Mercer

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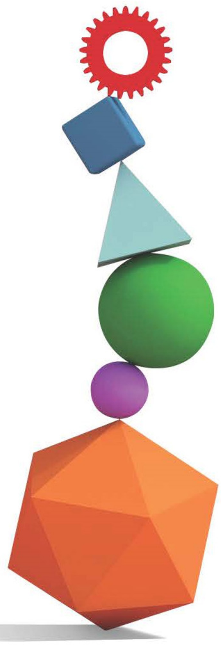
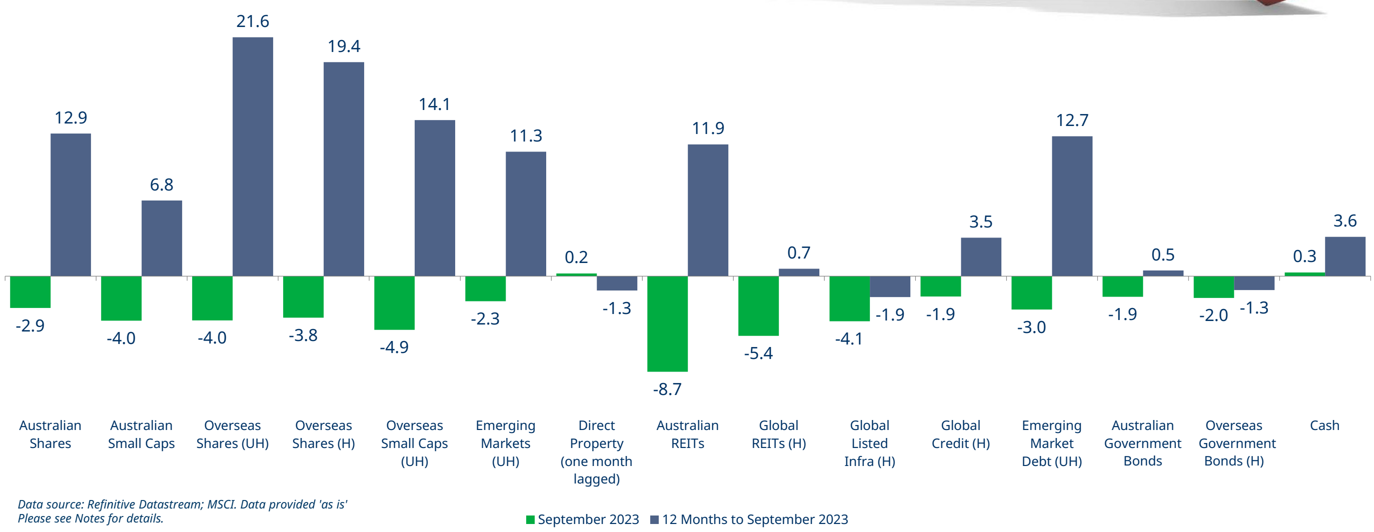
September 2023

Monthly market review



Asset class returns as at 30 September 2023



Economic overview

In Australia, short term economic indicators were mixed. Business activity across the services sector expanded in September, whilst the manufacturing sector remains contracted. Persistent growth in housing prices (0.9% month-on-month (MoM)), a tight labour market and positive wage pressures have helped support an increase in consumer spending. Notably, inflation reportedly moved higher to 5.2% p.a. in August, up from a 4.9% p.a. in July. While Core CPI, excluding food and energy, showed further softening to 4.5% p.a. in September, down from 5.3% p.a. in August, reaching its lowest level since August 2022. As a result, the Reserve Bank of Australia (RBA) left interest rates steady at 4.1%, noting the need to consider the implications of further lagged effects from previous increases in interest rates on household spending and inflation.

Recent data releases show a softening trend in growth across developed economies. In the US, activities across the manufacturing sector remained subdued, with the US Institute for Supply Management (ISM) Manufacturing PMI for September staying in contractionary territory, though edging up marginally from 47.6 in August to 49.0. Meanwhile, the US ISM Services index, whilst still in expansionary territory slightly retreated to 53.6 in September, down from August's six-month high of 54.5. Inflation in the US increased slightly to 3.7% p.a. in August, from 3.2% p.a. in July. Core inflation, while still elevated, fell to 4.3% p.a. in August, down from 4.7% in July. Labour market indicators remained resilient in September, with the unemployment rate holding steady at 3.8%, and average hourly earnings increasing by 4.2% p.a.

Economic activity in other regions, such as the Eurozone, has slowed down, as both the Manufacturing (at a level of 43.4) and Services PMIs (at a level of 48.7) remained in contractionary territory for September. Inflation in Europe continued to moderate, subsiding to 5.2%, with core inflation falling to 5.3% annually in August.

At their August meeting, the US Federal Reserve (Fed) decided to keep rates unchanged at 5.25%. Fed Chair Jerome Powell continued to reiterate that they will do whatever it takes to bring inflation back in line with the Fed's 2.0% target. Interest rates in Europe moved higher to 4.5%, though the European Central Bank (ECB) was more dovish, signalling a likely pause in interest rates going forward.

Market review

In September global equities (-3.8%) trended down in most regions, mainly driven by the US Fed signalling no immediate end in the current high level of US rates at its August meeting: with the Information Technology and Utilities sectors the notable underperformers. The Australian share market also declined (-2.9%) despite the RBA keeping interest rates unchanged. Notable declines for the Australian market were within Information Technology, Health Care and Telecommunications sectors.

Worldwide, government bond yields continued their upward path following the re-setting of higher US interest rate expectations. The Australian 10-year government bond yield increased by 46 basis points to 4.5%. Similarly, the US 10-year government bond yield increased by 47 basis points to 4.6%, the highest level since 2007. The move higher in US yields resulted in a stronger USD with the Australian dollar (AUD) depreciating to around 64 US cents. Commodities were mixed with oil prices up 9.7% to US$95.31/barrel, following supply cuts announced by the Organization of the Petroleum Exporting Countries (OPEC). Iron Ore prices were also stronger (1.7%) following some supply disruptions, while gold and copper prices fell over the month (-4.8% and -2.2% respectively), as Chinese demand continued to soften.

Market insights

Looking ahead, in Australia we continue to expect economic conditions to moderate in the coming quarters as the impact of higher interest rates flow through to households. While inflation may ease over the year, it is expected to remain elevated given tight labour and housing markets.

Elsewhere, we expect modest growth in other major developed economies as financial conditions are expected to remain tight. We don't foresee a severe economic downturn as both household and corporate balance sheets remain healthy, for now. In China, we continue to believe authorities have room to implement additional targeted stimulus measures in the absence of inflationary pressures. Thus, our outlook for the region remains optimistic.

From an asset class perspective, we continue to maintain a cautious view on equities, however see attractive relative value opportunities across regional equity markets. Current market valuations appear to reflect a relatively optimistic short-term economic outlook, despite potential downside risks. We have a favourable view of emerging markets in comparison to developed markets, notably to US equities, based on attractive relative valuations and an optimistic macroeconomic outlook. We also have a slight preference for emerging market debt, given its relatively higher yields and prospects for further interest rate cuts likely across the regions.

Asset class comments

Australian Shares

Australian shares declined in September, the S&P/ASX 300 Index returning -2.9%, following a softening in risk sentiment from global markets over the period. The S&P/ASX Mid 50 Ordinaries was the weakest segment of the local indices returning -4.6% in September.

The best performing sector for the month was Energy (2.2%), following a rebound in oil prices, after OPEC cut its daily production target. The Information Technology sector underperformed (-7.7%), driven by a sell-off in global tech stocks given concerns surrounding the potential impact of a sustained higher level of US interest rates. The negative investor sentiment also impacted Real Estate (-8.7%) and Healthcare (-6.4%), both of which were fuelled by worries regarding consumers' ability to withstand higher levels of inflation and interest rates. The largest positive contributors to index returns were BHP (-0.9%), ANZ (1.8%) and NAB (0.8%). Significant detractors included CSL (-8.2%), Goodman Group (-8.1%), and James Hardie (-12.1%) for the month.

Overseas Shares

The broad MSCI World ex-Australia Accumulation Index returned -3.8% in hedged terms and -4.0% in unhedged terms in September as the AUD weakened against the USD but strengthened against other major developed market currencies. The strongest performing sector was Energy (3.1%), while Information Technology (-6.5%), Real Estate (-6.1%) and Utilities (-5.3%) underperformed in September. The S&P Developed Ex-Australia LargeMidCap G Index (-5.3%) and emerging markets declined in September (-2.3%, MSCI Emerging Markets Index).

In September, the S&P 500 Composite Index (-4.8%), the Dow Jones Industrial Average (-3.4%), and the NASDAQ Composite Index (-5.8%) all declined in USD terms, in light of growing investor caution, prompted by the resurgence of oil prices, an uptick in inflation, and hawkish Fed commentary. Similarly, European markets were mostly negative (in local currency terms), with the CAC 40 (France, -2.4%) and DAX 30 (Germany, -3.5%) indices lower, while the FTSE 100 Index (UK, 2.4%) recorded an increase. Equity returns were mixed across Asia. The SSE Composite (China, -0.3%) and Hang Seng (Hong Kong, -2.6%) decreased, while the TOPIX (Japan, 0.5%) and S&P BSE 500 (India, 2.1%) increased, all in local currency terms.

Real Assets

Domestic listed property declined -8.7% in September (S&P/ASX300 A-REIT Accumulation Index). Similarly, Global REITs fell -5.4% (FTSE EPRA/NAREIT Developed, in AUD hedged terms) over the period, given higher bond yields globally and their higher correlation with listed equity markets. However, the Australian unlisted property sector (NAV) returned +0.2% (lagged basis) as transaction volumes still muted, limiting any significant repricing of Australian direct assets. The FTSE Global Core Infrastructure 50/50 Index returned -4.1% in September (in hedged AUD terms).

Fixed Interest

Following the repricing of expectations for interest rates to remain elevated for longer, global sovereign bond performance was negative in September as 10-year bond yields increased in the US (47bps to 4.57%), Germany (39bps to 2.84%), Japan (11bps to 0.76%) and the UK (9bps to 4.46%). Two-year bond yields also increased in the US (16bps to 5.14%), Germany (26bps to 3.29%), and Japan (2bps to 0.05%), while 2-year yields decreased in the UK (-25bps to 4.90%).

In terms of global bond indices, the Barclays Capital Global Aggregate Bond Index returned -1.8% and the FTSE World Government Bond (ex-Australia) Index decreased by 2.0% in September, both on a fully hedged basis.

Domestically, yields across the curve rose in line with the moves seen in global bonds, the 10-year bond yield rose 46bps to 4.48% and the five-year bond yield increased 37bps to 4.14%. Shorter term yields however declined with a lowering in the expected number of future interest rate hikes by the RBA after the Bank left interest rates steady at 4.1% for the quarter. As a result, the Bloomberg Ausbond Treasury index was weaker in September (-1.9%), while the domestic credit market tracked by the Bloomberg Ausbond Credit index returned -0.6%.

Currency Markets

The Australian Dollar (AUD) depreciated in September, declining against the US Dollar (-0.3%) given the shift for higher US interest rate expectations providing a positive interest rate return for USD based assets. The AUD however appreciated against Euro (2.2%), Pound (3.5%), and Yen (2.1%). On a trade-weighted basis, the local currency was 0.8% stronger in September.

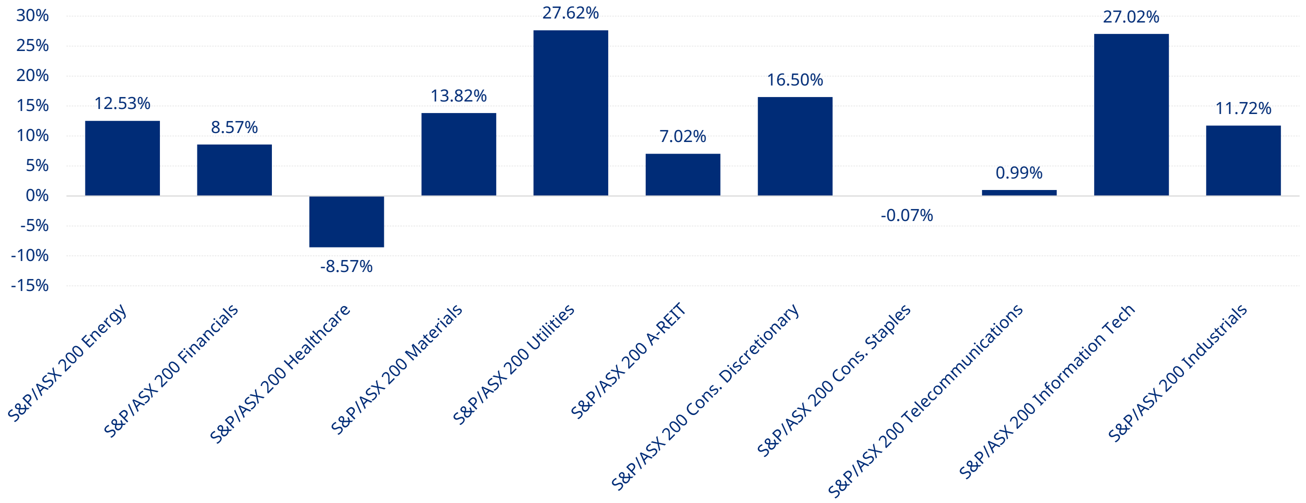
Commodities

The S&P GSCI Commodity Total Return Index increased by 4.5% in September.

Gold prices finished September at US$1,849.63 per ounce, falling 4.8% over the month. However, Iron Ore prices were stronger, increasing 1.7% to US$115.41 per metric tonne over the period. Similarly, Oil was another key commodity that rose in September, up 9.7% to US$95.31 per barrel (Brent Crude).

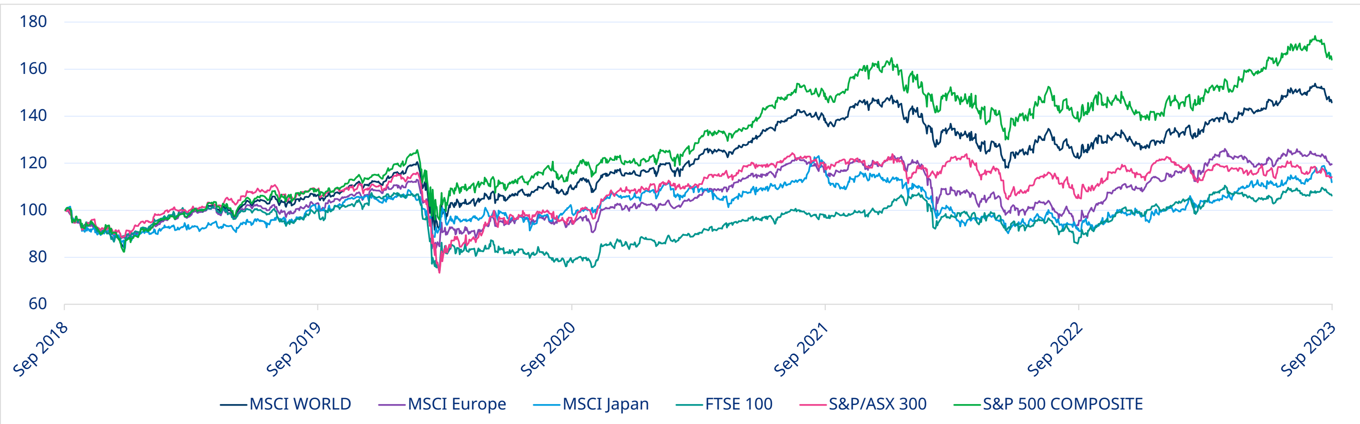
Market charts

ASX Sector Returns - Rolling 12 months



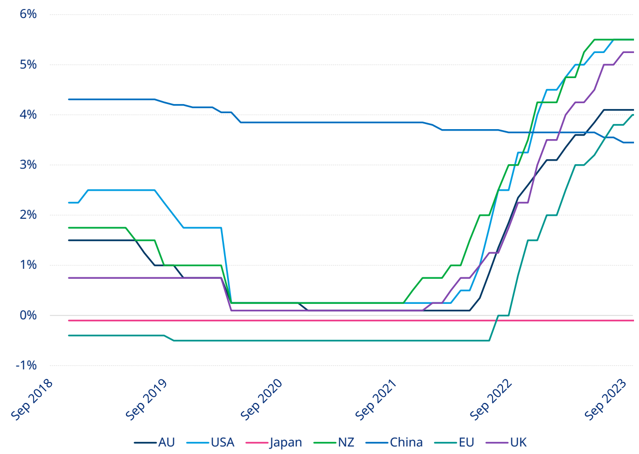
Source: S&P Global

Global Equity Indices - 5 years



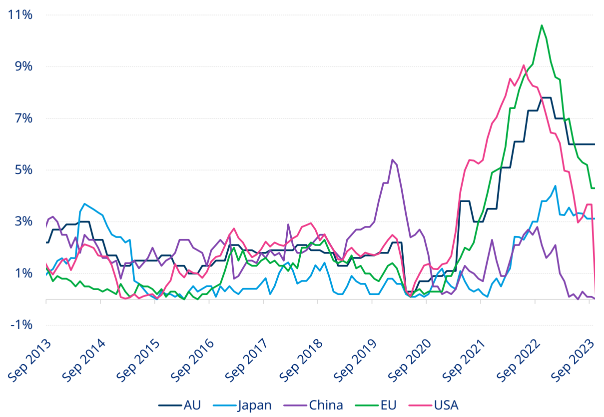
Source: MSCI, Refinitive DataStream (Rebased to 100. All returns denominated in AUD).

Central Bank Policy Rates



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 - September 2023

Australian shares		1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 300 Accumulation		-2.89%	-0.84%	12.92%	10.78%	6.62%
S&P/ASX 300 Industrials Accumulation		-3.71%	-1.05%	10.93%	8.55%	5.08%
S&P/ASX 300 Resources Accumulation		-0.66%	-0.27%	18.30%	17.85%	11.70%
S&P/ASX 300 Accumulation A-REIT		-8.66%	-3.04%	11.94%	4.89%	2.84%
S&P/ASX Small Ords Accumulation		-4.04%	-1.94%	6.85%	2.57%	1.63%
Global shares		**1 Month**	**3 Months**	**1 Year**	**3 Years**	**5 Years**
MSCI World ex Australia Unhedged in $A		-4.01%	-0.43%	21.64%	11.92%	9.80%
EPRA/NAREIT Developed Index Hedged A$		-5.57%	-5.18%	-0.39%	1.09%	-1.66%
STOXX Europe 600 Total Return		-1.74%	-2.54%	16.08%	7.63%	3.28%
S&P 500 Total Return		-4.77%	-3.27%	21.62%	10.15%	9.92%
Nikkei 225 Total Return		-1.65%	-3.27%	25.45%	13.40%	7.88%
Fixed interest		**1 Month**	**3 Months**	**1 Year**	**3 Years**	**5 Years**
Bloomberg AusBond Bank Bill Index		0.34%	1.08%	3.56%	1.36%	1.28%
Bloomberg AusBond Composite (0+Y)		-1.53%	-0.28%	1.61%	-3.92%	0.34%
Barclays Global Aggregate TR Hedged A$		-1.84%	-2.14%	0.53%	-4.55%	-0.24%
Commodities	**Month End Price**	**1 Month**	**3 Months**	**1 Year**	**3 Years**	**5 Years**
Bloomberg Commodity Index	104.84	-1.12%	3.31%	-5.96%	13.95%	4.24%
Generic Brent Crude Oil	95.31	9.73%	27.25%	8.36%	32.52%	2.87%
Generic WTI Crude Oil	90.79	8.56%	28.52%	14.22%	31.18%	4.39%
Gold US$/oz	1848.63	-4.80%	-3.68%	11.32%	-0.87%	9.16%
Iron Ore	115.41	1.70%	6.58%	20.72%	-1.35%	11.77%
Currencies	**Month End Price**	**1 Month**	**3 Months**	**1 Year**	**3 Years**	**5 Years**
AUD/USD	0.6435	-0.54%	-3.44%	0.55%	-3.55%	-2.29%
EUR/USD	1.0573	-2.45%	-3.08%	7.87%	-3.38%	-1.84%
USD/JPY	149.37	2.66%	3.51%	3.20%	12.28%	5.61%
GBP/USD	1.2199	-3.66%	-3.97%	9.21%	-1.87%	-1.31%

Source: Bloomberg

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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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