian equities with a cautious bias as well in light of the risks to the domestic economic outlook, whilst we have a more favourable view of growth fixed income given the yields on offer.

Australian Equities

Australian shares were positive over Q2 2023 as the S&P/ASX 300 Index returned 1.0% for the period. The S&P/ASX Mid 50 Accumulation Index was the strongest segment of the market, returning 4.6% over the quarter. On the flipside, the S&P/ASX Small Ordinaries was the weakest of the local indices at -0.5%.

Best performing sectors were Information Technology (18.5%) and Utilities (5.5%), while weakest sectors were Healthcare (-3.1%) and Materials (-2.6%). The largest positive contributors to index returns were Xero (33.0%), James Hardie (26.1%) and Woodside (6.2%). On the other hand, significant detractors were BHP (-2.6%), CSL (-3.5%) and NAB (-3.6%).

Global Equities

The broad MSCI World ex-Australia Accumulation Index returned 7.3% in hedged terms and 7.6% in unhedged terms over the quarter, as the AUD weakened modestly against the USD and most major developed market currencies. Strongest performing sectors were Information Technology (15.4%) and Consumer Discretionary (11.4%), while Energy (flat) and Utilities (0.1%) underperformed on a relative basis. Other global share indices also produced positive results, such as the MSCI Small Caps Total Return Index (4.0%) and the MSCI Emerging Markets Accumulation Index (1.5%).

Over the June quarter, the S&P 500 Composite Index (8.7%), the Dow Jones Industrial Average (+4.0%) and the NASDAQ Composite Index (12.8%) were all well ahead in USD terms. European markets were mostly positive (in local currency terms), with CAC 40 (France, 3.5%) and DAX 30 (Germany, 3.3%) indices higher, while the FTSE 100 Index (UK, -0.3%) was down slightly. Equity returns were mixed across Asia. The SSE Composite (China, -2.2%), Hang Seng (Hong Kong, -6.0%) decreased, while the TOPIX (Japan, 14.4%) and S&P BSE 500 (India, 12.6%) increased, all in local currency terms.

Real Assets

Domestic listed property generated a positive performance over the June quarter and returned 3.2% (S&P/ASX300 A-REIT Accumulation Index). Global REIT's returned 1.2% (FTSE EPRA/ NAREIT Developed, in AUD hedged terms) over the period. The Australian unlisted property sector (NAV) produced a broadly flat return over the quarter (on a one month lagged basis) and the FTSE Global Core Infrastructure 50/50 Index returned -0.7% for the quarter (in hedged AUD terms).

Fixed Interest

Global sovereign bonds produced negative returns over the June quarter as 10-year bond yields increased in the US (33bps to 3.81%), Germany (12bps to 2.41%), Japan (7bps to 0.40%) and the UK (89bps to 4.38%). Two-year bond yields increased markedly in the US (79bps to 4.94%), the UK (182bps to 5.26%) and Germany (45bps to 3.19%), while decreasing marginally in Japan (-2bps to -0.08%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index returned -0.3% and the FTSE World Government Bond (ex-Australia) Index decreased by 0.7% over the June quarter, both on a fully hedged basis.

Domestically, yields across the curve rose substantially including the 10-year bond yield (73bps to 4.03%), five-year bond yield (92bps to 3.95%) and two-year bond yield (113bps to 4.20%). The Bloomberg Ausbond indices were broadly negative over the three months to June, with the Bloomberg Ausbond Bank Bill producing the highest quarterly return (0.9%), and the weakest being the Bloomberg Ausbond Treasury Index, returning -3.6%.

Currency Markets

The Australian Dollar (AUD) depreciated against most major developed market currencies over the June quarter with the US Dollar (-0.6%), Pound Sterling (-3.3%) and Euro (-1.0%). Against the trend, the AUD appreciated against the Japanese Yen (7.9%). On a trade-weighted basis, the local currency appreciated by 2.3% over the quarter.

Commodities

The S&P GSCI Commodity Total Return Index decreased by 2.1% over the quarter. Gold prices finished June at US$1,916.00 per ounce, falling 3.1% over the three months and at the bottom end of its recent trading range. Iron Ore prices were decidedly weaker, dropping 10.6% to US$113.50 per metric tonne over the period. Oil was another key commodity that fell over the quarter, down 6.6% to US$74.51 per barrel (Brent Crude).

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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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- The value of Gilts, bonds, and other fixed income investments including unit trusts can go down as well as up and you may not get back the amount you have invested.
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- For higher volatility investments, losses on realisation may be high because their value may fall suddenly and substantially.
- Where investments are not domiciled and regulated locally, the nature and extent of investor protection will be different to that available in respect of investments domiciled and regulated locally. In particular, the regulatory regimes in some domiciles are considerably lighter than others, and offer substantially less investor protection. Where an investor is considering whether to make a commitment in respect of an investment which is not domiciled and regulated locally, we recommend that legal advice is sought prior to the commitment being made.