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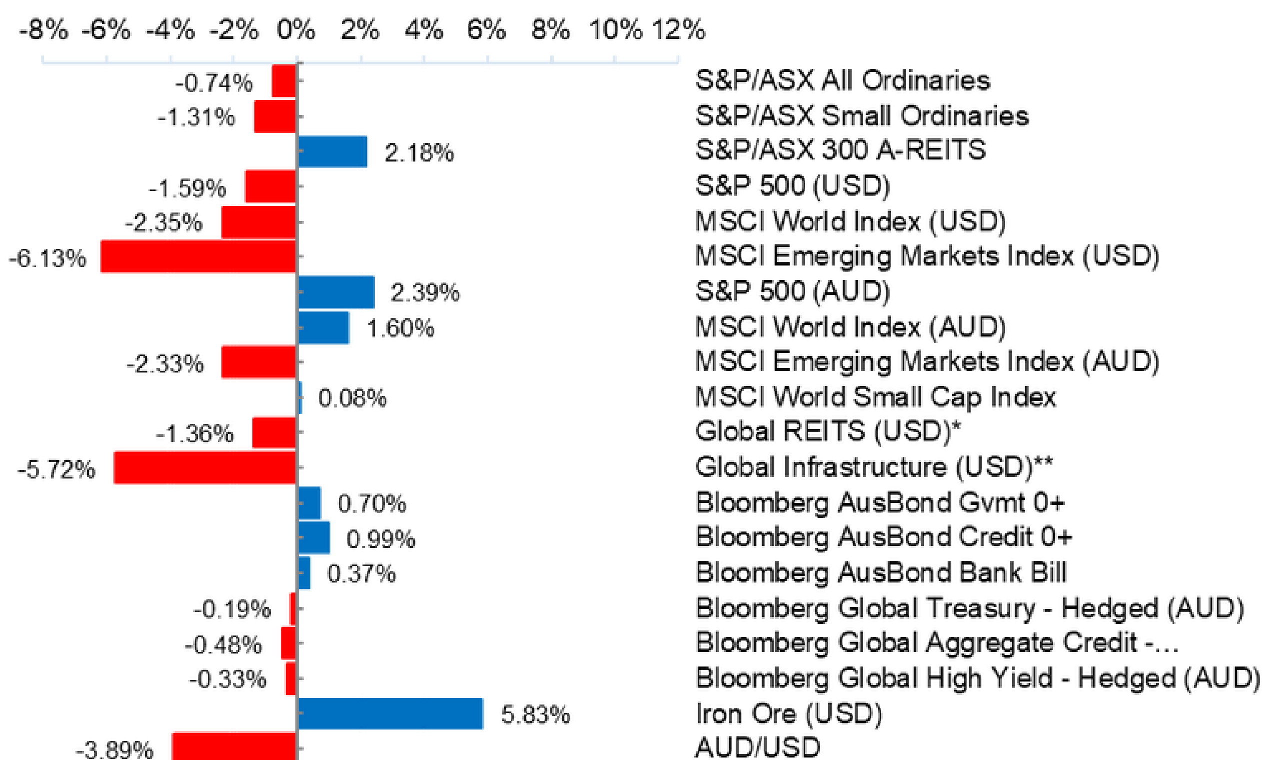
# Investment Market Update

## September 2023

Following strong performances since the start of the year, most markets took a well-deserved breather in August. The ASX 200 Accumulation Index fell by –1.42%, with the Utilities and Technology sectors lagging whilst Consumer Cyclicals was the top-performing sector. In the US, major indexes were lower across the board, with the S&P 500 down by –1.77%, the Dow Jones by –2.36%, and the Nasdaq by –1.74%. European markets were likewise weaker: Germany's DAX was off –3.04%, the French CAC down –2.42%, and the British FTSE down –3.38%. Japan's Nikkei 225 was weaker by –1.60% over the month.

Australian 10-year bonds were mostly higher closing the month at around 4.0% on expectations underlying inflation could be sticky, but well off the high of 4.3% reached mid-month. After trading up as high as USD 0.657, the AUD ended August around USD 0.647. Gold and oil were both weaker in August.

**Figure 1:** Selected Market Returns – 31 August 2023




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

There are three prominent issues influencing markets at present:

1. Rising bond yields
2. Weakness in China
3. Weakening real economy

Rising bond yields

We saw bond yields rising across August, with US 10-year Treasuries hitting 4.34%, the highest level since 2007.

Equities have largely shrugged off the move higher in the benchmark US 10 year, where the real rate (that is, the adjusted inflation rate) is now a touch under 2% bringing it to its highest level since the during global financial crisis (GFC). But real rates at this level have historically been correlated to price-to-earnings multiples for markets of about 17 times, rather than the 20 times the S&P 500 is currently trading on.

The question here is whether we are moving into a higher-for-longer regime or whether higher yields retreat as inflation reduces. The move up in rates has been driven by investors demanding higher returns for longer-term risks. Those risks include higher US budget deficits requiring more bond issuance, concerns about America's credit rating and debate about whether the neutral rate (the rate at which the economy is neither stimulated nor cooled) has now moved higher.

Investors should consider the possibility that higher yields could be a medium-term story and understand what that could mean for a highly indebted economy.

Weakness in China

Despite all the bad news out of China, the belief that a big stimulus is coming remains high, putting a floor under commodity prices and keeping our big miners more buoyant than perhaps they should be.

China's structural problems are enormous, with no easy fixes. Real estate and its related sectors account for nearly 30% of China's gross domestic product. It is heavily financed by the country's notoriously opaque $2.9 trillion trust industry, which appears to be wobbling. Even if China averts a full-scale crisis, long-term growth will be sharply constrained by a working-age population that will fall by nearly a quarter by 2050.

The next six months are likely to be telling: either stimulus arrives, and it works, or the slowdown in China broadens.

Weakening real economy

This is something that has been in sharp focus during results season. Local earnings in Australia were slightly better than expected in terms of 2023 results and 2024 guidance. But weaker economic conditions and weaker profits are still ahead, with analysts cutting 2024 earnings forecasts by around 5%.

The ASX 200 is trading on 15.5 times earnings, compared to a long-run average of 14.5 times which perhaps indicates a degree of complacency regarding the challenges ahead.

In the US, resilient economic data is keeping the Federal Reserve (Fed) watchful on inflation and the market remains nervous about rates.

At his month-end Jackson Hole speech, Fed chair Jerome Powell highlighted the Fed's progress in bringing down inflation but noted prices were still uncomfortably high and warned higher rates could be appropriate. He also pointed to better-than-expected economic growth and a resilient labour market as potential catalysts for further tightening of monetary policy. Turning to the Fed's upcoming meetings, while markets still expect rates to hold steady in September, investor opinion on whether there will be a further 0.25% increase in November is mixed.

The next few months and the approach to year end could be, particularly testing. Will rates tick up again? Will China's slowdown broaden? Will the resilient US consumer start to feel the pinch and stop spending?

Lots of questions remain.

*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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