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FINANCIAL GROUP

Investment Market Update

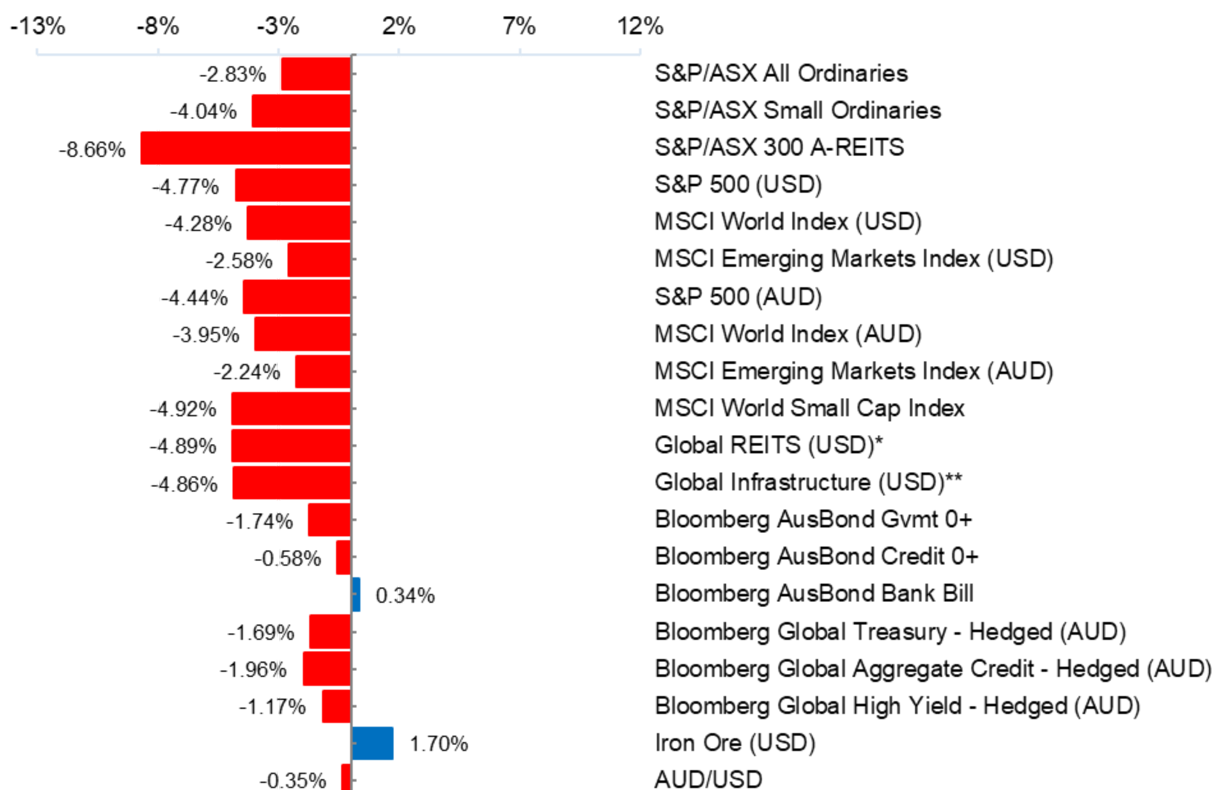
October 2023

September proved to be a reality check on markets, prompting reflection on the implications of a more robust US economy. This included the realisation of a slower decline in inflation and an extended period of elevated cash rates. Consequently, bond markets underwent a noticeable recalibration, marked by a surge in yields to cycle highs.

The ASX 200 Accumulation Index fell by –3.51% with 10 of 11 sectors in the red for the month.Energy was the only gainer (1.6%). The largest falls came from real estate (-8.5%), IT (-7.9%) and healthcare (-6.2%).

In the US, major indexes were lower across the board, with the S&P 500 down by over –4%, the Dow Jones by –3.50%, and the Nasdaq by –5.79%. Other key markets were likewise weaker: Germany's DAX was off –3.51%, the French CAC down –2.48% and Japan's Nikkei 225 was sown by –1.65% over the month. The the British FTSE surprised to provide returns for the month well in positive territory at 2.27%.

Figure 1: Selected Market Returns – 30 September 2023



*Sources: *Refinitiv G-7 Diversified REIT Index, **FTSE Global Core Infrastructure 50/50 Index*

2022 was a difficult year for investors as the diversification benefit of fixed income in portfolios failed to provide necessary protection. September was a haunting reminder of this. In 2022, rising rates and inflation negatively affected bond yields. In 2023, despite falling inflation and deteriorating economic data, concerns persist that central banks will maintain elevated rates, particularly in Australia, the US, and Europe, with a likely cash rate decrease not anticipated until H2 2024 due to slower declining inflation. This represents a notable shift in market expectations compared to previous months. Further to bond market woes, the US fiscal situation raises concerns with a looming government shutdown and the growing debt pile, hinting at increased Treasury issuance.

While commodity prices, particularly oil, rose due to supply restrictions and improved demand, they pose a risk to consumers and inflation.

A soft U.S. economic landing is becoming consensus, but not without market risks, offering opportunities for active investors as divergence in global growth and asset valuations persists. The reset in bond yields may position fixed income as a diversifier if weaker growth helps curb inflation.

Economic developments in the US

In September, the US Federal Reserve (Fed) updated its economic forecasts, indicating a stronger outlook with significant revisions. They raised the median forecast for real GDP growth in 2023 and 2024. The Fed also lowered its unemployment rate projections for 2023 and 2024 while revising down core inflation expectations for 2023. Importantly, the interest rate projection for 2023 remained steady, but there was a notable increase in the projection for 2024, suggesting a shift in the Fed's stance with a reduced likelihood of rate cuts in the following year compared to previous expectations.

Reserve Bank of Australia (RBA) changes

After the RBA decided to maintain the cash rate at 4.1% for the fourth consecutive month, newly appointed Governor Michele Bullock expressed concerns about inflation, particularly in sectors such as services, fuel, and rent prices. Notably, in August, Australian headline CPI inflation rose from 4.9% year-on-year to 5.2% year-on-year due to increased energy costs, while core CPI inflation slowed from 5.6% year-on-year to 5.3% year-on-year. In response to these inflationary pressures, the RBA has left the door open for the possibility of another interest rate increase, suggesting that "further tightening of monetary policy may be necessary to ensure that inflation returns to target within a reasonable timeframe".

Outlook

The current financial landscape is characterised by elevated interest rates, posing challenges for businesses and households with the highest borrowing costs in 15 years. Furthermore, there are clear indications of a global economic slowdown, particularly in Europe's manufacturing and services sectors, which may suggest a broader economic deceleration. Adding complexity are ongoing geopolitical issues, including the Russia-Ukraine conflict and recent Israel-Hamas tensions.

Given this challenging backdrop, caution is warranted.

All statistics and information referenced are sourced from the named Company's ASX announcements, share prices, website, or discussions with Clime unless otherwise stated.

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