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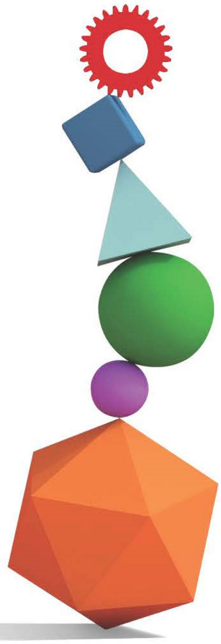
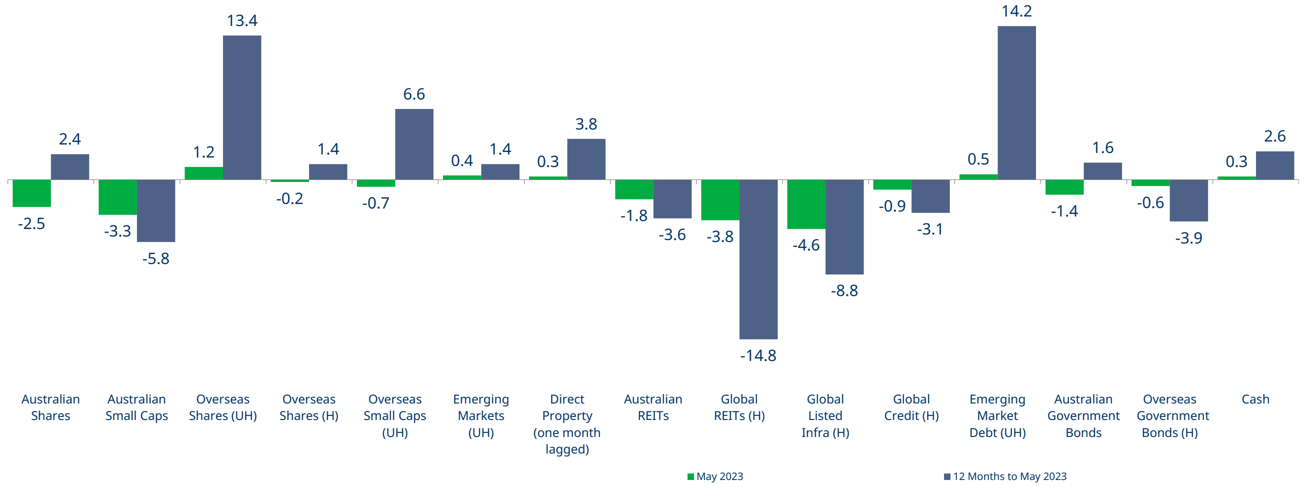
May 2023

Australian monthly market review

Selected market indicators commentary



Asset class returns as at 31 May 2023



Data source: Refinitiv Datastream; MSCI. Data provided 'as is'
Please see Notes for details.

Market recap

In May, risk asset returns in developed markets were mostly negative, bonds and real assets also generally declined. Emerging market equities returns were marginally positive.

News flow during May focused predominantly on the debt ceiling deadline looming in early June. Overall, the market impact has been fairly limited, although ratings agencies have placed US credit on watch for potential downgrades. The challenges facing regional banks in the US continued to be a major topic in early-May with regulators brokering a deal for JP Morgan to purchase First Republic Bank. However, the sell-off in shares of other vulnerable banks continued along with sizable deposit outflows.

Economic data in general remained resilient. US unemployment rose slightly in May but remains at historically low levels, although, other indicators such as wage growth show that the labour market is gradually cooling. Forward-looking purchasing manager indices remain in expansion territory across most major regions, with strength in services outweighing weakness in manufacturing. In spite of economic resilience, headline inflation continued to decline in most major economies with it falling to just under 5% in the US. Inflation in Japan rose to 3.5%, which is high by historical standards, but still lower than in other developed countries. In the UK and Eurozone, inflation remains more resilient, but also on a downward trajectory. Inflation in China remains low amid a slow and developing expected economic recovery.

Rate markets continue to grapple with the question of how long monetary policy will remain tight. The bond market is pricing in an initial rate cut toward the end of this year or early next year, but US Fed officials have generally cast doubt on that timeline. Credit spreads moved slightly higher during the month. Issuance is coming back after a slowdown earlier in the year when the first signs of distress emerged among US regional banks.

Over May, Hedged Developed Markets Overseas Shares returned -0.2%, equity volatility increased moderately over the month, with one spike early in the month due to renewed banking concerns and another spike later in the month amid debt ceiling negotiations. Earnings season for Q1 2023 is coming to an end, with a second consecutive quarterly decline. Equities markets have seen through weaker earnings so far as attested by strong year to date returns for Overseas Shares. Over the month, it was notable that growth outperformed value by a large margin, in spite of rising yields. A couple of contributors included optimism over developments in A.I. favouring growth stocks, while more cyclical sectors that dominate value indices lagged. Emerging Markets Shares (UH) gained 0.4%, as poor performance in China offset positive performance in other major emerging economies.

Hedged Overseas Government Bonds returned -0.6% over the month as bond yields generally increased during May. In the US, the 10-year bond yield rose by 22bps, while the 30-year yield was up by 18bps. In developed markets outside the US, 10-year yields rose by 8bps for Japan and 46bps for the UK, while falling 3bps for the Eurozone. US inflation expectations, as measured by the 10-year inflation breakeven rate, fell 3bps to 2.2%.

Australian Shares returned -2.5%, underperforming their overseas counterparts in May. IT (10.4%) and Utilities (1.1%) were the strongest sectors, meanwhile Consumer Discretionary (-6.2%), and Consumer Staples (-4.5%) were the largest detractors.

Significant Developments

- Australian seasonally adjusted employment decreased by 4,300 in April, below expectations for an increase of 25,000 and above the prior month’s decrease of 53,000. The unemployment rate increased to 3.7%, above expectations of 3.5%. The participation rate remained at 66.7%, inline with expectations. Part time jobs increased by 22,800 and full time jobs decreased by 27,100.
- Australian building approvals decreased by 8.1% month-on-month to April, compared to the decrease of 1.0% (revised) for March.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 46.9 in May, below consensus for 47.0 and below the 47.1 recorded in April. Of the four manufacturing industries that reported growth in May, the top performers were Non-metallic Mineral Products and Furniture & Related Products. There were 14 industries that recorded contraction in May compared to April.
- The ISM Services Index recorded 50.3 in May, below consensus for 52.4 and below the 51.9 recorded in April. Of the 11 services industries that reported growth, the top performers were Accommodation & Food Services and Management of Companies & Support Services. There were seven industries that reported a decrease in the month of May.
- US Non-Farm Payrolls increased by 339,000 in May, above the 253,000 increase recorded for April. The unemployment rate increased to 3.7% over May, above expectations of 3.5%.
- US GDP second estimate for Q1 2023 is 1.3% quarter on quarter (QoQ) annualised, above expectations of 1.1%.
- The Caixin Manufacturing PMI in China recorded 50.9 in May, above expectations of 49.5, as manufacturing output growth improves to 11-month high.
- The preliminary estimate of the European Core CPI recorded 5.3% over the year to May, below expectations of 5.5%.
- The Eurozone composite PMI increased to 52.8 in May, below expectations for 53.3.
- The Q1 2023 Eurozone seasonally adjusted GDP is -0.1% QoQ and 1.0% YoY.

Market Outlook

Looking ahead, our base case outlook is for weak growth over the next few quarters for most of the developed world as the monetary policy tightening to date take their toll. Whilst we believe that central banks are likely to maintain interest rates at a level that ensures growth is below trend, we believe that a hard landing is unlikely given the healthy state of household and corporate sector balance sheets. China remains the key exception, and we believe that the post COVID rebound is likely to continue in the near term.

Domestically, a mild recession outcome remains our base case in the near term with the high level of indebtedness and the significant rise in mortgage rates to date likely to weigh on consumption. Whilst we expect inflation in Australia to moderate this year, the pressures in the residential rental and services markets tilts the risk for core inflation to decline more slowly than more rapidly in our view, and consequently we believe that the risks are that the RBA cash rate remains higher for longer as the RBA seeks to manage these risks.

Against this backdrop, we maintain a neutral view on global equities albeit with a cautious bias with markets appearing to price in a benign macroeconomic outcome despite the downside macroeconomic risks. We also retain a neutral view with a cautious bias for Australian equities, whilst within fixed income, we maintain a preference to growth fixed income given the yields on offer.

Australian Shares

The Australian share market underperformed its hedged overseas counterpart over the month as the S&P/ASX300 Index returned -2.5%. The S&P/ASX Mid 50 Accumulation Index was the strongest relative performer, generating a flat return, while the S&P/ASX Small Ords was the weakest, returning -3.3% over the month.

The best performing sectors were IT (10.4%) and Utilities (1.1%), while the weakest performing sectors were Consumer Discretionary (-6.2%) and Consumer Staples (-4.5%). The largest positive stock contributors to the index return were CSL, Woodside Energy and Xero with absolute returns of 2.0%, 2.8% and 17.8%, respectively. In contrast, the most significant detractors were NAB, BHP and Westpac with absolute returns of -9.5%, -4.6% and -7.5%, respectively.

Overseas Shares

The broad MSCI World ex Australia Accumulation Index returned -0.2% in hedged terms and 1.2% in unhedged terms over the month as the AUD depreciated against the USD and GBP. In AUD terms, the strongest performing sectors were IT (10.5%) and Communication Services (5.8%), while Energy (-8.4%) and Materials (-5.2%) were the weakest performers.

In AUD terms, the MSCI Small Caps Total Return Index was down by 0.7%, while the MSCI Emerging Markets Accumulation Index was up by 0.4% over May.

Over the month, the S&P500 Composite Index (0.4%) and the NASDAQ (5.8%) increased, while the Dow Jones Industrial Average declined (-3.2%), all in USD terms. In local currency terms, for the major European share markets the DAX 30 (Germany) (-1.6%), the CAC 40 (France) (-3.9%) and the FTSE 100 (UK) (-4.9%) all decreased. In Asia, the Hong Kong Hang Seng (-7.9%) and the Chinese SSE Composite (-3.6%) decreased, while the Japanese TOPIX (3.6%) and the Indian S&P BSE 500 (3.5%) increased, all in local currency terms.

Real Assets

The listed real assets sector produced negative returns over May. Over the month the FTSE EPRA/NAREIT Developed (Global REITs) decreased by 3.8%, and the FTSE Global Core Infrastructure 50/50 Index returned -4.6% (both in AUD hedged terms). The S&P/ASX 300 Industry Group: A-REIT (Domestic REITs) decreased by 1.8% over May, whilst the MSCI/Mercer Australia Core Wholesale Monthly PFI NAV Post Fee (Australian Direct Property) returned 0.3% (on a one month lagged basis).

Fixed Interest

Global bond markets generated a negative return over May with the Barclays Capital Global Aggregate Bond Index (Hedged) returning -0.5% and the FTSE World Government Bond (ex-Australia) Index (Hedged) returning -0.6%. Most ten-year bond yields moved higher over the month, increasing in the UK (46bps to 4.18%), the US (22bps to 3.65%), and Japan (8bps to 0.43%), while decreasing in Germany (-5bps to 2.27%). Two-year bond yields were mixed over the month, increasing in the UK (55bps to 4.33%) and the US (44bps to 4.54%) while decreasing in Germany (-9bps to 2.70%) and Japan (-1bp to -0.06%).

Returns for most Australian bondholders were negative over May as 10-year bond yields (28bps to 3.61%), five-year bond yields (31bps to 3.38%) and two-year bond yields (48bps to 3.56%) increased.

Currency Markets

The AUD Trade Weighted Index remained unchanged at 59.8 over May. The AUD depreciated against the US Dollar (-2.1%) and the Pound Sterling (-0.7%), while appreciating against the Euro (1.4%) and the Japanese Yen (0.5%).

Commodities

Iron Ore decreased by 4.8%, finishing the month at US$100.00 per metric tonne. The S&P GSCI Commodity Total Return Index decreased by 4.1% over the month. Gold prices decreased by 1.0% to US$1,971.45 per ounce and the oil price decreased by 8.0% to US$73.18 per barrel over May.

Contact: Mercer IS

Tel: 1800 512 947
Email: merceris@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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- Investments denominated in a foreign currency will fluctuate with the value of the currency.
- Past performance is not an indication of future performance. The value of investments in real estate can go down as well as up, and you may not get back the amount you have invested. Valuation is generally a matter of a valuer's opinion, rather than fact. It may be difficult or impossible to realise an investment because the property concerned may not be readily saleable.
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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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