Market Update – February 2023

Asset class total return to 28/02/2023	1M (%)	3M (%)	6M (%)	1Y (%)	3Y (% p.a.)	5Y (% p.a.)	Current Yield (%)
Cash	0.3	0.8	1.4	2.0	0.8	1.0	3.6
Fixed Term Deposits	0.3	1.0	1.9	3.2	1.9	1.6	4.0
Australian Bonds	-1.3	-0.7	0.4	-6.4	-3.4	0.8	3.8
Australian Bank Hybrids	-0.3	1.8	3.4	2.5	3.4	3.5	4.4
Australian Property	-0.4	3.3	3.8	-6.4	1.2	6.7	4.2
Australian Shares	-2.5	0.3	6.4	7.2	7.9	7.9	4.1
Global Shares (unhedged)	2.1	-0.7	5.7	-0.5	8.3	10.1	2.0
Global Infrastructure (hedged)	-3.5	-3.9	-6.5	-1.0	3.3	6.7	3.0

Source: Refinitiv, RBA cash rate, 12M Term deposit, Australian Composite Bonds, Hybrids cash yield to call, Property ASX 300 AREIT, Australian Shares S&P/ASX 200, Global Shares MSCI World ex-Aust unhedged, Global Infrastructure FTSE Developed Core 50/50, hedged

Financial Indicator movement	28/02/23	1M	3M	6M	1Y
AUD/USD (cents)	0.67	-0.03	-0.01	-0.01	-0.05
Aust. 10-year bond yield (%)	3.87	0.31	0.33	0.26	1.71
Gold (US$/oz)	1,827	-5.0%	3.3%	6.8%	-4.2%
Brent oil (US$/bbl)	84	-0.7%	-1.8%	-13.1%	-16.9%
Iron ore (US$/t)	126	2.2%	35.2%	19.8%	-11.4%
Copper (US$/lb)	4.10	-3.1%	9.9%	16.5%	-7.8%

Note: Past performance is not a reliable indicator of future performance.

Global

January's optimism turned to caution in February. While headline inflation may be falling, core inflation continues to remain persistent with services and rent inflation new causes of concern. The inflation story is similar across the US, Europe and Australia. As a result, Central Banks have signaled interest rates need to go higher for longer. Short term interest rates have risen sharply, and the USD has rallied, which together act to tighten financial conditions considerably.

While US growth and employment remain robust to date, the US yield curve is clearly inverse, meaning short term interest rates are much higher than long term interest rates. Since 1950, an inverse yield curve has always correctly predicted that a US recession is ahead. In addition, EPS growth for the S&P 500 companies has just turned negative, which is another warning sign.

Positive sentiment over China's reopening has also begun to wane given China's lower economic growth target of 5.0% and reluctance to offer further stimulus to the property and infrastructure sectors. Instead, China will focus on internal consumption. China is also continuing its regulatory crackdowns, with the financial sector the next target.

Australia

The Australian economy has been resilient thus far, boosted by commodity sectors and resilient consumer spending. But interest rates have been rising at a rapid pace and households are yet to face the full impact of higher home loan rates coupled with rising expenses generally. We think that the full impact will arrive by mid-2023 and that consumer spending will slow considerably. Of course, this is what the Reserve Bank (RBA) is trying to achieve to lower prices.

But often a major slowdown can lead to a cascading effect and other problems within the economy. As the RBA states itself "the path to achieving a soft landing remains a narrow one."

The market now expects the peak cash rate to be around 4.1% by November 2023, or another two rate hikes to go. This is well above expectations at the start of the year (3.6%) and will add further pressure on households via the variable home loan rate.

The Australian reporting season has just wrapped up and there was no material slowdown evident in 1H23 but we think this is probably as good as it gets for many sectors. It was notable that the market heavyweight sectors – Banks and Resources – were down heavily in February. Banks are showing the first signs of trouble ahead regarding loan impairments. While commodity prices will also be at risk as the global economy slows.

The Australian Federal government has started to look for ways to fix the budget deficit. Rather than reducing spending, it seems to be targeting new taxes, with higher tax rates on large super balances announced.

Outlook

The US, Europe and Australian economies have been resilient thus far. However, buoyant growth and commodity prices are not good for the inflation outlook and are causing Central Banks to go 'higher for longer' on interest rates.

We are concerned that the full impact of higher interest rates and costs are yet to fully impact households, due to robust income and a drawdown in savings. We think the full impact will arrive by the middle of 2023 and that consumer spending will fall significantly (as Central Banks intend). Consumption makes up ~70% of demand in developed economies and will have a material impact on economic growth.

Accordingly, we expect challenging conditions ahead before inflation returns to target. We think interest rates will stay high for most of 2023 and won't be eased until 2024. We remain invested but positioned defensively and will be on the lookout for opportunities as they arise.

The next key events on the calendar include:

- Fed meeting – 21/22 March 2023
- RBA meeting – 4 April 2023

Bill Keenan

Principal, Portfolio Manager

Bill Keenan is the founder of Sunbird Portfolios. Sunbird provides independent advice to leading financial advisers across Australia.

Bill has 28 years' experience in financial markets and holds a Bachelor of Business in Accounting and a Graduate Diploma in Finance and Investment.

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W www.sunbirdportfolios.com.au

E bill.keenan@sunbirdportfolios.com.au

M 0403534426

T 03 8840 7886

A Exchange Tower, Level 1, 530 Little Collins Street, Melbourne, VIC 3000.