Mercer

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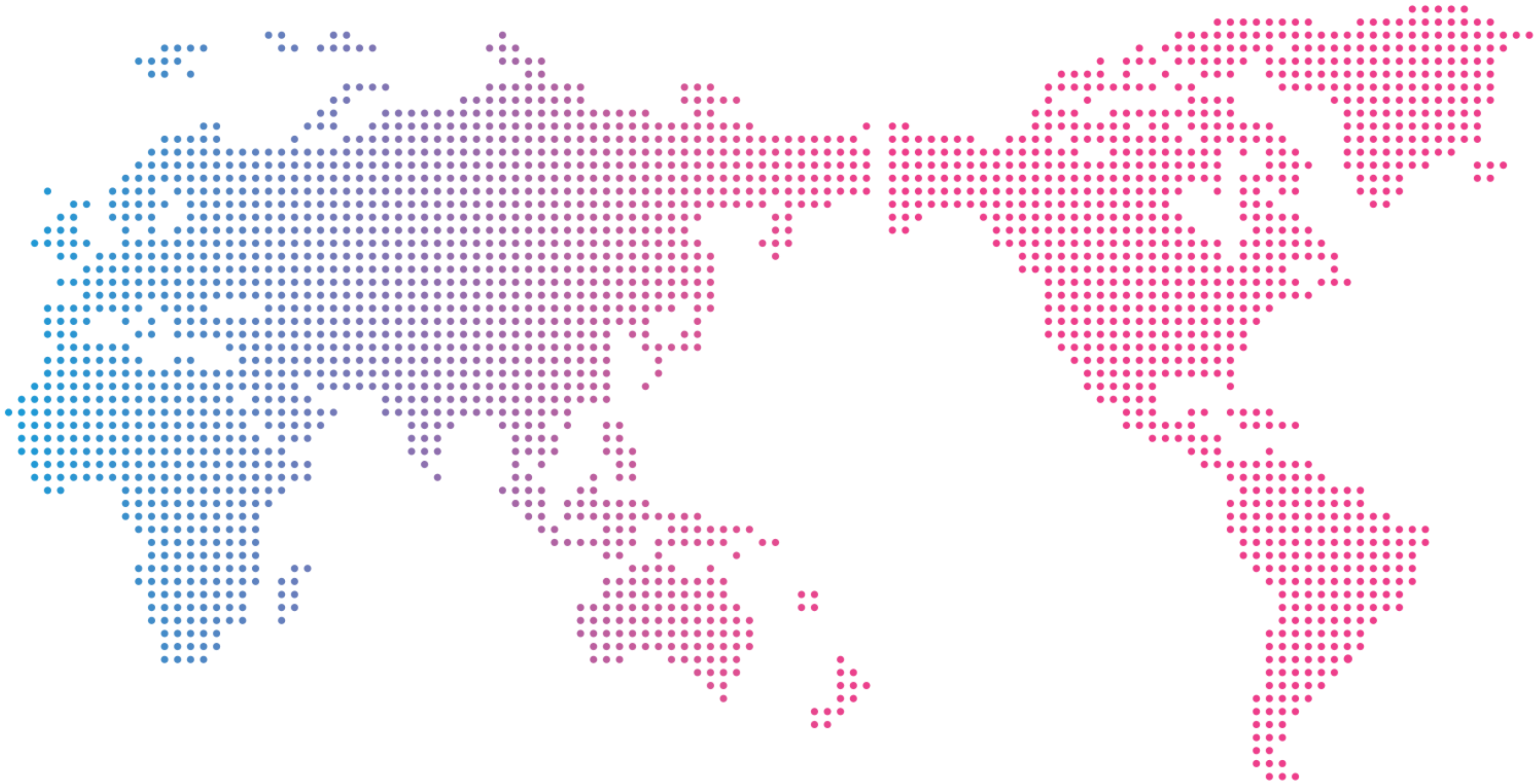
Market Review Quarterly

Q1 2024

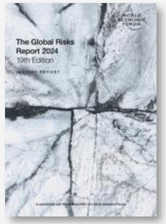


A business of Marsh McLennan

Key takeaways

- Regional economic divergences remained a theme with the US resilient and Europe weak.
- The US Federal Reserve (the Fed) and the European Central Bank (ECB) **kept interest rates unchanged** while guiding expectations for cuts later this year.
- Looking ahead, **we expect international growth to remain resilient** with the US to slow and China and other emerging economies to improve.
- Domestically, the risks to growth appear tilted to the downside relative to expectations.
- We prefer **emerging markets over developed markets** due to their more appealing valuations and promising economic prospects.
- We **favour Australian government bonds over cash** with signs growing that cash rates have peaked and more interest rate cuts are likely than priced in by markets.

AI governance



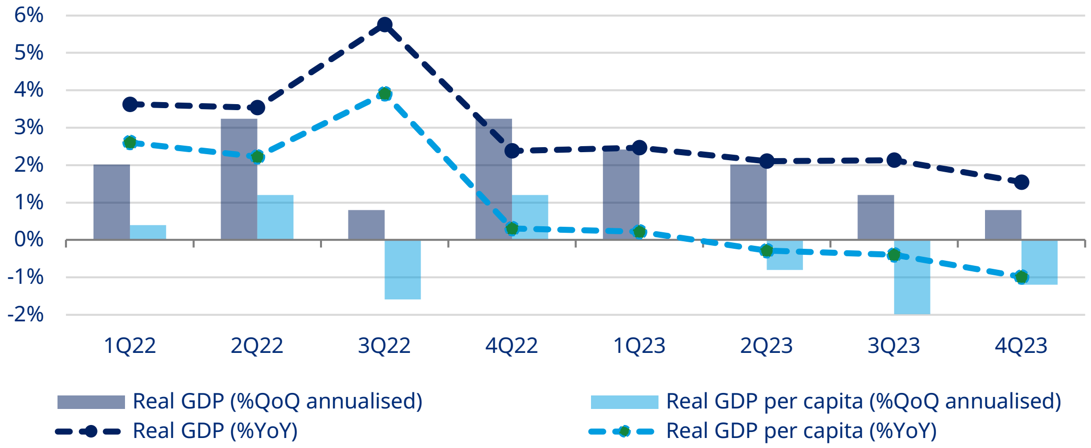
Global Risks Report 2024

Economic review

Australia: Signs of slowing emerging

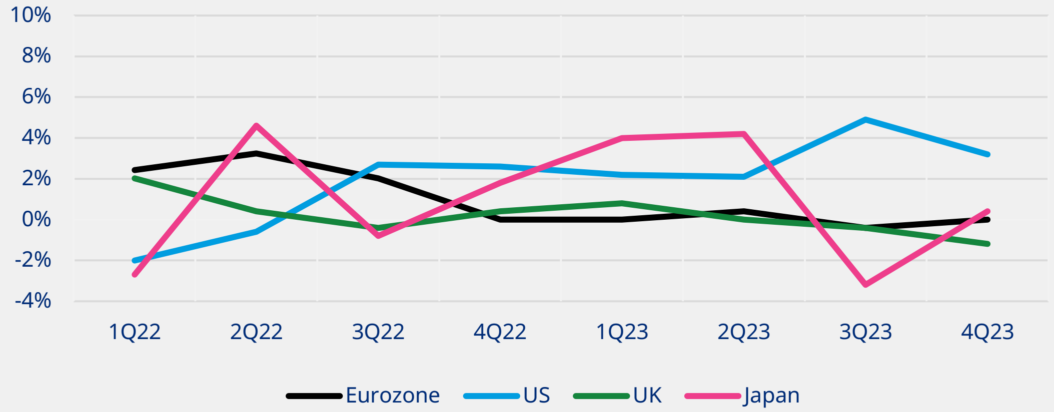
- Economic conditions have remained broadly resilient with the labour market remaining strong and business conditions holding up in most sectors.
- Q4'23 GDP was weak, with the underlying details suggesting that households are feeling the pinch with consumption down. Company insolvencies have also been rising, led by the construction sector.
- Despite encouraging signs for inflation, it remains above the Reserve Bank of Australia (RBA)'s 2-3% target.
- The RBA kept interest rates unchanged at 4.35% p.a., albeit its accompanying statement took a more neutral tone noting that it is "not ruling anything in or out".

Australian real GDP and real GDP per capita



Source: Bloomberg, Mercer; QoQ = Quarter-on-Quarter, YoY = Year-on-Year

US, Eurozone, UK and Japan Real GDP QoQ SAAR*



Source: Bloomberg, Mercer; *QoQ SAAR = Quarter-on-Quarter Seasonally Adjusted Annualised Rate

International: Divergent conditions across regions

- The **US** has remained resilient, with the services sector continuing to record growth whilst its manufacturing sector showed signs of recovering after a period of weakness.
- Conditions in **Europe** remain weaker with the UK entering a technical recession as of December quarter.
- **China's** growth has been lacklustre as weakness in the property sector continues to weigh on sentiment and activity. There are some signs of improvement in the services industries.
- The Fed and ECB kept interest rates unchanged, whilst the Swiss National Bank (SNB) became the first developed region central bank to cut interest rates, lowering its policy rate by 0.25% to 1.5% p.a.
- **Japan** raised interest rates for the first time in 17 years, raising its policy rate from -0.1% p.a. to 0.0-0.1% p.a. and terminating its Yield Curve Control program, whilst indicating that any further rate increases will occur slowly.

Market review

Equity markets had a strong start to the year

- **International shares** produced double digit returns for the March quarter with signs of resilient economic conditions and supportive rhetoric from central bankers.
- The Japanese market performed strongly on growing evidence that it's sustainably emerging from deflation.
- **Emerging markets** lagged, with Chinese equity markets weighed down by ongoing woes in its property sector.
- At a company level, Nvidia rose strongly amidst ongoing demand for chips, while Tesla and Apple weakened as sales slowed in China.

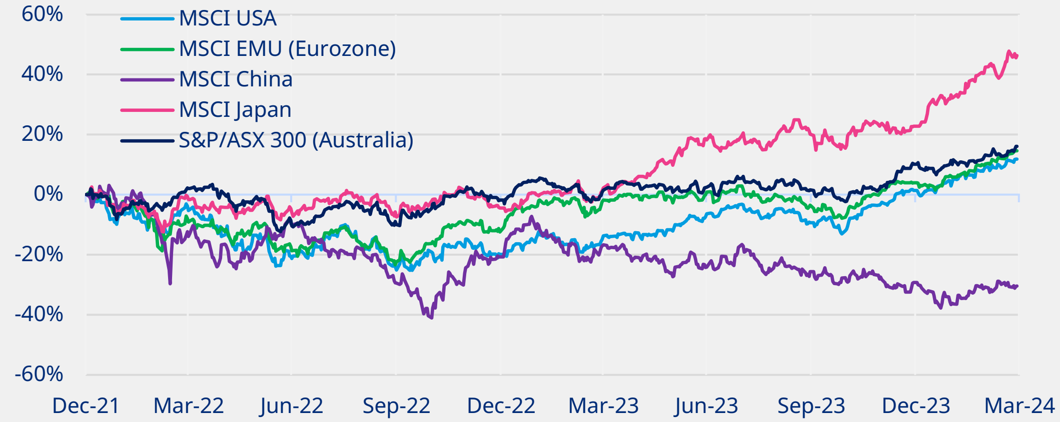
Bonds yields mostly higher

- **International government bond** yields ended the quarter higher with markets paring back expectations for interest rate cuts following the resilience in particular US economic data.
- **Australian government bond** yields were mixed, with the 2-year bond yield ending the quarter lower aided by the shift in the RBA's rhetoric to a neutral tone.

Commodity markets were broadly stronger

- **Gold prices** reached an all-time high on expectations of interest rate cuts, whilst oil prices rose following positive economic data and ongoing supply disruption concerns given Middle East tensions and OPEC+ supply cuts.
- **Iron ore** ended the quarter lower driven by rising inventory levels and the depressed Chinese property sector.

Cumulative equity market returns*



Source: Refinitiv Datastream, Mercer; EMU = Economic and Monetary Union* USA, EMU, China and Japan are net returns, whilst Australia is total return. Returns are shown in local currency terms.

Iron ore - US$ per tonne

Source: Bloomberg, Mercer

Market Insights

Australia: Potential downside risks ahead

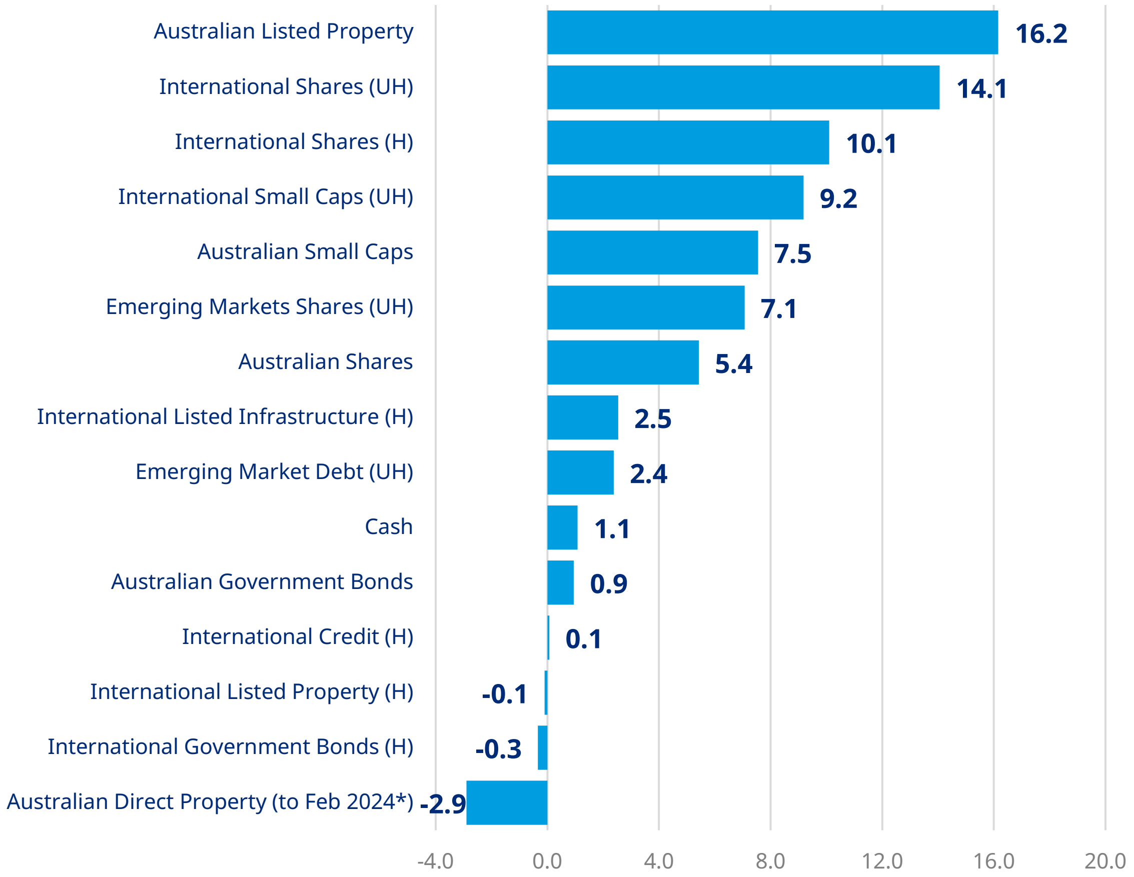
- We expect **growth to slow** as previous supportive factors such as (low) fixed rate mortgages and additional savings accrued over COVID-19 fades and the tighter monetary conditions begin to have a greater impact.
- **Inflation is likely to slow**, albeit less than other developed economies with pressures from the residential rental markets among the drivers.
- There is growing evidence that we have passed the peak in interest rates this cycle and the risks of a more pronounced slowdown in activity appears more likely than currently anticipated by markets.
- We have a favourable view of **Australian government bonds over cash** with signs growing that cash rates have peaked and more interest rate cuts likely than priced in by markets.

International: Emerging markets favoured over developed markets

- We expect growth to remain resilient but remain **regionally divergent**.
- We expect the **US to slow** yet remain resilient as the impact of higher interest rates and tighter financial conditions take their toll.
- We anticipate **stronger growth for the Eurozone** as manufacturing activity picks up and inflation slows, with conditions in Japan likely to strengthen as it emerges from a prolonged period of deflation.
- **Stronger growth is expected for China** driven by the supportive policy backdrop and the recovery in the manufacturing inventory cycle.
- Stronger growth is also likely in other **emerging economies** with their central banks better positioned to cut interest rates than in developed markets.
- We continue to **favour emerging markets over developed markets** due to more promising economic prospects and attractive valuations.

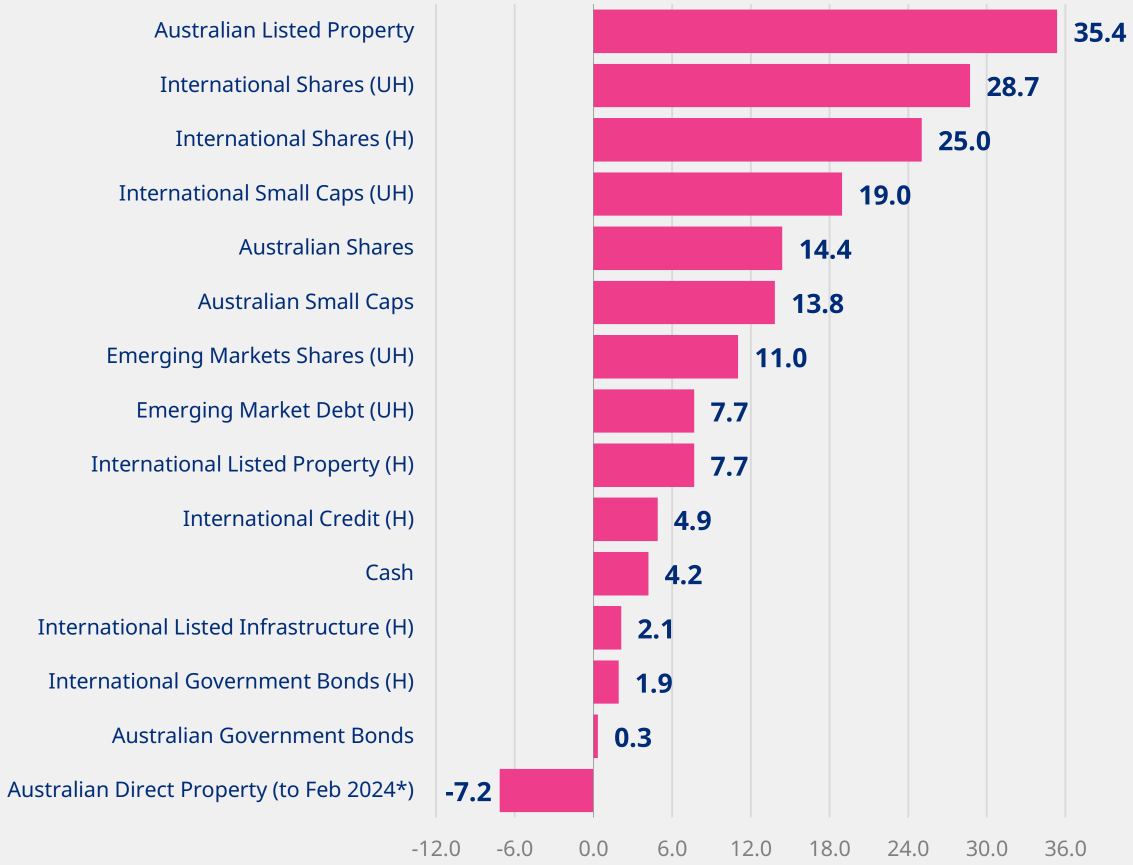
Performance

Market performance 3 Months to March 2024



Data source: Refinitiv Datastream; MSCI. Data provided 'as is'. Details on chart constituents can be found on back page.

Market performance 12 Months to March 2024



Data source: Refinitiv Datastream; MSCI. Data provided 'as is'. Details on chart constituents can be found on back page.

Asset class

▲ Australian equity

- Australian Shares returned 5.4% for the March quarter, supported by encouraging economic data releases and supportive central bank comments internationally.
- There was an undertone of cyclical outperformance with Consumer Discretionary (non-essential goods and services) performing well whilst Consumer Staples lagged. The Material sector was down for the quarter driven by softer iron ore prices.

▲ International equity

- International Shares had a remarkable quarter supported by positive momentum in economic data releases, the Fed and ECB still indicating cuts later this year, and with most US companies reporting Q4'23 earnings that exceeded consensus analyst estimates.
- The "Magnificent 7"[1] again performed, albeit with divergences growing within this group with Nvidia supported by demand for artificial-intelligence-supporting chips, while Tesla and Apple fell on news of slowing sales in China.
- Emerging markets lagged developed markets with China a key laggard, weighed down by negative headlines around its property developers.

[1] Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla

▼ ▲ Fixed interest

- International Government Bonds produced a negative return for the quarter, with markets paring back expectation for interest rate cuts this year following the resilience in recent economic readings.
- In contrast, Australian Government Bonds produced a positive return supported by a softening in the RBA's rhetoric from risks of potential hikes to risks being more balanced between hikes and cuts.

▼ ▲ Real assets

- The rise in government bond yields proved to be headwind for listed real assets, with International Listed Property and International Listed Infrastructure down for the quarter.
- Australian Direct Property was also softer driven by downward revaluations in response to the evolving economic environment and underlying fundamentals.
- In contrast, Australian Listed Property was strong with its main constituent, Goodman Group, rallying as investor optimism grew around its positioning in data centres.

▼ Currency

- The Australian dollar (AUD) ended the quarter lower against most major currencies, in part driven by the decline in iron ore prices and a change in the RBA's rhetoric.

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Chart Constituents

Asset class	Benchmark	Data type
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
International Shares (UH)	MSCI World ex Australia	Net Index
International Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
International Small Caps (UH)	MSCI World Small Cap	Net Return
Emerging Markets Shares (UH)	MSCI Emerging Markets	Net Index
Australian Direct Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian Listed Property	S&P/ASX 300 A-REIT	Total Return
International Listed Property (H)	FTSE EPRA/NAREIT Developed Hedged	Net Return
International Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Net Return
International 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
International Government Bonds (H)	Bloomberg Global Treasury Hedged	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

Notes

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

Important notices