Market Update – March 2023

Asset class total return to 31/03/2023	1M (%)	3M (%)	6M (%)	1Y (%)	3Y (% p.a.)	5Y (% p.a.)	Current Yield (%)
Cash	0.3	0.9	1.6	2.6	0.9	1.0	3.6
Fixed Term Deposits	0.3	1.0	1.9	3.2	1.9	1.6	4.3
Australian Bonds	3.2	4.6	5.0	0.4	-2.4	1.3	3.4
Australian Bank Hybrids	-1.1	-1.3	1.0	1.6	4.7	3.6	4.8
Australian Property	-6.8	0.3	11.9	-14.0	14.2	5.2	4.7
Australian Shares	-0.2	3.5	13.2	0.1	16.5	8.7	4.3
Global Shares (unhedged)	3.9	9.2	13.5	4.3	12.9	11.0	1.6
Global Infrastructure (hedged)	2.0	1.0	7.5	-6.0	10.1	6.8	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	31/03/23	1M	3M	6M	1Y
AUD/USD (cents)	0.67	-0.01	-0.01	0.03	-0.08
Aust. 10-year bond yield (%)	3.23	-0.65	-0.81	-0.73	0.44
Gold (US$/oz)	1,961	7.3%	7.5%	18.1%	1.2%
Brent oil (US$/bbl)	79	-5.6%	-7.8%	-10.0%	-26.6%
Iron ore (US$/t)	124	-1.4%	6.1%	26.5%	-17.9%
Copper (US$/lb)	4.01	-2.1%	5.4%	16.5%	-15.5%

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

Global

Financial markets remained remarkably resilient during the March quarter given it involved a mini-banking crisis, starting with US regional Banks and spreading to Credit Suisse in Europe. Central Banks and regulators acted quickly to contain the situation, but it is not yet clear whether this has resolved the issue or whether it will trigger other problems down the track.

Banks are now scrambling for deposits to build liquidity and it is expected that credit conditions will tighten considerably. This will do most of the work for Central Banks and hence the market now expects the US Federal Reserve (the Fed) to be close to peak rates, while bond yields have moved considerably lower.

A lower yield curve and the Fed providing liquidity for the Banking system has supported equities and commodities (particularly gold) in recent weeks but there is still a major question mark over global growth and company earnings moving forward. Lower bond yields indicate the bond market is bearish on the outlook, while the resilience of equities suggests the equity market remains optimistic.

Much will depend on whether the global economy is in for a hard or soft landing. And in turn this will depend on how quickly core inflation retreats to target. Central Banks can't reduce short-term interest rates until they see a disinflationary trend. Unfortunately, as every month goes by 'something tends to break' in the economy and one wonders whether events such as the US regional bank crisis will have a cascading effect on other parts of the US economy.

Australia

The good news is that the Australian Banking system is sound thanks to APRA tightening capital and liquidity ratios over the past 10 years, post the GFC and the Banking Royal Commission. In the short term, Australian Banks may face higher funding costs (for deposits and wholesale term funding) which will impact profitability, but liquidity and solvency are unlikely to be issues.

The Reserve Bank of Australia (RBA) recently left the cash rate at 3.6%, noting the cumulative effect of previous rate hikes were yet to fully impact the economy and that global credit conditions were likely to tighten from here. In addition, there is some doubt over the strength of the recovery in China, post COVID lockdowns.

However, core inflation still looms as an issue with the December quarter figure at 6.9% and the March quarter data due in late April 2023. The trajectory of core inflation will largely determine how long short-term interest rates will remain at current levels (or move even higher). Futures and bond markets have reassessed the outlook since the US and European banking issues and now expect 3.6% to be the peak cash rate, with a rate cut expected later in 2023. While this sounds positive, there will need to be quite a disinflationary shock to get core inflation down from 6.9% to 3.0% within a year! This seems unlikely without some major negative event.

Outlook

The mini-Banking crisis in the US and Europe has triggered a reassessment of the global outlook, with tighter credit conditions likely ahead. The bond market is clearly bearish on the growth outlook, yet the equity market remains optimistic. Both can't be right! We are leaning towards the bearish view, as a soft landing seems unlikely.

Our key concern is that core inflation remains well above target and is unlikely to return to target within a year (as markets are suggesting) without some sort of disinflationary shock. Accordingly, we expect challenging conditions ahead before inflation returns to target.

We think short term interest rates will stay high for most of 2023 and won't be eased until 2024 (unless there is a disinflationary shock). 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:

- RBA meeting – 2 May 2023
- Fed meeting – 2/3 May 2023
- Australian Federal Budget – 9 May 2023

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Date issued: Tuesday, April 11, 2023

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