Market Update – April 2023

Asset class total return to 30/04/2023	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	0.4	1.0	1.9	3.3	1.9	1.6	4.3
Australian Bonds	0.2	2.0	4.2	2.1	-2.3	1.4	3.7
Australian Bank Hybrids	1.1	-0.2	3.1	2.2	4.1	3.6	4.8
Australian Property	5.2	-2.4	5.5	-10.2	11.3	5.4	4.5
Australian Shares	1.9	-0.8	8.7	2.8	14.0	8.3	4.3
Global Shares (unhedged)	3.2	9.4	8.7	11.1	12.7	11.1	2.0
Global Infrastructure (hedged)	2.5	0.6	6.1	-2.9	7.7	5.9	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	30/04/23	1M	3M	6M	1Y
AUD/USD (cents)	0.66	-0.01	-0.04	0.02	-0.05
Aust. 10-year bond yield (%)	3.39	0.16	-0.18	-0.37	0.21
Gold US$/ounce	2,049	4.5%	6.6%	25.5%	8.0%
Brent oil US$/bbl	74	-5.9%	-11.8%	-20.1%	-30.8%
Iron ore US$/t	104	-10.3%	-17.5%	11.8%	-22.4%
Copper US$/pound	3.86	-5.8%	-8.6%	13.2%	-12.1%

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

Global

April brought calm after the unnerving US and European banking issues in March. Most asset classes finished higher, with only commodities down over the month. However, we may only be in the 'eye of the storm' as Central Banks have resumed the interest rate hiking cycle in May and US regional bank issues are appearing again.

While growth and employment remain reasonably resilient to date, the main problem remains core inflation, which is proving resilient as services inflation takes over from goods inflation. This is forcing Central Banks to go 'higher for longer' and one wonders whether we are now moving into dangerous territory, where something else 'breaks' in the economy.

Certainly, bond and futures markets expect trouble ahead as futures markets are pricing in interest rate cuts by late 2023 and long-term bond yields remain well below the cash rate. Rate cuts do not seem possible this year unless there is some major disinflationary event that is likely to bring core inflation down quickly. It is this 'known unknown' – a major disinflationary event – that keeps us cautious on the outlook.

Despite rising interest rates and US bank issues, the S&P 500 has managed to sustain a rally over the past six months. This seems to relate to company results coming in above lowered expectations but there is still much debate over the sustainability of US earnings. Much depends on how long interest rates stay elevated and whether the US economy experiences a mild or moderate recession.

Australia

The Australian economy remains resilient thus far buoyed by commodities and unemployment near 50-year lows. The May Budget update is due shortly and is expected to reveal a reduction in the budget deficit to ~$10bn from the ~$40bn level previously forecast. The improvement is forecast to come mainly from the extra tax revenue related to commodities and full employment. The Federal government will need to be careful not to provide further stimulus to the economy when inflation is running at 7%.

The Reserve Bank of Australia (RBA) held the cash rate at 3.6% in April but resumed rate hikes in May, with another 25bps increase, taking the cash rate to 3.85%. This was a bit of a surprise to financial markets who had expected a longer holding period. However, the RBA remains concerned over rising services inflation and potentially wages inflation, even though goods inflation is subsiding. As mentioned above, headline inflation is running at 7.0%, while core inflation is 6.6%. Both are well above the RBA's 2-3% target range.

A key uncertainty is the outlook for household consumption, with households facing a 'triple whammy' of higher interest rates, rising cost-of-living pressures and weakening asset prices. At this stage, the RBA is still expecting low growth, rather than recession, but it notes that "the path to achieving a soft landing remains a narrow one".

Outlook

Interest rates continue to move higher and credit conditions are tightening. Central Banks are aiming to bring inflation back to target, but core inflation remains resilient thus far. With each 25bps increase, we remain concerned that something else will 'break' in the economy. We have already seen trouble with US regional banks, who is next?

Bond markets are expecting rate cuts by late 2023 but this only seems possible after some major negative event. It is this 'known unknown' – a major disinflationary event or events - that worries us. Clearly equity markets are priced for relatively mild conditions and hence we find it hard to reconcile the two markets. The bond market is bearish, yet the equity market remains optimistic.

We are leaning towards the bearish view, until we see the disinflationary events that are likely to lead to core inflation returning to target. We will be more bullish once market valuations have adjusted to such events.

The next key events on the calendar include:

- Australian Federal Budget – 9 May 2023
- RBA meeting – 6 June 2023
- Fed meeting – 13/14 June 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.