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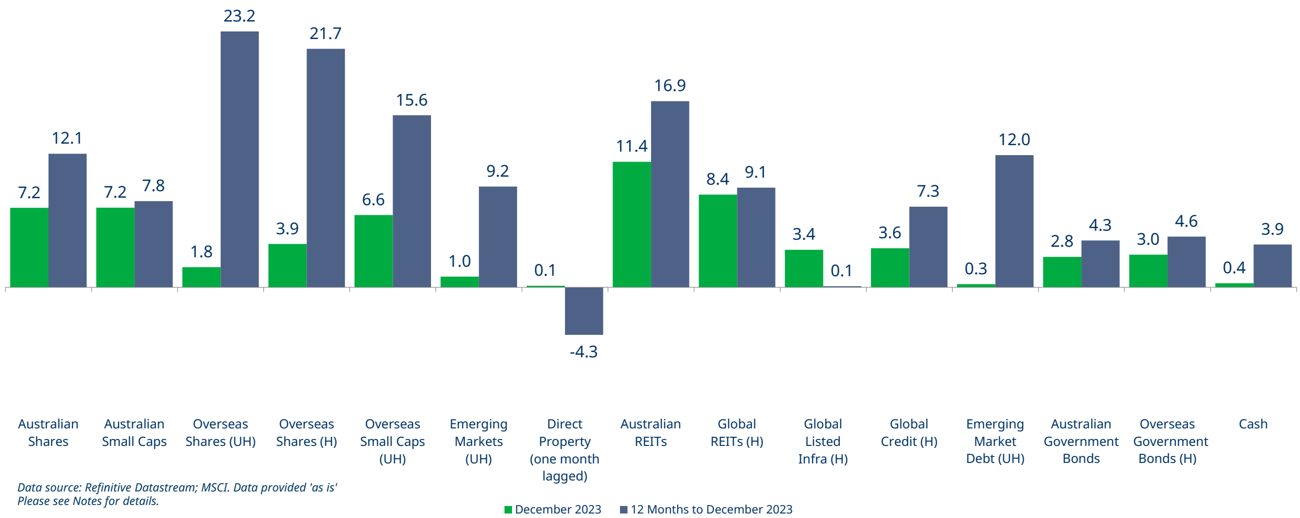
December 2023

Monthly market review

Asset class returns as at 31 December 2023



Economic overview

Economic data releases over the past month presented a varied picture for the Australian economy. The results of the latest NAB Business Survey continued to indicate resilience in business conditions, albeit with some easing evident, notably in the mining, transportation and utilities, and construction sectors. Meanwhile, house prices continued to rise, with a further 0.4% month-on-month (MoM) increase in December, resulting in a total of an 8.1% increase in 2023, supported by a tight labour market, population growth, and consumer resilience, but showing signs of slowing as a result of the lagged impact of high interest rates. On monetary policy, the Reserve Bank of Australia (RBA) left interest rates unchanged at its December meeting with the minutes from the meeting revealing that the board had considered the case for raising interest rates by 0.25%, but after evaluating the "encouraging signs" on inflation and the risk that unemployment could rise faster than expected, opted to keep interest rates at 4.35% p.a. and wait for more data.

Outside of Australia, data releases over the past month continue to show a mixed picture.

Business activity in the Eurozone remains weak, with surveys of both manufacturing and services companies showing slight signs of improvement in December but remaining in contraction territory. The inflation rate rose to 2.9% Year-on-Year (YoY) in December, primarily propelled by energy-related base effects, but the core inflation rate continued to cool to 3.4% YoY. In the US, economic data continues to remain resilient, particularly in the services sector, with the US Institute for Supply Management (ISM) Services Purchasing Manager's Index for December remaining in expansionary territory at 50.6, indicating positive growth, and the labour market remaining tight. On monetary policy, the Federal Reserve (Fed) kept interest rates steady at 5.25 - 5.50% p.a. for the third consecutive meeting at its December meeting with Fed Chair Jerome Powell noting that discussions of rate cuts had started. Meanwhile, the European Central Bank (ECB) also kept interest rates unchanged at their December meeting with ECB President Lagarde noting that "it was not the time to lower [our] guard" in the accompanying press conference.

Market review

Global equities rose in most regions over December, primarily driven by a decrease in bond yields, especially after the comment from the Fed Chair Jerome Powell noting that discussions of rate cuts had started. The Australian share market also followed this trend, with a notable increase of 7.2%. The rise in risk appetite and lower bond yields led to a strong performance in the Materials, Real Estate, and Healthcare sectors.

Government bond yields continued to decline in December, following more dovish signals from the US Federal Reserve, with the US 10-year government bond yield declining by 49bps to 3.87% p.a. Similarly, the Australian 10-year yield decreased by 52bps to 3.90% p.a., as the local market anticipates that the RBA will cut interest rates in 2024. This anticipation was backed by the weaker GDP data for Q3 and moderation in business confidence. The Australian dollar (AUD) appreciated against the weakening US dollar (USD), with the Fed's rhetoric shifting market expectations.

Commodity markets showed mixed performance in December. Oil prices continued its downward trajectory, dropping by 3.7% to its six-month low of US$77.69 per barrel in December, attributed to the weakening global demand and the strength of non-OPEC oil supply. Industrial Metals experienced a positive performance, with the Iron Ore prices strengthening by 7.5%, driven by the recent developments in the Chinese economy and the new support for China's housing market. Similarly, copper prices (S&P GSCI Copper) rose by 1.2% during the month, fuelled by optimism for further stimulus announcements in China and signs of improvement in factory activities in the country. In the precious metals sector, gold prices also rose by 1.36% to US $2,065.45, attributed to the weakening of the USD and the growing anticipation of interest rate cuts in 2024.

Market insights

Australia has experienced growth in recent quarters due to a number of factors, including households spending their excess savings buffer, an increase in population growth driven by immigration, a significant proportion of mortgages on (low) fixed rates, and government spending. However, looking ahead, we expect economic growth in Australia to moderate as these factors gradually diminish and the impact of higher interest rates becomes more pronounced. While overall inflation is set to slow and likely to slow more slowly than other developed economies largely due to the pressures from residential rental markets, the risks appear tilted towards a more severe slowdown in activity relative to expectations. This is most evident in current market pricing of interest rate expectations. At the time of writing the market was pricing in two interest rates cut in 2024 towards the end of the year, while we believe that more cuts are likely and sooner.

Globally we expect growth to remain resilient albeit regionally divergent. We continue to anticipate a moderation in economic conditions in major developed economies in the upcoming quarters, primarily due to expected tighter financial conditions and the impact of higher interest rates on households and businesses.

Meanwhile, we anticipate a period of stronger growth in China driven by supportive fiscal, monetary and regulatory policy measures, a turn in the manufacturing inventory cycle and a possible stabilisation in the housing sector, whilst we also anticipate growth in other emerging economies to be supported as their central banks ease their monetary policy settings.

From an asset class perspective, we maintain a cautious view towards developed markets due to their rich valuations and optimistic earnings outlook. We hold a favourable view towards emerging markets, as they offer attractive valuations and more promising economic prospects. In the domestic market, in light of our assessment of the relative risks around the market's expectations for interest rates, we find Australian Sovereign bonds to be attractive, albeit with risks persisting, given the volatility of global sovereign bond markets and their impact on our market.

Asset class comments

Australian Shares

Australian shares had a strong performance in December, with the S&P/ASX 300 Index returning 7.2%. This performance can be attributed to the market expectations shifting to reflect lower interest rates expected in 2024 and a soft landing of the US economy. Additionally, the shift in interest rate expectations for 2024 has led to support for small-cap stocks, resulting in the ASX Small Ordinaries index being up 7.2% over the period.

The positive market and interest rate outlook led to the outperformance of Materials stocks, with the sector returning 8.7% in December. Fortescue and James Hardie were among the names contributing to the sector's performance. Real Estate and Healthcare also continued to perform strongly, with returns of 11.4% and 9.1% respectively. CSL once again played a key role in the Healthcare sector, as investors considered whether the market had overestimated the adverse impact from GLP-1 diabetes and weight loss drugs. Meanwhile, Consumer Staples (5.1%), Energy (3.6%), and Utilities (2.5%) were among the worst performing sectors. This was due to investors rotating away from defensive stocks, and energy stocks lagging as oil prices continued to decline over the month.

Overseas Shares

The MSCI World ex Australia Index performed strongly in December, returning 3.9% in hedged terms and 1.8% in unhedged Australian Dollar (AUD) terms. Positive global equity market sentiment was boosted by the rapid repricing of interest rate cuts in the US in 2024, combined with softer inflation data from around the world. This has reinforced investor views that a soft landing of the global economy is more likely in 2024.

The US was the largest contributor to the index performance, despite the US Dollar weakening against the AUD during the period. The Materials (3.1%) and Industrials (4.5%) sectors had positive returns over the month, with Real Estate (5.4%) delivering the strongest return as investor appetite for interest rate-sensitive assets increased and bond yields declined.

Conversely, the Energy (-3.0%) and Consumer Staples (-0.3%) sectors were the only two sectors with a negative return for the month. This was due to a decline in oil prices for three consecutive months, as well as investors reallocating from defensive stocks.

The MSCI Emerging Markets Index also had a positive return in December (1.0%), but it continued to lag behind developed global equity markets. China's equity markets, as measured by the SSE Composite (-1.8%), underperformed by a considerable margin compared to most other countries. The performance was primarily driven by investor concerns about the country's economic recovery, which weighed on sentiment.

From a country perspective, the risk-on sentiment was evident in the outperformance of the US market, with the S&P 500 Index (4.5%), the Dow Jones Industrial Average (4.9%), and the NASDAQ Composite Index (5.5%), all up in USD terms. Similarly, European markets were mostly positive (in local currency terms), with the CAC 40 (France, 3.3%), DAX 30 (Germany, 3.3%), and FTSE 100 Index (UK, 3.9%) all performing strongly over the month. Equity returns were mixed across Asia, with the Hang Seng (Hong Kong, 0.2%) and Topix (Japan, -0.2%) broadly flat while the S&P BSE 500 (India, 8.0%) experienced a positive return in local currency terms, with investor appetite remaining supportive in light of its strong economic performance. It was a more challenging month the SSE Composite (China, -1.8%) however with market participants remaining unconvinced by the tentative signs of improving economic momentum in the country.

Real Assets

Domestic listed property (S&P/ASX 300 A-REIT Accumulation Index) experienced a significant increase of 11.4% in December and Global REITs (FTSE EPRA/NAREIT Developed, in AUD hedged terms) rose by 8.4%. Positive returns for both indices were driven primarily by growing expectations for softer monetary policy settings and interest rates cuts in 2024, which is largely seen to be beneficial for real estate earnings and property valuations.

The FTSE Global Core Infrastructure 50/50 Index returned 3.4% in December (in hedged AUD terms). Similarly, the Australian unlisted property sector (NAV) saw a 0.2% total return in November, primarily comprised of income return. No significant capital movements were recorded in November, with the next valuation cycle in December 2023 expected to yield more material capital movements.

Fixed Interest

Global sovereign bond performance was mostly positive in December. The yields on 10-year bonds decreased in the US (-49bps to 3.87% p.a.), Germany (-42bps to 2.03% p.a.), the UK (-63bps to 3.57% p.a.), and Japan (-6bps to 0.62% p.a.). The yields declined as market expectations of central banks starting to cut interest rates soon were reinforced by economic data and central banks themselves. In the US, Powell noted that the Fed is starting to discuss interest rate cuts, whilst in the Eurozone, data momentum has remained weak. In the UK, economic growth data was revised down and inflation in November softened, further supporting the overall rally in markets.

On the other hand, the Bank of Japan kept interest rates unchanged, while the market expectations of rate hike this year remained.

The FTSE World Government Bond (ex-Australia) Index and the Bloomberg Global Aggregate Bond Index both returned 3.0% in December on a fully hedged basis. Credit spreads decreased over the month, which can be partially explained by shifting expectations among market participants for a soft landing being the probable scenario for the US economy.

Domestically, bond yields across maturities declined in line with global bond markets, resulting in a fall of -52bps in the Australian 10-year bond yield for the month, bringing it to 3.90% p.a.. Consequently, the Bloomberg Ausbond Treasury Index gained 2.8%. The domestic credit market, as tracked by the Bloomberg Ausbond Credit Index, also experienced gains of 2.1% during the month. The decline in bond yields in the local market was explained by the market expectations of the RBA cutting interest rates in 2024. This anticipation was supported by weaker GDP data for Q3 and moderation in business confidence.

Currency Markets

The AUD appreciated against most major developed market currencies in December. The AUD was stronger against a weakening US Dollar (2.9%) as mixed US data shifted market expectations, pricing in an end to the Fed's tightening cycle, which is supportive for risk sentiment-based currencies like the AUD.

Furthermore, the RBA's decision to hold interest rates steady at a 12-year high of 4.35% p.a. in its December meeting, coupled with the increase in prices for Australia's commodity exports, has contributed to the upward movement of the Australian dollar. Consequently, the AUD appreciated against the UK Pound (2.2%) and Euro (1.6%), and on a trade-weighted basis, the local currency exhibited a 1.8% increase in December. However, the AUD witnessed depreciation against the Yen (-1.9%).

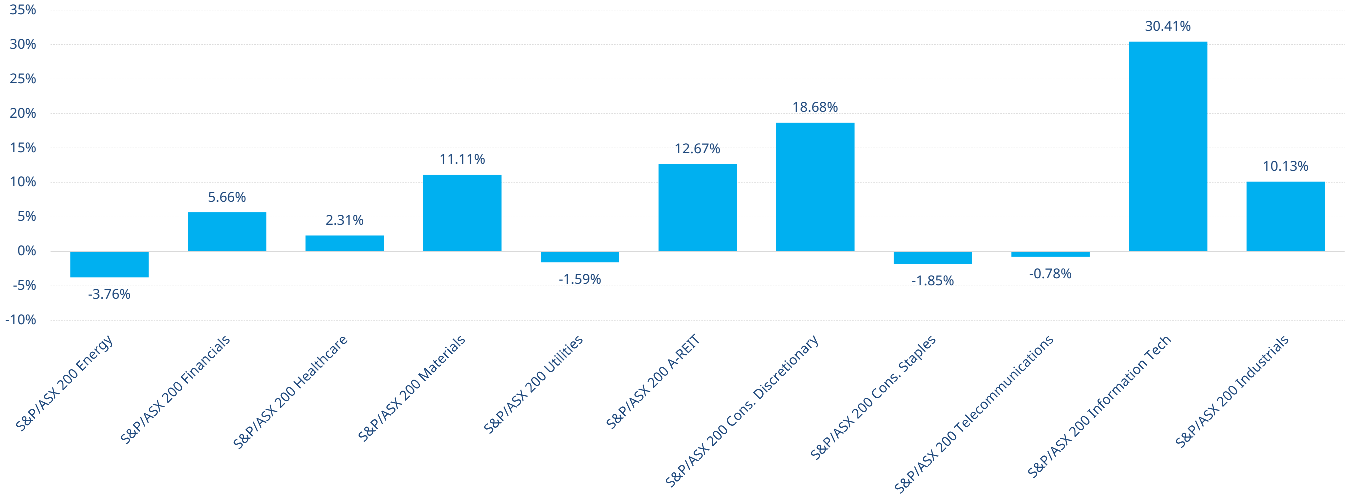
Commodities

The S&P GSCI Commodity Total Return Index experienced a decline of -6.0% in December. The energy sector, specifically oil prices (measured by Brent Crude), played a significant role in this decline, dropping by 3.7% to US$77.69 per barrel. The decline in price was attributed to the weakening global oil demand, which was influenced by the continued weakness in industrial fuels, LPG and lower seasonal uptake in heating oil in light of a milder winter, coinciding with the strength of non-OPEC+ supply. Despite the extension of OPEC+ output cuts, oil price remained relatively unaffected and continued to decline, reaching the lowest level since July 2023.

Meanwhile, Industrial Metals ended the month of December higher. Iron Ore ended the month higher by 7.5%, largely driven by recent developments in the Chinese economy and the new support for China's housing market. Similarly, copper prices (S&P GSCI Copper) rose by 1.2% over the month due to optimism around the prospects for further stimulus measures in China and signs of improvement in factory activities in the country. Furthermore, gold prices increased by 1.36% to US $2,065.45 per ounce, attributed to the weakening in the USD and the growing anticipation of interest rates cuts in 2024.

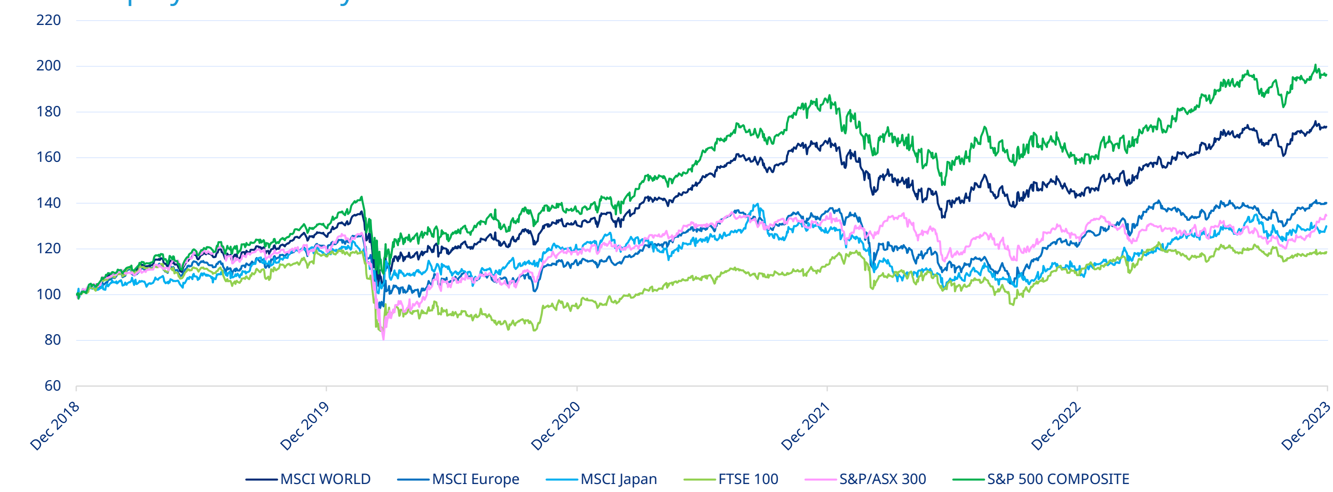
Market charts

ASX Sector Returns - Rolling 12 months



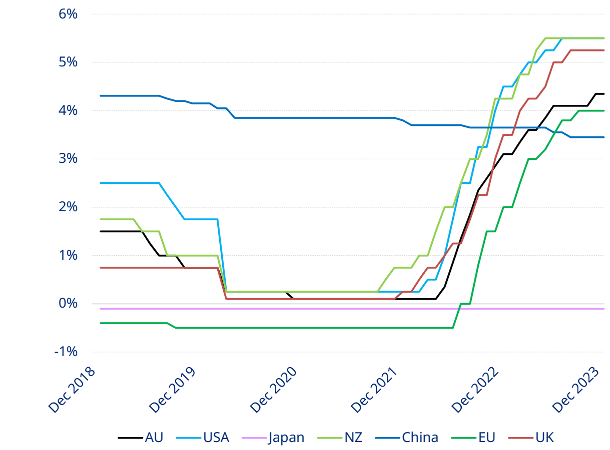
Source: S&P Global

Global Equity Indices - 5 years



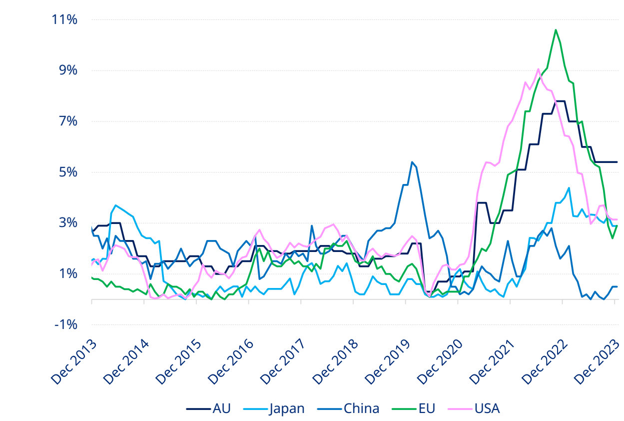
Source: MSCI, Refinitiv DataStream (Rebased to 100. All returns denominated in AUD).

Central Bank Policy Rates - 5 years



Source: Bloomberg

Inflation - 10 years



Source: Refinitiv, Australian Bureau of Statistics, Ministry of Internal Affairs & Communication (Japan), National Bureau of Statistics of China, Eurostat, Bureau of Labor Statistics, U.S. Department of Labor

Market data - December 2023

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 300 Accumulation	7.22%	8.36%	12.13%	8.99%	10.27%
S&P/ASX 300 Industrials Accumulation	7.02%	8.44%	12.18%	7.21%	8.69%
S&P/ASX 300 Resources Accumulation	7.73%	8.15%	12.06%	14.29%	15.49%
S&P/ASX 300 Accumulation A-REIT	11.40%	16.50%	16.90%	5.88%	6.39%
S&P/ASX Small Ords Accumulation	7.23%	8.52%	7.82%	0.95%	6.40%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia Unhedged in $A	1.83%	5.31%	23.23%	11.79%	13.58%
EPRA/NAREIT Developed Index Hedged A$	8.24%	12.71%	7.90%	1.72%	1.92%
STOXX Europe 600 Total Return	3.77%	6.39%	12.73%	6.28%	7.24%
S&P 500 Total Return	4.54%	11.69%	26.29%	10.00%	15.69%
Nikkei 225 Total Return	0.09%	5.23%	30.96%	8.98%	13.07%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.37%	1.06%	3.89%	1.71%	1.40%
Bloomberg AusBond Composite (0+Y)	2.69%	3.79%	5.06%	-2.69%	0.64%
Barclays Global Aggregate TR Hedged A$	3.02%	5.43%	5.31%	-3.11%	0.49%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	98.6460	-3.10%	-5.91%	-12.55%	8.12%	5.16%
Generic Brent Crude Oil	77.04	-6.99%	-19.17%	-10.32%	14.15%	7.45%
Generic WTI Crude Oil	71.65	-5.67%	-21.08%	-10.73%	13.88%	9.55%
Gold US$/oz	2062.98	1.30%	11.60%	13.10%	2.81%	9.97%
Iron Ore	131.8	5.16%	12.80%	18.02%	-4.84%	13.30%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.6812	3.13%	5.86%	-0.01%	-3.98%	-0.68%
EUR/USD	1.1039	1.39%	4.41%	3.12%	-3.32%	-0.76%
USD/JPY	141.04	-4.83%	-5.58%	7.57%	10.96%	5.16%
GBP/USD	1.2731	0.85%	4.36%	5.36%	-2.34%	-0.04%

Source: Bloomberg

Contact: Mercer

Email: merceradvisersolutions@mercer.com

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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