Market Update – July 2023

Asset class total return to 31/07/2023	1M (%)	3M (%)	6M (%)	1Y (%)	3Y (% p.a.)	5Y (% p.a.)	Current Yield (%)
Cash	0.3	1.0	1.9	3.3	1.3	1.2	4.1
Fixed Term Deposits	0.4	1.2	2.3	3.8	1.6	1.5	5.0
Australian Bonds	0.5	-2.6	-0.7	-1.5	-3.5	0.6	4.3
Australian Bank Hybrids	1.6	1.4	1.2	5.6	3.6	3.5	5.5
Australian Property	3.9	1.9	-0.5	-0.1	9.7	4.5	4.5
Australian Shares	2.9	2.0	1.2	11.7	12.0	7.5	4.1
Global Shares (unhedged)	2.1	6.5	16.5	17.6	14.0	11.4	1.9
Global Infrastructure (hedged)	1.0	-2.3	-1.7	-6.3	6.1	4.4	3.5

Total returns and yields are before franking credits. Source: RBA cash rate, 12M Bank term deposit, Bloomberg Austbond Composite Index, Solactive Aust Banking Preferred shares Index, S&P/ASX 300 A-REIT Index TR, S&P/ASX 200 TR, MSCI World ex-Aust unhedged TR, FTSE Developed Core Infrastructure 50/50, hedged, TR.

Financial Indicator movement	31/07/23	1M	3M	6M	1Y
AUD/USD (cents)	0.67	0.00	0.01	-0.03	-0.03
Aust. 10-year bond yield (%)	4.06	0.06	0.67	0.50	0.98
Gold US$/ounce	1,964	2.3%	-1.3%	2.2%	11.3%
Brent oil US$/bbl	86	14.2%	14.9%	1.3%	-22.2%
Iron ore US$/t	112	-0.9%	7.7%	-11.1%	6.7%
Copper US$/pound	4.00	6.8%	3.4%	-5.5%	11.5%

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

Global

US growth and employment continue to prove resilient, but interest rates continue to creep higher, with the US Federal Reserve (the Fed) recently increasing the cash rate to 5.25-5.50% - a 16-year high. In addition, bond yields have risen above 4.0%, after rating firm Fitch downgraded its US sovereign credit rating to AA+ (from AAA) citing concern over the outlook for the US budget deficit, which is likely to remain between US$1-2 trillion per year.

One major positive is that US inflation is on track to return to target (2.0%) with headline inflation at 3.0% and core inflation at 4.8%. It is widely expected that the Fed is at peak rates, with interest rate cuts possible in 2024.

However, the world's 2nd largest economy, China, continues to slow and seems to be on the precipice of deflation. Slowing global growth, a structural downturn in its property market and severe flooding in the Northern regions reduced June quarter growth to just 0.8% (3.2% annualised). This has led to calls for more China stimulus but so far, the administration continues to roll out micro reforms rather than any large macro stimulus.

Oil has managed to rally after OPEC extended its production cuts into the September quarter and the US maintained strong demand during the North American summer. Commodities generally remain supported by expectations for more China stimulus, but the risks remain to the downside, if Chinese growth continues to disappoint.

Australia

The RBA has maintained the cash rate at 4.10% for the last two meetings, as inflation has been tracking a little better than expected and hence there was room to pause. Headline inflation is still relatively high at 6.0% but the June quarter figure of 0.8% implies inflation should come down to 4.9% by September and 3.8% by December - if the quarterly rate is maintained at 0.8%.

The main upside risks to inflation include services, wages and energy inflation. The futures market is pricing in a peak rate of 4.20% by March 2024, which implies potentially one more rate rise ahead.

While China continues to slow, posing downside risks for commodity prices, there has been some progress on free trade between China and Australia, with China lifting its import restrictions on a variety of Australian exports including thermal coal, barley and timber but wine, beef and lobster remain restricted.

Surprisingly, house prices have been recovering, despite higher interest rates, which seems to relate to a resumption in population growth and a shortage of housing and rental stock. Government efforts to increase affordable housing remain delayed in Parliament, while property developers continue to struggle with rising costs and red tape.

Outlook

We retain a cautious outlook, despite interest rates potentially nearing a peak and inflation trending in the right direction. We are still concerned that the 'last mile' to target will be a challenge and that interest rates could stay 'higher for longer'. Interest rates remaining on hold still has a tightening effect, as households and companies gradually transition to higher loan rates.

The other major concern we have is China. We think China is coming to the end of the road on its property bubble and will need to implement major structural reforms and realise major losses across property valuations and debt. We expect falling steel production and weakness across many steel-related commodities, such as iron ore and coal.

Falling inflation and enthusiasm for the technology sector has supported equity markets to date, but the August-October period ahead tends to be a period of seasonal weakness. That said, we remain invested but positioned defensively, with a focus on quality, value and yield. We will become more bullish once market valuations have adjusted lower and we are closer to Central Banks easing interest rates.

The next key events on the calendar include:

- Aust. FY23 reporting season – August 2023
- RBA meeting – September 5
- Fed meeting – September 19/20

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Warnings, Disclosures and Disclaimer

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