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Lonsec Client Summary - November 2023

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Summary of Key Views

Insights from our CIO:

We are at the beginning of the end of this economic cycle. However, the duration of this slowdown remains elusive as employment conditions remain robust. Historical US recessions have been as short as two months to as long as 18 months but have averaged ten months overall. Now is the time to be cautious but not outright bearish.

Interest rates will stay higher for longer. Short-term interest rates continue to be influenced by inflation that, in turn, is not falling fast enough because of factors outside Central Banks' control. For example, Reserve Bank of Australia (RBA) rate hikes will not mitigate the inflationary impact of strong immigration pushing up rental prices. For long term interest rates, the unsustainability of the US fiscal path remains a simmering issue, putting upward pressure on long-term interest rates.

Compensation to Equity investors is poor for taking on equity risk at this point in the cycle. Equally poor expected earnings growth compounds the disadvantage to Equity investors.

Market developments during September 2023 included:

Australian Equities

October saw the ASX 200 finish down 3.8%, marking the third consecutive month of negative returns. 10 of the 11 sectors finished in the red, with Utilities finishing October as the only gainer (1.7%), while Information Technology (IT) (-7.6%), Health Care (-7.2%), Industrials (-6.4%), and Real Estate (-6.1%) saw losses. Several factors have contributed to the drag on returns, including stubborn inflation, rising bond yields, tentative company earnings outlooks and ongoing geo-political tension.

Utilities benefitted as investors moved to defensives, while IT was hit particularly hard by rising government bond yields. Megaport, a constituent of the IT sector, was a significant drag, as its quarterly customer growth report concerned investors. Expectations for a November RBA rate rise were high following accelerating retail spending data and a stickier-than-expected inflation report. This sentiment of rising interest rates was echoed in the yield-sensitive Real Estate sector as it saw a significant downturn. In all, the ASX 200 retreated in October, indicative of the significant headwinds that the local market continues to face.

Global Equities

Global equities had another negative month across the board, developed markets outperformed emerging markets counterparts returning -1.0% (MSCI World Ex-Australia Index (AUD)) versus a -2.0% return according to the MSCI Emerging Markets Index (AUD). Investor concerns continue around interest rates remaining higher for longer. US equities declined following the Federal Reserve's stance of a "restrictive" policy until inflation seems to ease. This saw the S&P500 Index decline by -2.1% (in local currency terms) during the month. The same concerns were raised in the UK, also holding interest rates at 15-year historical highs. The FTSE 100 Index returned a loss of -3.7% (in local currency terms) for the month.

Equities across Asia were also predominantly negative. China's economic growth recovery plans have seen relative slowdown, with headwinds in the real estate sector and investor pessimism around the levels of Government involvement. This was reflected by the CSI 300 Index, returning -3.1% (in local currency terms) for the month.

Fixed Interest

Michele Bullock has kept the cash rate at 4.10% in her first meeting as Governor of the RBA. The month saw bond yields rise, with Australian 10- and 2- Year Government Bond yield rising by 44bps and 37bps respectively. Unsurprisingly the Bloomberg AusBond Composite 0+ Yr Index returned -1.85% and the Bloomberg AusBond Credit 0+ Year Index AUD returned –0.77% over the month. The Australian economy has remained strong and has meant inflation has been slower to fall. Another rate hike is priced in for the RBA's November Cup Day meeting.

Yields in the US continued to rise this month with US 10-Year Treasury note yields rising 36bps and 2-Year Treasury note yields rising 5bps. Strong economic data has kept central banks hawkish, and a peak this month in yields represented the highest yields for US 10-Year Treasury since 2007. However, the strong job market has maintained higher consumer spending levels and future rate hikes may lead to further rate hikes from the Fed.

REITs (listed property securities)

Local and Global REITs continued to sell off during October. Domestically the A-REIT index (represented by the S&P/ASX 200 A-REIT Accumulation Index) ended the month –5.8% lower. Global REITS (represented by the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)) slightly outperformed the local REIT index, albeit still experiencing a significant drawdown of –4.4% during the month. Australian infrastructure finished lower through October, with the S&P/ASX Infrastructure Index TR returning –3.1% for the month.

October saw some activity on the M&A front across the A-REIT sector. Mirvac (ASX: MGR) entered an agreement to acquire land lease operator Serenitas for $643mn. The acquisition expands Mirvac's residential offering and makes them one of the largest owners in the lad lease community sector.

Centuria Industrial REIT (ASX: CIP) announced the divestment of two assets for a combined value of $70 during the first quarter of FY24. Dexus (ASX: DXS) announced that long standing CEO Darren Steinberg will step down after 11 years in the role in 2024. Dexus are yet to announce a replacement.

The Australian residential property market experienced a +0.9% change month on month represented by Core Logic's five capital city aggregate. Perth (+1.6%), Brisbane (+1.4%) and Adelaide (+1.3%) were the best performers. Notably, all five cities experienced positive change month on month through October.

Alternatives
Preliminary estimates for October indicate that the index increased by 3.3 per cent (on a monthly average basis) in SDR terms, after increasing by 4.3 per cent in September (revised). The non-rural sub-index increased in the past month, whilst the rural and base metals sub-indices decreased. In Australian dollar terms, the index increased by 3.7 per cent in October. Over the past year, the index has decreased by 16.8 per cent in SDR terms, led by lower thermal coal and liquified natural gas prices. The index has decreased by 14.6 per cent in Australian dollar terms.

Consistent with previous releases, preliminary estimates for iron ore, coking coal, thermal coal and LNG export prices are being used for the most recent months, based on market information. Using spot prices for the bulk commodities index, the index increased by 0.6 per cent in October in SDR terms, to be 15.3 per cent lower over the past year.