



MARKET COMMENTARY – Oct. 2023

Quarter-End Commentary

Overview

- Both stocks and bonds fell over the quarter, as recessionary risks continue to loom, and yields continue marching higher.
- Inflation and interest rates continue to dominate the market narrative, with “higher for longer” now the consensus.
- Longer-term performance is still positive, demonstrating the value of taking a long-term view and patience when investing.

Global shares

The MSCI World Ex-Australia NR Index showed a return of -2.7% in local currency terms for the quarter, though the annual return stood at a respectable 20.6%. However, when considering Australian dollar terms, we observed quarterly returns at -0.4% and a robust annual performance of +21.6%, largely due to the AUD weakening against major currencies.

Sector performance during the quarter demonstrated some winners and losers. Energy and Communication Services sectors posted positive returns of +12.5% and +2.0%, respectively, while Financials remained flat at +0.4%. Conversely, most sectors recorded negative returns, including Health Care (-1.9%), Materials (-2.3%), Industrials (-4.0%), Consumer Discretionary (-4.8%), Consumer Staples (-5.3%), Information Technology (-5.8%), Real Estate (-6.6%), and Utilities (-8.2%).

Regionally, Norwegian equities (+10.8%) were the strongest performers among developed markets, followed by Israeli equities (+6.7%). In emerging markets, Turkish equities stood out with an impressive return of +39.6%, closely followed by Malaysian equities at +5.1%.

Australian shares

Australian shares experienced a challenging quarter, with the S&P/ASX200 accumulation index returning -0.8%. Notable sector winners included Energy (+11.6%), Consumer Discretionary (+5.6%), and Financials (+2.3%). Lagging sectors included Utilities (-1.9%), Materials (-2.7%), Industrials (-2.9%), Information Technology (-4.9%), Consumer Staples (-5.8%), Telecommunication Services (-6.9%), and Health Care (-9.0%).

Bonds

The bond market saw yields rise over the quarter, primarily driven by escalating U.S. inflation. This upward pressure on yields resulted in declines in the global benchmark index.

Key 10-year treasury yields as of September 30, 2023, were 4.5% for Australia and 4.6% globally in local currency terms.

Global property & infrastructure

Global property & infrastructure investments, both domestic and global, also faced negative results during the quarter. In AUD hedged terms, Australian listed property posted a -3.0% return, global listed property returned -5.1%, and global listed infrastructure recorded a -6.5% decline.



MARKET COMMENTARY – Oct. 2023

Currencies

The U.S. dollar appreciated against most major currencies, with the Australian dollar finishing the quarter at 64 US cents, down from 66 US cents at the start of quarter.

Important Perspective

The third quarter of 2023 brought its share of difficulties for investors, with both stock and bond markets experiencing declines. These setbacks offsetting some of the gains witnessed earlier in the year.

The Morningstar Global Markets index ended Q3 with a 3.2% decline. Despite this, it's important to note that the index still maintains a positive performance year-to-date, returning 9.9% and a substantial 21.0% over the past 12 months. The losses during the quarter, though widespread, were relatively shallow, with low single-digit declines observed in regions such as the U.S., Europe, and emerging markets.

Bond markets also experienced decline during the quarter, with the Bloomberg Global Aggregate Bond index showing a 3.6% decrease. This places the bond market in modestly negative territory for the year. However, the silver lining is that bond yields are becoming increasingly attractive, offering more favorable rates.

Seven noteworthy factors are currently shaping market dynamics:

1. A potential resurgence of inflation risk due to significant energy price increases.
2. A preference among central banks for keeping interest rates at elevated levels for an extended period.
3. Company earnings that are trending sideways and expected to dip during the upcoming reporting season.
4. Ongoing considerations of a possible recession, despite a resilient consumer.
5. Mounting political uncertainty as we enter another election cycle.
6. The rapid growth of artificial intelligence, accompanied by speculation and excitement.
7. The "Higher for Longer" Landscape

Perhaps the most significant shift is the emergence of the "higher for longer" landscape, where expectations for prolonged elevated interest rates are reshaping market dynamics.

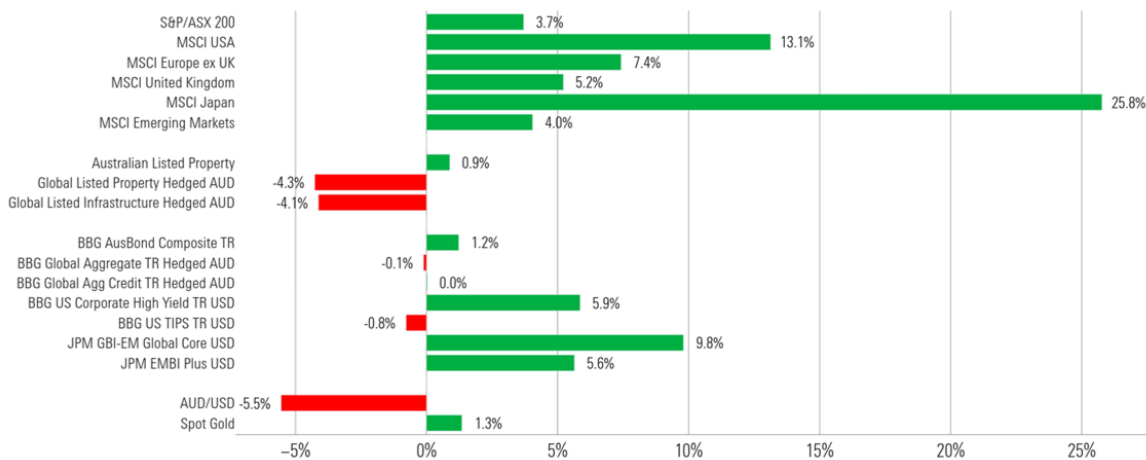
Notably, in Australia, stocks and bonds experienced a downturn following the October meeting of the Reserve Bank of Australia. Despite the central bank's decision to maintain steady interest rates, market participants interpreted Governor Michele Bullock's comments as an indication of the central bank's intention to keep interest rates elevated for an extended duration. This narrative mirrored discussions at the September meetings of the Federal Reserve and the European Central Bank.

Given these dynamics, it's unsurprising that value stocks outperformed growth stocks during the quarter. Particularly noteworthy were the strong performances of energy and materials stocks, while utilities lagged. In the bond market, shorter-

duration bonds demonstrated resilience during the quarter, though few segments managed to secure positive returns. High-yield debt, against market expectations, emerged as a leader, while inflation-linked bonds faced headwinds due to shifting inflation expectations.

In this environment, cash played a stabilising role throughout the quarter, with the strength of the U.S. dollar also deserving mention. These factors reflect the broader financial landscape during the third quarter of 2023.

Australian Global Asset Class Returns – Year to date



Latest data point is Sep 29, 2023

Source: Cleareconomics, Morningstar, MSCI, Bloomberg, JP Morgan.

Looking Ahead

Looking at the bigger picture, global stocks have displayed impressive annual gains of 7.2% over the past three years and 6.6% over five years. This achievement is particularly striking when considering the unforeseen challenges of a pandemic, a war in Europe, and the highest inflation rates in decades. Moreover, it underscores the power of a patient investment strategy, as even at this pace, the market would double approximately every 11 years.

While global stocks haven't plummeted dramatically, it's essential to recognise that households remain cautious, with consumer sentiment scores persistently below typical levels.

Acknowledging potential risks, a concern is the stagnation in earnings growth. Investors have driven prices higher relative to earnings, a phenomenon known as multiple expansion. This expansion has, in part, been fueled by expectations of swift and aggressive interest rate cuts by central banks. Consequently, two critical, yet highly unpredictable variables come into play: the trajectory of interest rates and corporate earnings.

To highlight the unpredictability of the financial landscape, earlier this year, many were anticipating an economic slowdown or even a recession by the third quarter, with bond markets pricing in rate cuts for 2023. As it became evident that recession



MARKET COMMENTARY – Oct. 2023

risks were not imminent, bond markets started pricing in as many as five rate cuts for 2024. Investor sentiment appears to have shifted, with these scenarios no longer being the focal point of concern.

Simultaneously, the outlook for corporate profits remains uncertain. Notably, a record 116 S&P 500 companies have provided earnings guidance ahead of the quarter's end, with expectations for flat (-0.1%) year-on-year earnings. This increased clarity is a logical response to the current climate of investor nervousness, which may reduce emotional reactions to potential disappointments.

At the portfolio level, it's important to anticipate unforeseen developments. Such surprises are inherent to investing and underscore the need for resilient and well-diversified strategies. As such, we maintain a strategy of seeking exposure to assets with promising long-term return prospects while balancing risks through defensive exposures. This approach will remain crucial in navigating the evolving financial landscape.