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Summary of Key Views

Insights from our CIO: Positioning for economic slowdown

The much-anticipated slowdown in economic growth appears to be upon us, with GDP in Australia slowing to 2.3%. While only slightly below long-term trend GDP at this point, it is the direction and speed of travel that counts. Discretionary spending has eased (-1.0%), as cost of living pressures finally hit the consumer. Perhaps not surprisingly, the slowdown is being felt most in the more expensive housing markets of NSW and Victoria, where high house prices translate into high mortgage costs.

As reporting season wraps up, the picture is also becoming clearer for corporates. Earnings have come down, but not by as much as expected which has so far pleased equity markets. There have been good reasons why earnings have been so resilient to date; from very tight labour markets to consumers being flush with covid cash buffers and businesses, in many cases, able to pass on rising input costs. Looking forward, however, earnings growth looks harder to come by in 2024 as these tailwinds ease. The impact of rising rates, tighter credit conditions and higher costs are indeed feeding through the economy albeit with a long lag.

Our base case remains that Australia will avoid recession thanks to a significant rebound in migration this year and the continued demand for our resources as the global economy continues its decarbonisation path. Inflation continues to soften slowly with the latest headline number coming in at 4.9%. It's still a long way away from the central bank's target range of 2-3%. The RBA has kept rates on hold for a second month in a row but remains on alert as inflation has the potential to remain stickier here than in other parts of the developed world.

We remain cautious and positioned for the weaker economic conditions ahead. Our focus is on quality investments, liquid assets and active portfolio management which should put us in good stead to manage any volatility that may arise as the year progresses.

Market developments during August 2023 included:

Australian Equities

The S&P/ASX 200 Accumulation Index fell 0.7% in August, as earnings results dampened market returns. Of the 11 sectors, only Consumer Discretionary (+5.7%), Property (+2.3%) and Energy (+0.5%) had positive returns for the month, while Utilities (-3.9%) and Consumer Staples (-3.2%) were the biggest drags on the Index.

Share prices battled with a combination of mixed earnings results and a conservative outlook for companies, while soft economic data out of China continued to weigh on local investors.

Consumer Discretionary was the standout performer for the month, benefitting from resilient consumers. Given the continued strain on households through a higher cost-of-living, many companies in the sector had flagged headwinds in the months leading into reporting season, with a conservative outlook already baked into share prices. Another theme to emerge from earnings reports is the ability for companies to manage cost pressures, particularly those brought about through higher financing rates. Despite revenue growth, Consumer Staples reported disappointing profit results, leading to their waning share prices. More broadly, the sustained impact of a slowing Chinese economy was seen across the market, particularly Materials.

The month saw all Factors perform negatively. Enhanced Value (-3.1%) and Low Volatility (-2.5%) were the worst performing factors, while Growth was able to limit its losses (-0.4%).

Global Equities

Primarily negative economic data in August resulted in a rise in bond yields and a decrease in equity markets. With renewed investor concerns, US equities stumbled with the S&P500 Index declining -1.6% (in local currency terms) during the month.

Most sectors across Europe fell, with the DAX 30 Index returning -3.0% (in local currency terms) for the month. Energy was one of the sole positive contributors, inflation has remained stable but is yet to decline below previous months levels. The European Central Bank's next meeting will be a watch point for investors.

China experienced some of the sharpest declines for the month with a potentially challenged real estate sector. Investor concerns around stimulus deployment largely contributed to this decline, with the CSI 300 Index returning -6.0% (in local currency terms) for the month (in local currency terms). In Hong Kong, stocks fell sharply with weaker manufacturing and real estate market concerns in surrounding markets. This was reflected in the Hang Seng Index returning -8.2% for the month (in local currency terms).

Fixed Interest

In their August meeting, the Reserve Bank of Australia have for the second time elected to pause rate hikes and leave the target cash rate at 4.10%, citing slowing economic growth and pressure on household budgets. The Australian bond market reacted mildly, with Australian 2- and 10- Year Bond yields falling 23bps and 3bps respectively over the course of the month. The Australian yield curve continued to flatten throughout August, and the Bloomberg AusBond Bank Bill Index returned 0.37%. Markets are expecting a similar story in September, with the RBA expected to hold rates steady next month. RBA Governor Philip Lowe's tenure will soon end, and the position will be headed by his deputy Michele Bullock.

In the US, the Federal Funds Rate remains at 5.25%-5.50% following the most recent July rate hike, with the Fed's first rate cut being priced into futures contracts by March 2024. The Bloomberg Barclays Global Aggregate Index (AUD) returned 2.62% over the month, and US 2- and 10-Year Treasury yields rose 1bp and 15bps respectively. In the UK, the interest rate is similarly at 5.25% after the BoE hiked by 25bps in their August 2 meeting, resulting in UK Gilt yields rising over the month.

REITs (listed property securities)
The S&P/ASX 200 A-REIT Accumulation Index finished +2.3% higher in the month of August as the A-REIT sector continued its consolidation in recent months. In contrast, the Global Real Estate Equities market (represented by the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged) finished lower (-2.7%). The Australian Infrastructure sector (as represented by the S&P/ASX Infrastructure Index) finished -2.8% lower.

In the month of August, M&A activity was relatively muted as companies reported their full year results. Abacus Group (ASX: ABG) officially completed its de-stapling from Abacus Storage King (ASX: ASK). Ingenia Communities Group (ASX: INA) extended their development partnership with Sun Communities for an additional seven years. Meanwhile, Goodman Group (ASX: GMG) reported that Senko Co Ltd. signed a major lease agreement at their Goodman Joso location in Japan. The Australian residential property market experienced an increase by +0.1% Month on Month (as represented by CoreLogic's five capital city aggregate). Brisbane was the biggest riser (+1.5%), followed by Adelaide (+1.1%). Over the one-year period, Perth was the largest gainer (+4.5%). In contrast, Hobart (-0.1%) was the only city to deliver negative returns in the month of August. Similarly, Hobart has the lowest percentage change year on year (-10.0%).

Alternatives
Preliminary estimates for August indicate that the index decreased by 2.3 per cent (on a monthly average basis) in SDR terms, after decreasing by 2.2 per cent in July (revised). The rural, non-rural and base metals sub-indices decreased in the past month. In Australian dollar terms, the index increased by 0.7 per cent in August.

Over the past year, the index has decreased by 23.2 per cent in SDR terms, led by lower thermal coal and liquified natural gas prices. The index has decreased by 16.5 per cent in Australian dollar terms.