Monthly Market Commentary

October 2022

Key Market Performance

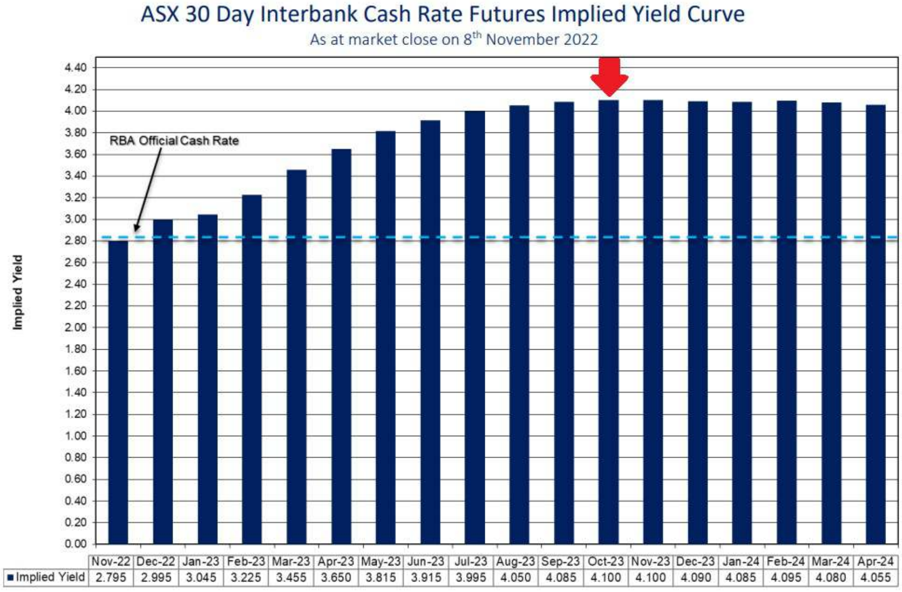
Total Trailing Returns (%)						
Period ended 31 October 2022	1 mth	3 mths	12 mths	3 yrs (p.a.)	5 yrs (p.a.)	10 yrs (p.a.)
Australian Shares	6.0	0.7	-2.0	4.8	7.2	8.7
Australian Small Caps	6.5	-4.9	-18.3	1.5	4.2	5.1
Global Shares - All Country (Local)	6.1	-5.8	-15.4	6.6	6.5	9.7
Global Shares - All Country (Unhedged)	6.6	0.8	-6.0	7.5	9.1	13.3
US Shares (USD)	8.1	-5.9	-14.6	10.2	10.4	12.8
Europe Shares (EUR)	9.1	-2.2	-12.8	2.3	2.1	6.4
Emerging Mkts Shares (Local)	-2.6	-10.7	-24.2	-0.8	-0.2	4.2
Emerging Mkts Shares (Unhedged)	-2.6	-6.3	-19.0	-2.0	0.5	5.8
Global Property (Hedged)	3.1	-14.3	-21.6	-6.3	0.1	5.1
Australian Property	9.9	-8.4	-14.1	-2.7	4.1	8.1
Global Infrastructure (Hedged)	3.2	-8.9	-3.3	0.9	4.0	8.7
Australian Fixed Interest Composite	0.9	-3.0	-7.2	-3.0	0.7	2.4
Global Fixed Interest Composite (Hedged)	-0.4	-6.5	-12.9	-3.7	-0.3	2.3
Cash - Bank Bills	0.2	0.5	0.8	0.4	1.0	1.7
Evidentia 70% Growth SAA Benchmark	4.3	-1.1	-5.2	3.3	5.6	8.2

Economic Review

Despite a backdrop of economic and political uncertainty, global share markets rallied in October. Market sentiment was perhaps buoyed on speculation that central banks were nearing the peak of their tightening cycles, despite economic data continuing to point to current inflationary challenges being far from over. Although most central banks around the world have indicated they will slow the pace of their rate adjustments, they continue to reinforce the message that interest rates have further to rise from here, moving peak rate expectations higher and further out into the future. But with valuation starting points for shares and bonds now broadly more attractive than at any point since the global financial crisis, this bodes well for longer-term returns.

Australia

The most important data release over the month was the September quarter CPI numbers which confirmed headline inflation of 7.3% (against a 7% consensus) which was the highest annual increase since 1990. Trimmed mean CPI jumped 6.1% year on year and confirmed pressure is broad based with prices of nearly all components rising. This was a possible red flag for the Reserve Bank of Australia (RBA) who had slowed the pace of their rate rises at their October meeting. But the RBA stuck to its prudent playbook of allowing the effects of a period of aggressive rate hikes to flow through the economy before making a more definitive call on the outlook for inflation and economic growth, and subsequently raised the official cash rate by 25 basis points to 2.85% at their November meeting on Melbourne Cup Day. The futures market is currently anticipating the official cash rate will peak at 4.1% towards the end of 2023. The RBA said it anticipates inflation will peak at close to 8% later this year, before tapering off next year to 4.75% and a little over 3% in 2024 as global supply-side issues, commodity prices, and domestic demand ease.



The Federal Budget did not contain much of relevance for markets but did outline Treasury's economic predictions. GDP growth was revised down to 3.25% in 2022-23 and 1.5% in 2023-24 but Treasury expects the economy will recover back to its long-run potential expansion pace of 2.5% by 2024-25 and in the process avoid a 'hard landing'. The strength of the job market has been a major contributor to the resilience shown in the economy thus far. Treasury have forecast the unemployment rate to rise modestly from 3.5% to 4.5% by the June quarter of 2024, which is still well below the pre-pandemic jobless rate of 5%. Domestic consumption is beginning to slow as higher living costs and mortgage repayments bite, and there is still a degree of uncertainty about how households who fixed mortgages at ultra-low rates during the pandemic will respond once they hit the so-called 'refinance cliff'. An estimated $500 billion of fixed-rate mortgages charging interest rates of between 2-2.25% will switch to variable rates of 5%+ over the next 12 months.

US

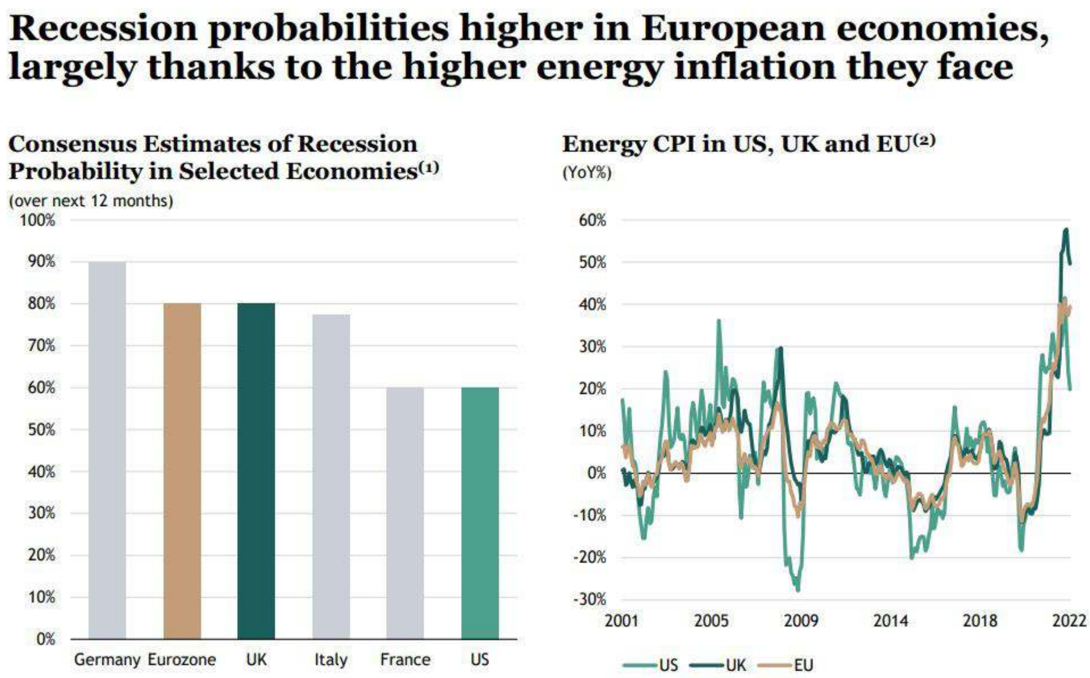
Following a strong core (excluding food and energy) personal consumption expenditures (PCE) price index read of 5.1% for September, the US Federal Reserve (Fed) raised its federal funds rate by 75 basis points to 3.75%-4.00% in early November. Markets initially rallied on the dovish tone set by the Fed's statement which indicated a deceleration in the pace of rate hikes was near, but later reversed course during Fed Chair Jerome Powell's more hawkish press conference where he emphasised that markets should expect further rate hikes and the possibility of a higher peak rate. The latest jobs report had non-farm payrolls up 261,000 and well above the 200,000 consensus forecast, and although the data showed a slight moderation quarter on quarter it is unlikely to alter the Fed's decision-making path. This means the Fed is likely to hike again in December and whether it is by 50 or 75 basis points remains in the balance and will depend on upcoming jobs and inflation data. Futures are currently forecasting the federal funds rate will peak at over 5% by mid-2023.

In the US midterm elections currently underway, Republicans appear set to take control of at the House from the Democrats, while the Senate, currently held by the Democrats, is yet too close to call. Historically, a divided government has been good for financial markets as a gridlock typically results in less policy changes and less risk to individual sectors such as health care or energy favoured more or less by one party or the other. Split rule in Washington could however mean heightened risk of government shutdowns if compromises cannot be found on the federal budget.

Europe

Recession in Europe appears likely as the region faces a severe energy crisis. High energy prices and threat of gas storage depletion are sapping consumer spending and hobbling industry, while unemployment of 6.6% in the EU is already higher than in most other global developed regions. At the same time, inflation is running rampant, hitting a record high of 10.7% year-on-year in October with energy by far the largest contributor highlighting the challenges facing the European Central Bank (ECB) as it tries to balance a slowing economy and high inflation. The ECB hiked interest rates by 75 basis points to 1.5% in October but has yet to provide any details about when it will start reducing its €8.8 trillion balance sheet.

UK markets reacted positively to Rishi Sunak's appointment as prime minister. His fiscally conservative reputation and prior experience as chancellor helped to stabilise gilt yields and in turn interest rate expectations. But UK economic data continued to deteriorate, with the economy unexpectedly contracting by 0.3% in August, and PMI surveys suggesting this weakness had continued into October adding to fears that a recession is imminent. Headline CPI spiked to 10.1% in September. The Bank of England signalled that most of the heavy lifting had already been done after a 75 basis points rate rise in November took its policy rate to 3%.



China

The closely watched 20th Party Congress reinforced President Xi's authority and failed to signal any near term let-up in the zero-Covid policy which has hampered growth in the world's second largest economy. Entrenched support for Xi suggests further development of the country's current policy direction and no near-term policy relief for property markets. Ongoing tensions with Taiwan continue to strain China's global relationships. An economic slowdown in China has global ramifications, none more so than for iron ore, of which China consumes approximately 70% of the global supply, with wavering demand pushing prices down to levels not seen since the onset of the pandemic.

Managers are saying:

"Chair Powell's relatively hawkish press conference comments contrasted the dovish statement. Even though Powell was clear that it is not yet time for the Fed to stop hiking interest rates, we view the statement changes and his comment that it was possible the pace could slow as soon as the next meeting (December) as a first step in this direction.

There are three main reasons why we believe it makes sense for the Fed – as well as other major central banks – to pause interest rate hikes once the policy rate has reached a meaningfully restrictive level:

First, and most important, monetary policy works through lags. This means that with perfect foresight central banks shouldn't shift policy based on what inflation is doing today, but rather what they forecast inflation to do one to two years from now.

Second, recession risk is elevated. We think a U.S. recession is more likely than not, and the speed and global synchronized nature of this tightening cycle risks reinforcing and amplifying the impact of tighter financial conditions. In the U.S., there are still good reasons to believe that the size of the coming economic contraction will be more moderate than what was realized in 2008. However, the sheer speed and magnitude of the financial tightening against a backdrop of already weak real GDP growth risks overdoing it if the Fed were to maintain 75-bp hikes.

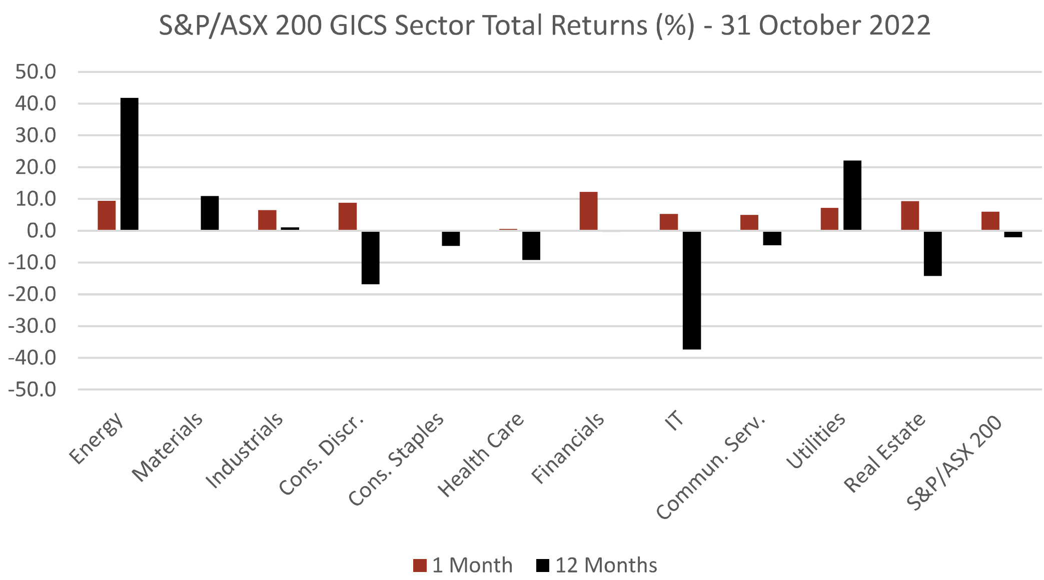
Third, central bankers must also manage the risk that inflation eventually falls just as rapidly as it has risen. Even though we see signs that inflation is likely to be sticky on the way down, and therefore slower to fall back toward central bank targets, this outlook remains uncertain." ***Pimco***

Australian Shares

Australian shares enjoyed a strong October, which started after the RBA surprised the market with a lower than expected 25 basis point rise in the official cash rate as it waited to see how the recent rate hikes were impacting the local economy. The S&P/ASX 200 Index finished the month up 6.0%, while smaller companies also performed well with the S&P/ASX Small Ordinaries Index lifting 6.5% and clawing back some of the falls it has experienced over what has been a challenging year. From a sector perspective, Financials (+12.2%) were the main outperformers with increased focus on widening deposit spreads for the banks. Amongst other outperforming sectors were Energy (+9.5%) which benefited from higher oil prices, and interest rate sensitive sectors like Real Estate (+9.3%) and Utilities (+7.2%) which rebounded from the previous month's losses. Consumer Staples (-0.2%) struggled following disappointing sales updates from the major supermarkets, and Materials (-0.1%) lagged on the back of broad-based commodity price declines. Health Care (+0.6%), Communication Services (+4.9%) and Information Technology (+5.4%) also underperformed the S&P/ASX 200 over the month.

There continues to be downside risk to current earnings estimates, which appear optimistic in the context of a more challenging economic outlook. The current AGM season has seen cautious first quarter updates, triggering some analyst downgrades. Companies which benefited from Covid lockdowns in 2021 are cycling a difficult comparable period, and those exposed to high energy costs, negatively impacted by a lower Australian dollar, and/or exposed to weather disruptions have seen expectations tempered. In the absence of a sharper or more protracted downturn than is currently forecast, revisions at an aggregate level are likely to be modest and largely captured in market de-ratings to date.

Headline valuations for Australian shares are below long-term averages, albeit less so for industrials. Earnings estimates are however yet to be revised lower to reflect weaker conditions and risks to household consumption posed by the RBA's current rate path. Quality companies, with pricing power, strong cost management, and solid balance sheets, are preferred within a more uncertain growth environment.



Managers are saying:

"Short-term volatility is expected to persist as the market digests each data release on a 'case by case' basis however, when looking at the trends in unison, a clearer picture is depicted of an impending economic slowdown and evidence of scarce growth prospects....Overtime, high living costs, tightening monetary policy and declining property and stock prices will continue to erode household balance sheets and will ultimately restrict consumer demand and spending power. This will have a bull-whip effect on supply chains demonstrated by falling global freight costs, as well as company supply-demand fundamentals as sticky costs, lower sales volumes and higher inventories deteriorate margins and their ability to raise prices. In our view, cyclical stocks will be most susceptible to the impact of this slowdown first reinforcing now the need to invest in high quality companies that have the ability to grow their top line irrespective of the market cycle and do so profitably." ***First Sentier Investors***

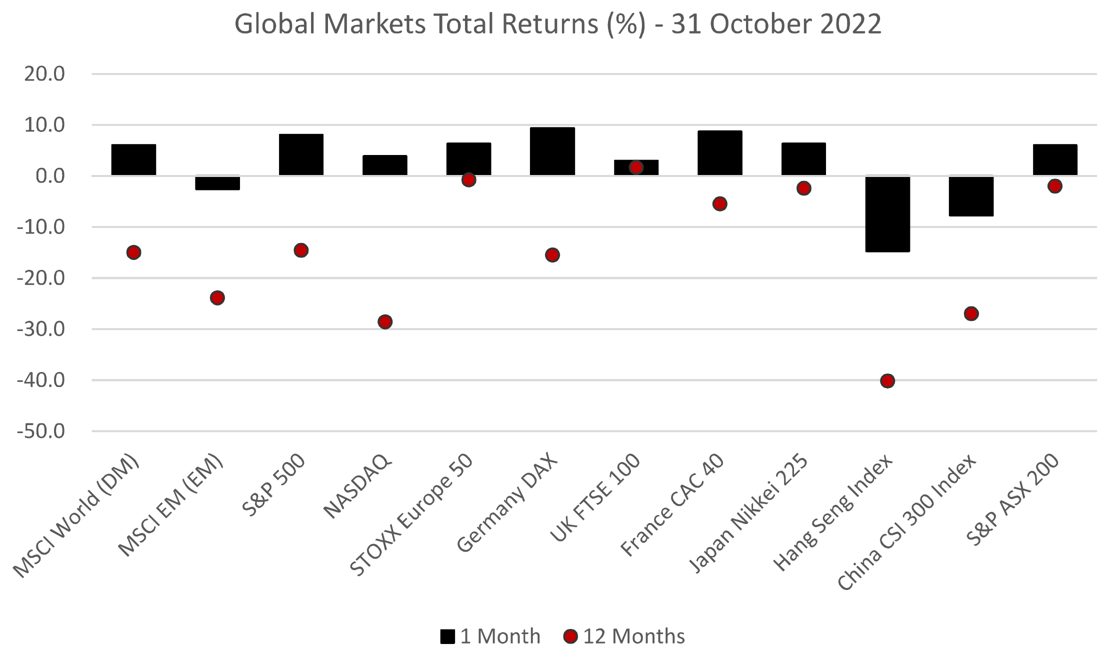
Global Shares

Global share markets rebounded in October. The MSCI AC World Index rose +6.1% (hedged) and was up +6.6% (unhedged). Developed Markets rose +7.2% and significantly outperformed Emerging Markets (-2.6%) which was dragged lower by large falls in Chinese markets (Hang Seng -14.7%, CSI 300 Index -7.7%) and the ongoing implications of a stronger US dollar. Chinese mega-cap companies Alibaba and Tencent fell by more than 20%

in the month as sentiment soured following the country's 20th Party Congress, where President Xi was reappointed as expected but other changes in party leadership surprised, fueling concerns that state objectives will be prioritised to the detriment of the private sector. Ongoing Covid restrictions, property slowdown and geopolitical tensions also continue to depress market sentiment.

The S&P 500 snapped a two-month losing streak ending the month up +8.1% on speculation the Fed would slow the pace of its current tightening cycle. At a sector level on the S&P 500, Energy (+25%), Industrials (+13.9%), and Financials (+12%) all outperformed on robust earnings results, while Consumer Discretionary (0.2%), Communication Services (0.1%), Utilities (2.1%), and Real Estate (2%) all underperformed. In the recent third quarter reporting season, approximately 60% of the US companies to report have beaten earnings estimates with the full impact of weaker demand, inflationary pressures, and rising finance costs yet to be fully reflected, suggesting room for further downward revisions. The NASDAQ Composite, which is more heavily weighted in technology and growth companies, finished up +3.9%, and lagged the broader market due to softer third quarter results from some of its biggest constituents in Microsoft, Alphabet, Meta, and Amazon.

The contraction in earnings multiples is in-line with the rise in nominal bond yields. The earnings outlook remains uncertain. Small companies are trading at multi-decade valuation discount to large companies, this discount has extended as fears of economic slowdown increase. Emerging markets are trading at a large discount to historic valuations, with China undergoing an easing cycle.



Managers are saying:

"The investment landscape remains volatile amid an increasingly complex backdrop for global equity investors. Encouragingly, in this environment, corporate fundamental earnings, which along with cash flow generation that ultimately drive long-term stock prices, have come into greater focus; we are now seeing more differentiated stock performance, which is well suited for active investors." ***T.Rowe Price***

Property and Infrastructure

Global infrastructure has been a massive beneficiary of supportive fiscal policy, whereas global property is very sensitive to long-term interest rates and has been battered about as rates have risen. Global infrastructure returned 4.8% in October, underperforming global shares but has enjoyed a relatively good period as the only major asset class to show positive (3.1%) returns over the past 12 months. Australian property enjoyed a strong month in October with the S&P/ASX 200 A-REIT Index jumping 9.9%. Property valuations are under pressure across all major property asset groups. Office property remains in a difficult operating environment with vacancy rates at 10-15% in Melbourne and Sydney, retail is likely to come under pressure as the costs of inflation start to weigh on consumption, and industrial properties are starting off with very low cap rates. Global property, as measured by the S&P Global REIT Index, rose 4.2% but lagged global shares.

A sharp sell-off in property has taken forward dividends above 4%, in line with long-term average. Rising real yields are a headwind to property valuations but given moves in real yields this risk is moderating. The spread between property dividend yields and US real yields has fallen to be in line with long-term averages.

Global Listed Infrastructure has been the strongest performing asset class over 12 months. The spread between the infrastructure dividend yield and the US real yield has fallen to 2.6% vs 10 year average of 3.8% - suggesting infrastructure is moderately expensive relative to bonds. Infrastructure assets are less economically sensitive, and therefore should be less impacted if an economic downturn occurs.

Australian Cash & Fixed Interest

The Australian fixed interest market, as measured by the Bloomberg AusBond Composite 0+ Year Index, ended October up 0.93% but endured another volatile month with yields continuing to trade in wide ranges. UK political and policy instability along with hawkish Fed commentary initially drove bond yields higher (and bond prices lower) mid-month, only for them to retreat later in the month on the announcement of a new UK prime minister and potential signs of a slowing in the pace of the global tightening cycle. At the shorter end of the yield curve, the Australian 2-Year Government bond yield rose to as high as 3.66%, before ending the month lower at 3.24%. Further along the curve, Australian 10-Year Government bond yields peaked at 4.20% before ending at 3.76%.

Short-term money market yields initially fell on the smaller than expected RBA tightening but climbed again following hawkish Fed signaling and RBA guidance that it would continue to tighten further to bring demand and supply into better balance. After falling to as low as 2.85%, three-month bank bill yields ended the month only 2 basis points higher at 3.09%. In terms of the tightening cycle, markets are looking for around a 3.1% cash rate by year's end and for a further 100 basis points of hikes next to peak at 4.1% in late 2023. The Australian dollar had relatively flat performance against the US dollar over October (-0.5%).

Yields on Australian long duration bonds are at attractive levels and offers upside if the economy slows, while shorter terms yields appear to be pricing in unrealistic RBA hikes. Credit spreads have widened to attractive levels, but we also remain cautious of fundamentals deteriorating if an economic slowdown occurs.

Managers are saying:

"Despite the rising interest rate environment, we believe that pockets of the Australian credit market are alive and well, offering good levels of compensation for risk. That being the case, our approach in these market conditions is to keep powder dry for when markets hit rough patches to capitalise on buying opportunities when quality goes on sale. Through various cycles we have observed that valuations overshoot fundamental fair value in periods of heightened uncertainty or acute needs for liquidity, one such example being the recent liquidation of assets from UK pension funds.

As we move into an environment of slowing growth, high rates and tighter liquidity, the risk of wealth destruction and the potential for permanent capital losses in the form of defaults is magnified. Like buildings in a storm, those with solid fundamentals are far more likely to survive, while the less solid, riskier, and illiquid companies are more prone to feeling the severe pinch of more discerning capital allocation." ***Janus Henderson***

Fixed Interest Rates & Spreads

Period ended 31 October 2022	Month End	1 month earlier	3 months earlier	12 months earlier	10 Year Avg
Australian RBA Cash Rate	2.60	2.35	1.35	0.10	1.50
Australian 10 Year Bond Yield	3.76	3.89	3.06	2.09	2.46
Australian Corporate Composite Bond Spread	2.16	1.90	1.79	1.05	1.20
US Fed Funds Rate	3.25	3.25	2.50	0.25	0.87
US 10 Year Bond Yield	4.05	3.83	2.65	1.56	2.10
US Aggregate Corporate Bond Spread	1.58	1.59	1.44	0.87	1.25
US High Yield Bond Spread	4.64	5.52	4.69	2.87	4.32
Bloomberg Ausbond Comp 0+ Yrs – Yield	3.87	3.99	3.11	1.70	2.31
Bloomberg (Barclays) Global Aggregate – Yield	3.82	3.70	2.60	1.29	1.65

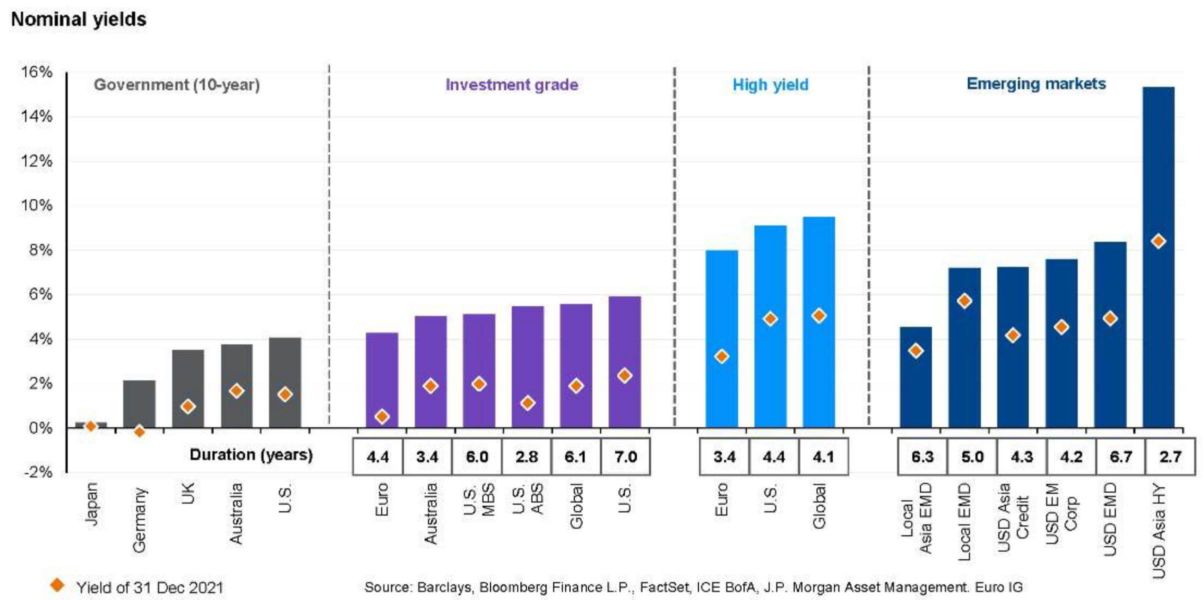
Global Fixed Interest

Global fixed interest markets had a better month than last ending October fractionally down at -0.4%. US Treasuries underperformed other major markets, with better-than-expected labour market data and an upside surprise in inflation once again reinforcing a hawkish response by the Fed. Bond prices fell as the US 10-Year Treasury yield rose from 3.83% to 4.05%, and the US 2-Year Treasury climbed from 4.28% to 4.49%. The UK was a notable outperformer with the appointment of new prime minister Rishi Sunak and a fiscal U-turn helping to stablish gilt yields and in turn interest rate expectations. Yields remained high but fell compared to September, with the UK 10-Year Gilt yield decreasing from 4.15% to 3.51% and the UK 2-Year Gilt yield falling from 3.92% to 3.27%. Elsewhere, the ECB raised rates by an expected 75 basis points but the communications were interpreted as dovish due to the increasing concern over the region's growth outlook and yields on most European government bonds remained virtually unchanged over the month.

A combination of higher nominal rates, wider credit spreads, and new supply, are resulting in increasingly attractive total yields on high quality investment grade credit. Spreads have also widened in the more economically sensitive high yield bond market which are yielding close to 10% but are not as attractive given the risks to credit fundamentals of an economic slowdown. In October, UK credit performed well driven by the restored some calm to the domestic market, as did European investment grade and high yield as the fundamentals and credit worthiness of companies highlighted in third quarter results were better than feared. Emerging markets and US investment grade credit saw negative returns.

Yields on global duration are at attractive levels and offer upside if the economy significantly slows. Recent underperformance relative to Australian duration, means we have shifted our outlook for global duration from underweight to positive. Credit spreads have widened to attractive levels, but we also remain cautious of fundamentals deteriorating if an economic slowdown occurs.

Fixed Income Yields - 31 October 2022



Managers are saying:

"Although the peak and duration of inflation and interest rates are uncertain, our economists concur that increasing fixed income investments in general and adding some duration seems to make sense. While it is very difficult to predict the peak of interest rates, the likelihood of a recession means interest rates are also likely to fall. While cash rates look relatively high right now compared to recent years, they tend to be volatile and aren't likely to stay at current peaks. However, buying a bond at an elevated yield locks in that income over the investment time horizon. Globally, bonds in many Asian countries may provide opportunity to increase yield. All of this leads to a preference for beginning to tilt toward fixed income within a multi-asset portfolio." ***Franklin Templeton***