Market Update – September 2023

Asset class total return to 30/09/2023	1M (%)	3M (%)	6M (%)	1Y (%)	3Y (% p.a.)	5Y (% p.a.)	Current Yield (%)
Cash	0.3	1.0	2.0	3.6	1.5	1.3	4.1
Fixed Term Deposits	0.4	1.2	2.3	4.0	1.7	1.6	4.9
Australian Bonds	-1.5	-0.3	-3.2	1.6	-3.9	0.3	4.6
Australian Bank Hybrids	1.7	2.8	3.7	4.7	3.6	3.5	5.0
Australian Property	-8.7	-3.0	0.0	11.9	4.9	2.8	4.6
Australian Shares	-2.8	-0.8	0.2	13.5	11.0	6.7	4.3
Global Shares (unhedged)	-4.0	-0.4	7.2	21.6	11.9	9.8	1.9
Global Infrastructure (hedged)	-4.4	-7.9	-8.7	-2.3	2.8	2.8	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	30/09/23	1M	3M	6M	1Y
AUD/USD (cents)	0.64	0.00	-0.03	-0.02	0.00
Aust. 10-year bond yield (%)	4.49	0.45	0.49	1.26	0.54
Gold US$/ounce	1,848	-4.7%	-3.7%	-5.7%	11.4%
Brent oil US$/bbl	95	9.7%	27.2%	20.4%	8.4%
Iron ore US$/t	121	11.0%	7.1%	4.3%	31.5%
Copper US$/pound	3.73	-1.2%	-0.4%	-9.2%	8.3%

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

Global

The US equity market retreated during the September quarter as upward pressure on core inflation raised expectations for interest rates to remain ‘higher for longer’. The recent rally in the oil price, related to OPEC production cuts, has also added to inflation concerns.

While the US Federal Reserve (the Fed) has remained on hold for the last two meetings, it recently reiterated a tightening bias. Of more immediate concern is the persistent rise in the US 10-year bond yield, which has rallied from 3.6% to 4.7%, over the past six months.

A rising bond yield is problematic in many ways, including raising the cost of debt for government, companies and households and increasing the discount rates used to value growth investments. US investors can now get close to 5% in essentially ‘risk free’ cash and bonds (if the bond is held to maturity), which is raising the hurdle rate for all other investments.

The persistent rise in bond yields seems to relate to a number of factors, including rising real yields, increased issuance of bills and bonds (to fund the US budget deficit), dysfunction within Congress, a recent US credit rating downgrade and reduced investor demand for bonds (from the Fed, China and Japan).

It seems growth and inflation will need to fall sharply for bond yields to retreat. One also wonders at what point the Fed will switch from QT (quantitative tightening or selling bonds) to QE (quantitative easing or buying bonds). This is not out of the question, the Bank of Japan is already intervening in bond and currency markets and the Bank of England had to intervene in the bond market in 2022, in response to the Liz Truss government mini-budget shock. However, it would be hard for the Fed to switch its position, without some sort of crisis.

Most other developed countries are also experiencing rising interest rates, but China is going in the opposite direction in an effort to stimulate its lumbering economy. However, China is limited in its ability to act as it must support a sharply depreciating currency (related to US/China interest rate differentials) and it also doesn't want to encourage leverage in an oversupplied and already overleveraged property sector.

Australia

Australia is in a similar situation to the US, where the RBA has remained on hold for the past three meetings but is also worried about core inflation rising. Futures markets are still pricing in one more 0.25% rate rise to go this cycle to take the peak rate to 4.35%.

Elevated Chinese steel production is keeping bulk commodities (iron ore and coal) buoyant for now, but the downside risks seem to be increasing, due to rising evidence of excess steel production and low steel margins. In addition, there has been a recent surge in Chinese migration to Australia (seems to be related to a mistrust of government and a depreciating currency) which has helped prop-up Australian house prices. Although, this is now feeding into core inflation via dwelling shortages and higher rents.

The main positives are that growth and employment remain resilient to date and the Federal government is in a relatively strong financial position with a budget surplus of $20bn and a Debt/GDP ratio below 40%, which is close to the lowest in the developed world. In addition, the Australian Banking system is in a strong position, in terms of liquidity, provisions and capital.

Outlook

Interest rates continue to rise, and investors are now receiving attractive returns on cash, deposits and bonds (for new money). However, we remain cautious on growth assets, as earnings growth is likely to slow and market valuations will also be under pressure from higher bond yields.

This is a direct result of the short-term tightening cycle and will reverse when Central Banks get closer to easing, as growth and inflation retreat. Timing this event is very difficult and there are likely to be many 'false dawns' along the way.

We expect FY24 to be a challenging year for growth assets, but this will lead to great opportunities to buy quality equity, property and infrastructure assets, on a long-term view. Investors should ensure their portfolios are appropriately diversified and accept that volatility comes with investing in assets that offer growth, income and liquidity, such as listed securities.

The next key events on the calendar include:

- US 3Q23 reporting season – October 2023
- Fed meeting – 1 November 2023
- RBA meeting – 7 November 2023
- Australian Bank reporting season – November 2023
- Australian AGM season – November 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.

Warnings, Disclosures and Disclaimer

Date issued: Friday, October 6, 2023

This document is provided by Sunbird Portfolios Pty Ltd (Sunbird) |ABN 91 620 481 218 | AFSL 503266.

Warnings

Any advice provided in this document is general in nature only and does not take into consideration your objectives, financial situation or needs. Before acting on the advice, you must consider whether it is personally appropriate considering your financial circumstances or should seek independent financial advice on its appropriateness. Past performance is not a reliable indicator of future performance.

Disclosures

Sunbird DOES NOT accept fees or gifts from companies or product issuers. Sunbird and its respective officers may have an interest in the financial product of any entities referred to in this material. See www.sunbirdportfolios.com.au for a list of Director shareholdings. All views expressed in this report accurately reflect the author's personal views about the subject investment theme and/or company securities.

Disclaimer

The material in this report has been obtained from sources reasonably believed to be true and neither Sunbird nor its associates make any representation or warranty concerning the accuracy, or reliability or completeness of the information or the performance of the companies or portfolios referred to in this report.

Any opinions and/or recommendations expressed or implied in this material are subject to change without notice and Sunbird is not under any obligation to update or keep current the information contained herein. References made to third parties are based on information believed to be reliable but are not guaranteed as being accurate. Every attempt has been reasonably made by Sunbird to verify the accuracy of the information contained in the report. Sunbird, its associates, officers, directors, employees and agents are not liable for any errors or omissions (except any statutory liability which cannot be excluded) in connection with this report. Except for any liability which cannot be excluded, Sunbird, its directors, employees and agents accept no liability or responsibility for any loss or damage of any kind, direct or indirect, arising out of the use of all or any part of this report.

This report is intended for certain recipients only. It is confidential and may contain information which is privileged or personal. If you are not an intended recipient, you must not disclose or use this report for any purpose. If you have received this report in error, please call us and then destroy the report or delete it from your computer system.

W www.sunbirdportfolios.com.au

E support@sunbirdportfolios.com.au

M 0403534426

T 03 8840 7886

A Exchange Tower, Level 1, 530 Little Collins Street, Melbourne, VIC 3000