Market Update – December 2023

Asset class total return to 31/12/2023	1M (%)	3M (%)	6M (%)	1Y (%)	3Y (% p.a.)	5Y (% p.a.)	Current Yield (%)
Cash	0.4	1.1	2.1	4.0	1.9	1.4	4.4
Fixed Term Deposits	0.4	1.2	2.4	4.2	2.0	1.8	5.1
Australian Bonds	2.7	3.8	3.5	5.1	-2.7	0.6	4.2
Australian Bank Hybrids	0.4	0.8	3.6	3.2	3.6	3.5	4.7
Australian Property	11.4	16.5	13.0	16.9	5.9	6.4	4.1
Australian Shares	7.3	8.4	7.6	12.4	9.2	10.3	3.8
Global Shares (unhedged)	1.8	5.3	4.9	23.2	11.8	13.6	1.8
Global Infrastructure (hedged)	2.4	8.8	0.1	0.0	3.9	5.1	3.4

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	31/12/23	1M	3M	6M	1Y
AUD/USD (cents)	0.68	0.02	0.04	0.01	0.00
Aust. 10-year bond yield (%)	3.96	-0.43	-0.53	-0.04	-0.08
Gold US$/ounce	2,063	1.3%	11.6%	7.5%	13.1%
Brent oil US$/bbl	77	-7.0%	-19.2%	2.9%	-10.3%
Iron ore US$/t	136	4.6%	12.4%	20.4%	10.6%
Copper US$/pound	3.88	1.3%	4.1%	3.7%	2.0%

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

Global

Global equity markets rallied into the end of 2023, as US inflation and oil prices retreated. The US Federal Reserve (the Fed) itself has indicated that the cash rate is likely to come down in 2024. In turn, bond yields have retreated leading to a welcome boost for growth assets. In addition, the USD is expected to weaken as US interest rates retreat.

While the US economy seems headed for a soft-landing there are still some major challenges ahead, including a widening US budget deficit (around 5-6% of GDP) and a US Presidential election due in early November 2024. US support for the wars in Ukraine and Israel, will continue to challenge the US budget. One also wonders whether China will take advantage of US engagement in Eastern Europe and the Middle East to escalate tensions with Taiwan in 2024.

The Chinese economy seems stable despite ongoing issues in its property sector. Commodity prices have remained surprisingly resilient, outside of oil. Oil prices have retreated as non-OPEC supply has risen to record levels, while conflicts in Ukraine and Israel have not materially disrupted OPEC oil supply (as yet). OPEC has had to keep extending production cuts to support the oil price. Weakness in oil is a positive for the inflation outlook and financial markets generally.

Australia

The Australian economy has slowed but seems likely to avoid recession, while employment remains robust. High immigration levels have boosted nominal GDP and demand for housing. But in turn this has led to falling GDP per capita and rental inflation. House prices have surprisingly risen during a period of rising interest rates, which seems to relate to high rental costs and a shortage of housing stock.

The Federal Government has benefited from stronger-than-expected company and income tax revenue (related to buoyant commodity prices, employment and wage inflation) resulting in the Federal Budget remaining in surplus. With asset prices remaining firm, the balance sheets of Australian banks, companies and households also remain strong.

The main short-term issue is inflation which at 5.0% is still well above the RBA's 2.0-3.0% target range, forcing the RBA to increase the cash rate to 4.35% in November 2023. The Australian economy seems around 6 months behind the US economy in terms of its inflation trajectory, which implies Australian interest rates are likely to remain 'higher for longer' in 2024. This should lead to strength in the AUD during the year.

Longer term, Australia's main challenges are around a lack of growth and productivity on a per capita basis and the energy transition from fossil fuels to clean energy.

Outlook

With inflation retreating in the US, interest rates should ease thus improving the outlook for growth assets (equities, property and infrastructure). However, inflation and interest rates are likely to settle at higher levels than in the past decade, due to inflationary pressures from global mega-trends such as the energy transition, ageing populations, reshoring and central bank money printing (to purchase government bonds). Technology, including AI, offers the greatest promise for productivity and lower inflation.

The key short-term risks are around any rebound in inflation and oil prices. The key 'known unknowns' relate to geopolitical risks (conflict in Eastern Europe, Middle East, Taiwan) and natural disasters (earthquakes, pandemics, climate change events), which are impossible to predict and usually only have a short-term impact on financial markets.

We retain a cautiously optimistic outlook. We note that company balance sheets are in good shape and that an easing in inflation and interest costs should boost company earnings. Our focus on quality, value and yield will continue to be important in driving returns and minimising risk.

The next key events on the calendar include:

- 4Q23 US reporting season – January 2024
- Fed meeting – 30/31 January 2024
- RBA meeting – 6 February 2024
- 1H FY23 Aust. Reporting season – February 2024

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Warnings, Disclosures and Disclaimer

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