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Lonsec

Summary of Key Views

Insights from our CIO:

In brief

• We believe an apparent imbalance between the supply and demand of US government debt could lead to higher long-term interest rates regardless of the inflation path. For defensive allocations, we prefer Australian long-term bonds over the US equivalent.

• We believe the key drivers of Australian inflation are largely outside of the Reserve Bank of Australia's influence, meaning it is uncertain whether they will keep raising interest rates. This keeps us neutral on Australian Equities.

• The persistent underperformance of China's equity market has extended to where we now believe the balance of outcomes justifies removing our underweight call to Emerging Markets

• We believe the general interest rate environment will be flat, with the potential for higher interest rates in the near term. This environment has historically been challenging for interest rate-sensitive equities.

Market developments during September 2023 included:

Australian Equities

The ASX 200 finished September down 2.8%, reflecting the losses seen globally. Energy was the only gainer (1.6%), with all the other 10 sectors finishing the month in the red. The largest drops were seen in Real Estate (-8.6%), Information Technology (-7.9%), and Healthcare (-6.2%). However, Australian equities did manage to outperform some global markets.

Energy was the lone bright spot in the market, returning 1.6%, riding the tailwinds of rising global oil prices. In terms of the laggards, the Real Estate sector was hit hard with an 8.6% drop, reflecting the "higher-for-longer" rhetoric regarding interest rates, and the potential impact on property values.

Given the potential impact of interest rates on high-growth tech stocks, IT was another sector seemingly hampered by the hawkish sentiment in September, suffering losses of 7.9%. This mirrored the sell-off in US tech giants such as Apple, Nvidia, and Amazon.

Global Equities

Global equities had a negative month, with September typically being the worst performing month historically for stocks. Emerging markets outperformed developed market counterparts returning -2.3% (MSCI Emerging Markets Index (AUD)) versus a -4.0% return according to the MSCI World Ex-Australia Index (AUD). Continued negative economic data in September saw another rise in bond yields and a decrease in equity markets, with inflation falling slower than expected, primarily due to rising energy costs. US equities stumbled amid an interest rate hold and the prolonged possibility of a government shutdown, recording one of its worst months for the year with the S&P500 Index declining -4.8% (in local currency terms) during the month.

The UK was one of the few positive performers for the month, with the FTSE 100 Index returning a gain of 2.4% (in local currency terms). This was driven by a decrease in domestic core inflation and surprising GDP data above expectations. The Bank of England also kept interest rates on hold.

Fixed Interest

In his final meeting as RBA Governor, Phillip Lowe has kept the cash rate on hold at 4.10% for the third month running. This month's meeting signifies Lowe's final monetary policy decision hand down, with his seven-year term not being renewed. During his term, Lowe and the RBA board cut rates to a historic 0.1 percent, and subsequently hiked rates 12 times in a bid to control inflation. Lowe's successor, Michele Bullock, took over the role on September 17.

The month saw a sharp repricing of bond markets with yields rising to cycle highs. Australian 2- and 10- Year Bond yields rose 25bps and 46bps respectively, and the Bloomberg AusBond Composite 0+ Yr Index returned -1.53%. Despite inflation rates falling and economic data showing a slowing economy, bond markets appear to be repricing due to concerns central banks are expected to maintain higher interest rates for a prolonged period.

The story was similar in the US, with the Federal Reserve holding the target cash rate steady at 5.25%-5.50% citing easing inflation pressures and concerns of slowing economic growth. Despite rate hike respite, bond markets experienced a poor month, correlating positively with equity markets. US 2- and 10- Year Treasury yields rose 18bps and 46bps respectively, and the Bloomberg Barclays Global Aggregate Index (AUD) returned -2.58% over the course of the month.

REITs (listed property securities)

The S&P/ASX 200 A-REIT Accumulation index finished September lower after consecutive positive months in July and August, with the index finishing the month -8.6%. Global real estate equities (represented by the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)) also fell, returning –5.3% for the month. Australian infrastructure finished lower through September, with the S&P/ASX Infrastructure Index TR returning -1.6% for the month.

In the month of September, M&A activity was relatively quiet. BWP Trust (ASX: BWP) announced the divestment of their Wollongong property to an unrelated third party for $40mn. In broader news Charter Hall (ASX: CHC) announced new CFO Anastasia Clarke following the resignation of former CFO Russel Proutt. Cromwell Property Group (ASX: CMW) announced the resignation of their CFO Michael Wilde and are yet to announce a replacement.

The Australian residential property market experienced an increase by +0.9% Month on Month (as represented by CoreLogic's five capital city aggregate). Adelaide was the biggest riser (+1.7%), followed by Brisbane and Perth (both +1.3%). All five capital cities performed positively for the fifth consecutive month with Melbourne (+0.4%) being the worst performing city. Over the one-year period, Perth was the largest gainer (+8.8%).

Alternatives

Preliminary estimates for September indicate that the index increased by 3.9 per cent (on a monthly average basis) in SDR terms, after decreasing by 2.5 per cent in August (revised). The rural, non-rural and base metals sub-indices all increased in the past month. In Australian dollar terms, the index increased by 3.9 per cent in September.

Over the past year, the index has decreased by 22 per cent in SDR terms, led by lower thermal coal and liquified natural gas prices. The index has decreased by 17.1 per cent in Australian dollar term

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