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ISSUE DATE: 14-03-2023

Summary of Key Views

Insights from our CIO: Bear market rally or are we off to the races?

The start of 2023 has been generally positive for markets. While the rally has been a welcome relief from the tumultuous market environment in 2022, the key question is whether the recent rally has legs or whether it is simply a bear market rally with more volatility to follow as we progress into 2023.

The market has been skittish over the past 12 months with any positive news on the inflation front, such as any sign that inflation is moderating, resulting in the market to rally. While the most recent rally has partially been driven by some evidence that we are closer to reaching peak inflation, we have also seen liquidity pumped into the market which has not doubt supported market returns. Central banks have been generally decreasing their balance sheets with key central banks such as the US Federal Reserve moving from a quantitative easing policy to a quantitative tightening policy, which has reduced the overall liquidity that's supporting markets. But we also have seen some central banks, notably the Bank of Japan (BoJ) and the People's Bank of China (PBOC), add liquidity to markets in recent months, which markets have liked. However, we do not believe that this trend is structural and that the direction of inflation and potential impact on economic growth will be the key driver of markets as we progress throughout 2023.

Our base case remains that the third quarter of 2023 will be 'd-day' for markets as the direction which company earnings will take, due to the impact of higher interest rates, will be clearer. The most recent company reporting season suggests that there is evidence of slowing in demand, however this is not consistent across all sectors and companies.

Overall, we believe that market returns may trend sideways for the full year with a possible downturn later in the year. In such an environment being able to pick out the 'winners' from the 'losers' will be increasingly important as simply riding the broader market to generate returns will be more challenging.

Market developments during February 2023 included:

Australian Equities

The month of February saw the S&P/ASX 200 Accumulation Index finish negatively after its strongest month on record in January. The main driver of the negative performance was the persistently high CPI figures in the US and the evaluation of earnings season in the Australian market. The Utilities (+3.4%) and Information Technology (+2.7%) were the top performers, whilst the Materials (-6.6%) and Financials (-3.1%) sectors were the biggest laggards in the month.

The Utilities and Information Technology sectors led all sectors as several companies reported robust earnings or positive corporate actions (i.e., Origin Energy). In contrast, the Materials and Financials sectors were the worst performers as concerns around the global macroeconomic outlook and policy response, coupled with the evaluation of earnings reports resulted in selloffs within these sectors. Investors continued to grapple with the inflation-driven interest rate outlook facing central banks globally and the implications that this may have on the future economic outlook.

In February, the Growth (-3.2%) and Shareholder Yield (-3.1%) factors were the worst performers. The top year-to-date performers have been Dividend Opportunities (+4.6%) and Quality (+4.4%). Over the previous 12 months, Value (+9.5%) and Dividend Opportunities (+8.9%) were the top performers.

Global Equities

Resilient economic data in February resulted in a rise in bond yields and a decrease in equity markets. With renewed inflation concerns, US equities stumbled with the S&P500 declining 2.4% during the month.

The European Central Bank, Bank of England, and Federal Reserve announced rate hikes at the beginning of the month. The overall message from their accompanying statements was that inflation remains excessively high despite recent declines and that central banks must continue their efforts.

Economic data suggesting a postponed recession prompted investors to adjust their forecasts for the peak in interest rates and future rate cuts, given the potential lengthier route to target inflation.

Despite the typical positive correlation between robust economic data and stock market performance, equity markets had priced in anticipated rate cuts and were more dismayed by the possibility of reduced monetary easing than they were encouraged by the delayed recession.

Across the globe, a rebound of consumer confidence helped the Eurozone stay positive with the FTSE 100 returning 1.8% and the DAX 30 returning 1.6%, while the Hang Seng Index fell 9.9% driven by escalating geopolitical tensions.

Fixed Interest

In a continued bid to reduce inflation to target levels, the Reserve Bank of Australia has raised the cash rate for a ninth month in a row, with a 25 bps increase announced in February. This brings the current February cash rate to 3.35%. Meeting minutes noted uncertain global outlook, upward surprises on inflation and wages, and the substantial increases in rates so far. The bond market reflected the rate rise with yields rising over the course of the month. Australian 2Yr and 10Yr Govt Bond yields rose by 49 bps and 30bps, respectively, leading to the Bloomberg AusBond Composite 0+ Yr Index to return -1.3% over the month. The Australian CPI inflation over the year to December 2022 was 7.8%. Globally, fixed income markets were much the same. The US. Federal Reserve announced another 25bps rate rise on February 1, bringing the target cash rate to 4.5%-4.75%. US 2Yr and 10Yr Bond yields rose by 41bps and 69bps respectively. Similarly, U.K. 2Yr and 10Yrs Gilt yields rose by 61bps and 37bps, respectively, following the BoE decision to raise the Bank Rate by 50bps.

REITs (listed property securities)

The S&P/ASX 200 A-REIT Accumulation index sold off in February after a strong start to the calendar year in January, with the index finishing the month -0.4% lower. Global real estate equities (represented by the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)) also regressed, returning -3.6% for the month. Australian infrastructure performed well during February, with the S&P/ASX Infrastructure Index TR advancing 1.9% for the month.

February was relatively quiet across the A-REIT sector. Some activity includes Centuria Industrial REIT (ASX: CIP) settling a $300mn convertible bond raising. The move enables CIP to secure debt at 3.45-3.95% at a time when the cost of bank debt is 5.5%. The funds raised through this effort will primarily be utilized to pay off existing debts, as well as for general corporate purposes.

The Australian residential property market experienced no change (0%) month on month in January represented by Core Logic's five capital city aggregate. Melbourne (-0.4%) and Brisbane (-0.4%) were the worst performers whilst Sydney (+0.3%) advanced during the month for the first time in twelve months.

Alternatives

Preliminary estimates for February indicate that the index decreased by 1.5 per cent (on a monthly average basis) in SDR terms, after no change in January (revised). The non-rural and base metal sub-indices decreased in the month, while the rural sub-index increased. In Australian dollar terms, the index decreased by 1.3 per cent in January.

Over the past year, the index has increased by 3.6 per cent in SDR terms, led by higher thermal coal prices. The index has increased by 2.5 per cent in Australian dollar terms.

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