parker financial 30 years

EVIDENTIA GROUP

Monthly Market Update

July 2023

The Highlights:

- The Reserve Bank of Australia (RBA) left the cash rate unchanged at 4.1% in its August meeting, encouraged by inflation falling faster than expected.
- After raising the federal funds rate to a target range of 5.25% to 5.50% in late July, United States (US) Federal Reserve (Fed) Chair Jerome Powell was more optimistic about the US economy, stating he no longer predicts a recession later this year, merely a slowdown in growth.
- Global share markets got off to a roaring start in the new quarter as moderating inflation and resilient economic data provided a dose of optimism that Central Banks may achieve a soft landing — whereby inflation is tamed without tipping the economy into recession. Traditionally volatile small companies and emerging market segments outperformed.
- Fixed interest (bond) markets were mixed. Fading recession fears and higher for longer rate expectations weighed on global government bonds returns as yields rose, while the less interest rate-sensitive credit markets posted positive returns.

Key Markets - Trailing Total Returns (%)

As at 31 July 2023	1 mth	3 mths	6 mths	12 mths	3 yrs p.a.	5 yrs p.a.	10 yrs p.a.
Australian Shares	2.9	2.0	1.2	11.7	12.0	7.5	8.3
Australian Small Cap Shares	3.5	0.2	-1.5	0.8	5.9	3.2	6.2
International Shares (Hedged)	3.1	8.1	10.0	10.5	10.0	7.4	n/a
International Shares	2.4	6.4	15.2	16.9	12.7	10.4	11.8
Developed Markets Shares (Hedged)	2.8	8.2	10.8	11.1	11.3	8.2	10.3
Developed Markets Shares	2.1	6.4	16.2	17.5	14.0	11.3	12.5
Emerging Markets Shares (Hedged)	5.2	7.3	3.2	5.7	0.6	1.3	n/a
Emerging Markets Shares	4.9	6.3	8.0	12.2	3.6	3.7	6.5
Australian Property	3.8	2.0	-0.2	0.3	9.2	4.1	8.1
International Property (Hedged)	3.2	2.0	-3.5	-9.9	3.8	-0.1	4.2
International Infrastructure (Hedged)	1.4	-1.6	-1.3	-6.0	5.5	4.4	7.4
Australian Fixed Interest	0.5	-2.6	-0.7	-1.5	-3.5	0.6	2.4
International Fixed Interest (Hedged)	0.0	-0.8	-0.1	-3.6	-4.0	0.2	2.5
Cash - Bank Bills	0.4	1.0	1.8	3.1	1.1	1.2	1.7

Economic Review

Australia

The RBA continues to navigate mixed economic data but will be encouraged things are moving in the right direction on the inflation front. Despite the stickiness of services inflation, the June quarter Consumer Price Index (CPI) showed annual headline CPI fell from 7.0% to 6.0%, while core CPI (excluding volatile energy and food prices) came in at 5.9%. However, a 0.9% rise in quarterly core inflation — an annualised pace of 3.6% — was more revealing and suggests inflation is moving back closer to the RBA's target of 2-3% faster than expected. Inflation is expected to reach 3.25% by the end of next year and be back within target by late-2025.

The job market remains remarkably tight, with another month of employment gains and a drop in the unemployment rate from 3.6% to 3.5% in June. However, the job market is a leading indicator, and forward indicators, like job advertisements, have been weaker, implying the market may be close to peaking. Household spending is slowing, and consumer confidence remains low. Against this backdrop, the RBA left the cash rate on hold at 4.1% in its August meeting. The Central Bank's decision was referred to as a 'dovish hold' due to a softening in language around the path of the economy and the need for future rate hikes. This resulted in the market pricing only a 50% chance of another hike in this cycle.

US

At its July meeting, the Fed delivered on its well-telegraphed plans to raise the federal funds rate by 0.25% to a target range of 5.25% to 5.50% — the highest level in 22 years. Fed Chair Jerome Powell was more positive about the US economy, stating he no longer predicts a recession later this year, merely a slowdown in growth. This potentially affords the Fed more flexibility to hike rates if the economy can take it. Much will depend on the path of inflation and the job market from here.

Annual headline CPI increased by 3.0% in June, down sharply from a peak of 8.9% 12-months ago. While core CPI, which remains higher and more persistent due to the resilience of the US economy, rose 4.8%. Despite the pace decelerating, job growth continues at a healthy rate. At the same time, the unemployment rate ticked down to 3.5% in July. This supports the recent narrative the US economy might even avoid a soft landing and instead experience a 'no-landing' scenario — a newly-coined phrase where rates remain high to fight inflation while economic growth continues.

Europe

The European Central Bank (ECB) raised its primary rate by 0.25% to 3.75% in July, and while it did not share any forward guidance about its next moves, it did broach the possibility of a pause in rate hikes at its next meeting in September. The ECB's dovish shift was due to falling inflation and weaker economic data leading up to its July meeting. According to Eurostat, annual inflation for the eurozone is expected to be 5.3% in July, down from 5.5% in June, while the Purchasing Managers' Index (PMI) indicated a modest economic contraction over the month.

The Bank of England (BoE) raised rates by 0.25% to 5.25% in its August meeting — its 14th consecutive hike since it started raising rates in December 2021. Although recent economic data in the United Kingdom (UK) has been mixed, key indicators, notably wage growth, suggest inflationary pressures persist. Annualised headline CPI was 7.9% in June, while core CPI rose by 6.9%, down from 7.1% in May.

Asia

Incoming economic data points to a swiftly fading rebound in China, heightening pressure on the government to release new stimulus measures to steady growth. Manufacturing PMI dropped below 50 in July, indicating a contraction in manufacturing activity. Imports and exports fell faster than expected in July, clouded by weaker global demand prospects. Growth in the short-term is likely to be underpinned by accommodative government policy with reports out of China about more support for the struggling property market boosting sentiment across Asian markets in July. In Japan, a strong annual core CPI inflation read of 4.2% in June steered the Bank of Japan to relax its yield curve control, allowing 10-year Japanese government bond yields to rise from 0.5% to 1.0%.

Asset Class Review

Australian Shares

Australian shares enjoyed a strong start to the new financial year, participating in a broad global upswing as softer inflation data buoyed economic hopes. The S&P/ASX 200 Index returned +2.9% during July. Small companies outpaced large companies — the S&P/ASX Small Ordinaries Index jumped +3.5%. Energy (+8.8%) was the best-performing sector domestically, as investor confidence in a soft landing scenario triggered a 16% jump in oil prices. Positive economic sentiment also drove financials (+4.9%) and real estate (+4.1%) higher. Information technology (+4.5%) was again a beneficiary of the momentum created by the recent artificial intelligence (AI) boom and a strong rally in US mega-cap technology companies. While the health care sector (-1.5%) underperformed again as investors sought to add risk exposure.

What Fund Managers are saying….

"The upcoming reporting season is likely to be challenging for the smaller companies' market, with meaningful earnings downgrades to come. While these earnings headwinds are partly already reflected in share prices – the Small Ordinaries is down 15% since the start of calendar year 2022 – the equity market is likely to, in many cases, extrapolate and overreact to what are, in our view, mostly just short-term cyclical earnings headwinds creating compelling opportunities for long-term investors)."

Yarra Capital Management

International Shares

International shares surged higher in July as positive economic data surprises and signs of easing inflationary pressures boosted investor sentiment. The unhedged MSCI All Country World Index lifted +2.1%, while hedged shares rose +2.8% as the US dollar declined. Performance was positive across all developed market sectors. Energy (+6.1%) led the pack on higher oil prices. Communication services (+6.0%) advanced thanks to strong gains in sector-heavyweights and AI benefactors — Alphabet (Google) and Meta Platforms. Health care (+0.8%), utilities (+1.3%), and consumer staples (+1.2%) made gains but lagged behind the broader market as more defensive sectors fell out of favour with investors.

In the US, the S&P 500 Index rose +3.2% in July. While the technology-heavy Nasdaq also had a strong month lifting +4.1%. With the June quarter reporting season nearly complete, approximately 80% of US companies have beaten earnings expectations, although a smaller percentage have beaten revenue forecasts.

European and UK shares advanced but lagged behind the US. The Euro Stoxx 50 Index gained +1.7% as June quarter company earnings generally proved resilient. The FTSE 100 Index performed better, lifting 2.4% due to its greater exposure to energy and financial sectors.

In contrast to much of the year, emerging markets outperformed developed markets, with the MSCI Emerging Markets Index (hedged) jumping +5.2%. Reports out of China suggesting more support for the property market was on its way also boosted sentiment and shares across the broader Asian region. After a poor couple of months, the MSCI China Index rebounded +10.0% in July. Following a stellar six months, the Japanese market came down to Earth, with the Topix Total Return Index returning +1.5% in July. The market was driven by mid and small-cap companies, which resulted in weaker returns from the large-cap focussed-Nikkei 225 Index — which came off the 33-year high it started the month on.

International Shares - Trailing Total Returns (%) All Local Currency

As at 31 July 2023	1 mth	3 mths	6 mths	12 mths	3 yrs p.a.	5 yrs p.a.	10 yrs p.a.
Australia	2.9	2.0	1.2	11.7	12.0	7.5	8.3
US	3.2	10.5	13.5	13.0	13.7	12.2	12.7
Europe	1.7	3.8	9.6	23.7	14.7	7.4	7.6
UK	2.3	-1.3	1.3	7.8	13.3	3.8	5.5
Japan	1.5	13.1	19.2	23.0	18.6	8.4	9.9
China	10.0	5.5	-5.8	2.3	-9.5	-2.7	3.8
Asia (Ex-Japan)	5.4	6.8	2.7	7.2	1.9	3.0	5.9

What Fund Managers are saying….

"We believe the market is potentially underestimating the value in high-quality businesses with persistent earnings and sales growth in a slowing economic environment. Throughout the year to date, several positive emerging themes arose that we believe will continue throughout the year and beyond. The first of which is a shift in corporations focusing more on efficiencies within their businesses, particularly at the bottom line (earnings). We believe the ability for corporations to run their businesses harder by being more astute with their spending and sizing their workforce appropriately can help them achieve earnings leverage, which may produce considerable upside to margins over the medium term. The second positive has been around artificial intelligence (AI) and machine learning (ML), where we are starting to see an inflection point. A key structural theme that Hyperion identified approximately 10 years ago was AI and ML, however, the potential upgrades to revenue/earnings streams, efficiencies in productivity and increases in market leadership are only now starting to be recognised by market participants."

Hyperion Asset Management

Property and Infrastructure

Listed property followed shares higher in July, shrugging off the prospects of higher-for-longer interest rates and slower economic growth. The local S&P/ASX 200 A-REIT Index jumped +3.8%, while global property, measured by the FTSE EPRA Nareit Developed Index (Hedged), rose +3.2%. The performance of globally listed Infrastructure — also susceptible to higher interest rates — was positive but trailed international shares in July. The FTSE Global Core Infrastructure 50/50 (Hedged) Index rose +1.4%.

Fixed Interest

Fixed interest (bond) markets were mixed in July. Returns from Australian government bonds held up, but global government bonds underperformed due to rising yields triggered by optimism a severe economic downturn can be avoided and recent rate hikes by the Fed and ECB. In contrast, credit (corporate bonds) markets, which are less sensitive to interest rate rises, performed better. The Australian fixed interest market, measured by the Bloomberg AusBond Composite 0+ Yr Index, gained +0.5%. The Bloomberg Global Aggregate Bond Hedged Index was flat in July.

Short and longer-dated government bond yields moved in opposite directions. Yields at the shorter end of the curve were flat or marginally lower, signalling the market believes we are approaching the end of rate hikes. 2-Year Australian Government Bond yields ended the month lower at 4.04%, while the 2-Year US Treasury yield drifted sideways to end at 4.88%.

However, at the long end of the curve, yields moved higher, meaning the recession-predicting inverted curves are beginning to flatten out. 10-Year Australian Government Bond and US Treasury yields ended the month up at 4.06% and 3.96%, respectively.

Softer inflation and broadly resilient global growth were supportive of credit markets. Australian and global investment grade credit returned +0.8% and +1.0% in July. Lower-quality global high yield credit delivered strong returns, up +1.4% over the month in local currency terms. The Australian money market points to one further rise in the cash rate, with the three-month bank bill swap rate (widely used to set lending rates) of 4.26% at the end of July.

Fixed Interest - Rates, Yields & Spreads

As at 31 July 2023	month end	1 mth earlier	3 mths earlier	6 mths earlier	12 mths earlier	10 yr average
Australian RBA Cash Rate	4.10	4.10	3.60	3.10	1.35	1.54
Australian 10-Year Government Bond Yield	4.06	4.02	3.34	3.55	3.06	2.48
Australian Corporate Composite Bond Spread	1.66	1.72	1.85	1.75	1.79	1.24
US Fed Funds Rate	5.50	5.25	5.00	4.50	2.50	1.22
US 10-Year Treasury Yield	3.96	3.84	3.43	3.51	2.65	2.23
US Corporate Bond Spread	1.12	1.23	1.36	1.17	1.44	1.24
US High Yield Bond Spread	3.67	3.90	4.52	4.20	4.69	4.29
Bloomberg AusBond Comp 0+ Yrs Yield	4.30	4.38	3.55	3.69	3.11	2.35
Bloomberg International Aggregate Yield	3.85	3.84	3.52	3.47	2.60	1.78

What Fund Managers are saying….

"As recession fears scaled back, markets have been pricing in a more muted credit default cycle. Our view is more circumspect, as we expect more 'trouble credits' to emerge as the lagged impact of tighter policy takes effect. That said, the timeline could be protracted, given many companies will not refinance for the next one to four years, on average.

Nimbleness and careful credit selection remain key. All-in yields look attractive across the credit spectrum today, relative to history, because policy rates have moved up. However, investors need to consider the extent of the upside available in higher yield issuances given considerations around default risk and liquidity concerns. Spreads have tightened further, particularly in the higher-yielding segments. Unless a soft landing materialises, yields on some sub-investment grade bonds may not offer a sufficient cushion for slowly rising default risk and liquidity declines. Attractive yields are available in some of the safer areas of the market, such as short-duration, high-quality assets. However, investors might want to favour a cautious stance on highly leveraged companies with significant exposure to floating rate debt amid a higher-for-longer interest rate scenario."

Janus Henderson

parker financial 30 years

EVIDENTIA GROUP

This publication is produced by Evidentia Group Pty Ltd ABN 39 626 048 520 AFSL 511802 (Evidentia Group) and has been prepared solely as an information service. This material is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. This material is limited to factual information and commentary about broader market conditions. It does not constitute legal, financial or other professional advice. Nothing in this publication should be interpreted as financial product advice. Before making any investment decision, Evidentia Group recommends obtaining financial product advice from a qualified financial adviser. Past performance is not a reliable indicator of future performance. This publication is based on information considered to be reliable. Our commentary is based on our judgement at the time of issue and is subject to change. No representation, warranty or undertaking is given or made in relation to the accuracy or completeness of the factual information presented in this document. Except for liability which cannot be excluded. Evidentia Group, its directors, employees, agents, and related corporate bodies disclaim all liability in respect of any error or inaccuracy in, or omission from, this document and any person's reliance on it.