The Monthly Market Report

ISSUE 110 | April 2023

Asset Class Returns April 2023

Asset Classes	Month % chge	3 Month % chge	6 month % chge	FYTD%	YTD %	1 year % chge	3yr return pa	5yr return pa	10yr return pa
Australian Shares (ASX 200 Accumulation)	1.85	-0.80	8.71	15.73	5.38	2.83	13.99	8.26	7.90
Global Shares (MSCI World ex Aust-net(USD))	1.79	2.60	12.24	12.92	9.77	3.33	13.06	8.20	8.88
Global Shares (MSCI World ex Aust ,net, AUD)	3.16	9.40	8.61	17.50	12.64	11.12	12.71	11.11	13.91
MSCI World ex Australia 100% hedged to AUD Index (Net)	1.61	2.47	8.81	10.62	8.86	1.47	12.08	7.52	9.93
Australian Property (S&P/ASX 200 - Property Trusts (TR)m)	5.29	-2.11	7.38	10.08	5.84	-9.90	10.71	4.94	7.36
Global REITs (FTSE EPRA Nareit DEV HEDGED IN AUD L - TOT RETURN IND)	2.02	-5.46	3.06	-4.87	2.11	-16.36	4.29	0.52	3.19
Australian Cash (Bloomberg AusBond Bank Bill Index)	0.30	0.83	1.60	2.28	1.10	2.37	0.81	1.11	1.68
Australian Bonds (Bloomberg AusBond Composite 0+ yr Index)	0.19	1.99	4.23	4.52	4.80	2.06	-2.28	1.38	2.64
Global Bonds (Barclays Global Aggregate (AUD Hedged))	0.41	0.69	3.86	-0.45	2.80	-2.28	-3.17	0.43	2.35

Sub Asset classes	Month % chge	3 Month % chge	6 month % chge	FYTD%	YTD %	1 year % chge	3yr return pa	5yr return pa	10yr return pa
MSCI All Country ex Aust(net, AUD)	2.80	8.30	9.03	15.84	11.70	9.75	12.06	10.19	13.16
US Shares (S&P 500 Total Return Index)	1.56	2.72	8.63	11.70	9.17	2.66	14.52	11.45	12.20
Australian Small Caps (ASX Small Ords Accum (Ex 100))	2.78	-1.74	5.77	12.07	4.71	-9.43	9.22	3.90	5.95
Global Small Caps (MSCI Small Cap Index (USD, net))	-0.10	-4.66	6.80	9.30	4.18	-1.81	12.72	4.24	7.47
Global Small Caps ex-Aust (MSCI World Small Caps ex Aust (NI) AUD)	1.36	1.67	3.73	13.90	6.93	6.66	12.42	7.11	12.55
Global Emerging (MSCI Emerging Markets (USD))	-1.13	-4.74	16.36	-0.30	2.78	-6.51	4.32	-1.05	1.80
Global Emerging (MSCI Emerging Markets (AUD, net))	0.20	1.57	12.59	3.75	5.47	0.53	4.00	1.62	6.51
Global Infrastructure (FTSE Global Core Infrastructure 50/50 Index - AUD Hedged NR)	2.06	0.26	4.84	-0.02	1.70	-3.40	6.97	5.63	7.34
Global Credit (Barclays Global Aggregate Credit (AUD Hedged))	0.71	0.02	6.68	0.87	3.25	-1.94	-2.45	0.76	2.67
Global High Yield (Barclays Global Aggregate High Yield TR Hedged AUD)	0.23	-1.03	6.57	6.55	2.55	-1.70	2.52	0.70	3.73
Australian Govt Bonds (Bloomberg AusBond Infl Govt 0+ yr Index (d))	0.32	2.19	6.81	9.03	7.17	4.16	1.97	3.02	3.06
Treasury Yields (Bloomberg Treasury Index)	0.01	1.90	3.88	4.39	4.90	1.99	-2.89	1.37	2.43
Australian Credit (Bloomberg AusBond Credit Bond Index (d))	0.45	1.68	4.65	4.99	3.90	2.99	-0.17	2.09	3.32
Australian Floating Rate Bonds (Bloomberg AusBond Credit FRN 0+ Yr Index)	0.46	1.16	2.36	3.26	1.59	3.23	1.61	1.89	2.57
AUD-USD (m)	-1.52	-6.07	2.96	-4.05	-2.44	-7.53	0.22	-2.68	-4.40
Trade Weighted Index of AUD (AUD TWI(m))	-0.83	-4.17	-2.45	-3.24	-2.61	-5.23	1.14	-0.75	-2.67
US Broad Dollar Index -- Nominal, Monthly	-1.15	-0.30	-6.27	-0.45	-2.28	1.91	-1.06	2.04	2.64

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1. Markets

GLOBAL DEVELOPED EQUITIES

- The volatility that had characterised the last few months in equity and bond markets subsided in April, underpinning a slight bid tone to most assets. A combination of declining inflation, expectations of a peak in central bank hawkishness and better than expected earnings results helped push equity markets higher despite lingering risks of recession. Global equity markets rose a further 1.8 per cent in April, following the 3.2 per cent advance in March, taking the annual gain to 3.3 per cent. The turmoil in the bank sector in March was put aside for the most part although as we exited April, First Republic was quietly closed, the 2nd largest bank failure in US history, and taken over by JPMorgan.
- The data remains mixed. As noted above, the inflation news has been broadly better. US inflation dropped to 5 per cent from 6 per cent although the core CPI rose modestly to 5.6 per cent. In Europe inflation continued to ease although in the UK inflation remained over 10 per cent. On the activity front, manufacturing PMI readings are below the important 50 level in most jurisdictions while service sector PMI's paint a stronger story, reflecting the strong trend in consumer spending on services post-Covid, backed by excess savings and solid income growth.
- However, there is also growing evidence of recession. In the US, particularly in the aftermath of the failure of several US banks, credit conditions and accessibility appear to be tightening while business capex intentions are pointing to weakness in investment spending. US GDP growth slowed to a 1.1 per cent rate in the March quarter and the latest Atlanta Fed GDPNow estimate is 1.8 per cent for the current quarter. The labour market, although softening a touch, remains tight with unemployment at 3.5 per cent and the broadest measure of wages growth, the employment costs index, just under 5 per cent.
- For equities, the combination of hefty prices rises and a relatively resilient household sector has meant corporate earnings have exceeded expectations and is a reminder that equities carry an inflation hedge component. The latest data from Factset suggests earnings have so far notched up their best performance relative to analyst expectations since Q4 2021. Combining actual results to date with estimates, the earnings decline for the first quarter is -3.7 per cent, compared to an earnings decline of -6.7 per cent at the end of the first quarter.
- In AUD terms the MSCI World ex-Australia index rose 3.2 per cent in April, taking the annual gain to 11.1 per cent, clearly supported by a fall in the AUD. Europe ex-UK was the stand-out, up 3.8 per cent with France and Italy up by at least 4.5 per cent. For the 12 months Europe ex-UK has risen 13.1 per cent in USD terms, outperforming global equities. The US managed a 1.2 per cent lift and Japan 0.4 per cent. For the year, the MSCI US index is up just 1.4 per cent.
- At the sector level, insurance, consumer staples and healthcare outperformed, perhaps reflecting the ability of those sectors to offer inflation protection. The IT sector was off marginally while banks lost 2.2 per cent as tightening credit conditions undermined the outlook. Defensive sectors gained 3.7 per cent while momentum and quality exceeded the index. For the past 12 months defensives and quality have returned over 5 per cent with momentum stocks down slightly.

AUSTRALIAN EQUITIES

- The Australian equity market rose 1.9 per cent in April, producing an annual gain of 2.8 per cent. The Australian market's outperformance of global markets seemingly ended in the first few months of 2023 as investors turned to growth stocks and became more cautious on domestic banks in light of concerns over the household sector and on materials as China's post-Covid recovery proved underwhelming.
- Although banks gained 3 per cent in April, over the three months they have declined almost 7 per cent with investors acknowledging that the bank sector may be negatively impacted by any further movements in short term rates. For most of 2022 banks benefited from the rising interest rate environment however signs of a peak in net interest margins and the impact of cumulative mortgage rate increases on household disposable incomes and the housing market has been undermining the sector in 2023. Meanwhile, the materials sector declined 2.6 per cent in the month, taking the three-month decline to 3.7 per cent, partly reflecting the 17 per cent drop in iron ore prices in April. Weaker than expected growth in construction in China, after an initial burst post-lockdowns, was cited a factor behind the weakness.
- After a period of poor performance, REITs gained 5.3 per cent in April while insurance, benefiting from higher bond yields, extended its run, up a further 4.9 per cent to take the annual increase to 18.5 per cent.
- The RBA kept the cash rate unchanged in April after hiking at each of the previous ten meetings with RBA governor Philip Lowe noting "The decision to hold interest rates steady this month provides the board with more time to assess the state of the economy and the outlook, in an environment of considerable uncertainty,". The RBA had commented that at 3.6 per cent the cash rate was already in "restrictive territory". Furthermore, the board had been discussing the lags in monetary policy, the effects of the large cumulative increase in interest rates since May 2022 and the difficulties that higher interest rates were causing for many households. Hence, the 25 basis point increase in early May was seen as a surprise.
- In hindsight, markets had been "blinded" by this language and by the pause in April. Recent data on employment had been strong (up 53,000 in march and unemployment at 3.5 per cent) and the March quarter CPI data showed that although headline inflation dropped from 7 per cent to 6 per cent, core inflation was a stubbornly high 6.6 per cent. Markets had placed greater weight on wages growth, which had shown signs of steadying at lower than expected levels.

EMERGING MARKETS

- The MSCI Emerging markets index declined 1.1 per cent in USD terms in April, taking the 3-month loss to 4.7 per cent and the annual decline to 6.5 per cent. In AUD terms emerging markets managed to lift slightly although for the 12 months are up just 0.5 per cent.
- The major reason for the recent weaker performance relative to developed markets was the weakness in China where an uneven recovery in the economy emerging from Covid lockdowns undermined confidence. Although the Chinese economy grew a stronger than expected 4.5 per cent in the March quarter, led by the consumer sector, the bounce is not as large as experienced by most western economies in the aftermath of lockdowns due to the fact that the Chinese government and central bank did not provide the same degree of stimulus. While real estate prices and sales have recovered, investment in the sector remains weak. This fits with the government's emphasis on consumption rather than real estate as the driver of growth going forward.
- MSCI Asia declined 2.4 per cent in the month with MSCI China down 5.2 per cent, and Taiwan down 4.3 per cent. For the 12 months China is down 5.8 per cent, Taiwan 8.4 per cent and Korea 9.5 per cent. India provided an offset, rising 4.2 per cent in April. Latin America rose 2.7 per cent, assisted by a solid performance from Brazil. EM Europe was up 5.3 per cent as Poland and the Czech Republic rose sharply.
- The outlook for emerging markets is heavily dependent on the outlook for China. While the performance of Chinese equities has been volatile, a combination of solid growth, low inflation and accommodative policy settings stands in contrast to most developed markets. Policy uncertainty and risks associated with the heavily indebted property sector remain.

REITS AND INFRASTRUCTURE

- After falling 6.8 per cent in March AREITs rose 5.3 per cent in April, taking the annual return to -9.9 per cent, well below broader equities. Global REITs managed a 2 per cent increase during the month although the 12 month return was -16.4 per cent.
- REITs are typically an interest rate sensitive sector but given the deteriorating economic backdrop and tightening credit conditions, the focus has been on the underlying asset values. While REITs have adjusted and priced in lower asset values, the magnitude of any revaluation in commercial and retail assets is shrouded in uncertainty. In the US it is estimated that office values in some areas have declined by as much as 20 per cent. A combination of higher interest rates and bond yields, lower occupancy rates following Covid and tightening credit conditions have all contributed to a lift in cap rates. The turmoil in the smaller regional US commercial banks and the associated decline in deposits is adding to pressure on the commercial real estate market given commercial real estate loans account for about 40 per cent of smaller banks' total lending, compared with around 13 per cent for the larger banks.
- Meanwhile, the global infrastructure sector managed to rise 2.1 per cent during the month. Despite the decline in real yields over the past 6 months infrastructure returns have lagged broader equity market returns.

GLOBAL FIXED INTEREST

- The volatility in global bond markets subsided in April with the US 10 year yield trading in a tighter range, ending the month at 3.44 per cent from 3.48 per cent in March. Shorter-dated bond yields rose slightly as markets more confidently priced in a May Fed funds hike. The US 2 year yield ended the month at 4.04 per cent, little changed for the month. Markets were effectively pricing in two cuts in the second half of 2023 with a further five cuts to just over 3 per cent in late 2024. The March FOMC meeting materials suggest the Fed funds rate would remain at 5.1 per cent in 2023, and remain there, before easing to 4.1 per cent by end-2024.Clearly, the market does not support the Fed's view.
- Unlike previous rate cycles and reflecting the idea that inflation will prove sticky and that any recession is likely to be mild, market pricing implies that the Fed will remain well above neutral for an extended period and ease relatively modestly.
- US TIPs yields also rose slightly with the yield on 5-year TIPs rising to 1.31 per cent while for the 10-year TIP the yield rose to 1.26 per cent, still well off the highs of just under 2 per cent. Implied inflation expectations drifted slightly lower over the month to 2.2 per cent, a vote of "confidence" in the Fed's inflation-fighting policy.
- On the data front, US inflation dropped from 6 per cent to 5 per cent although the core CPI rose modestly to 5.6 per cent. European inflation continues to ease although in the UK inflation remained over 10 per cent. Manufacturing PMI readings across the major markets are below the important 50 level while service sector PMI's paint a stronger story, reflecting resilient consumer spending on services post-Covid, backed by excess savings and solid income growth.
- However, there is also growing evidence of recession. In the US, particularly in the aftermath of the failure of several US banks, credit conditions and accessibility appear to be tightening while business capex intentions are pointing to weakness in investment spending. US GDP growth slowed to a 1.1 per cent rate in the March quarter and the latest Atlanta Fed GDPNow estimate is 1.8 per cent for the current quarter. Although there is some evidence of a softening in the labour market, it remains tight with unemployment at 3.5 per cent and the employment costs index rising close to 5 per cent. This is inconsistent with inflation near target.
- Global bonds returned 0.4 per cent for the month and 0.7 per cent for the quarter but are down 2.3 per cent for the year. Global high yield was up just 0.2 per cent as concerns over the banking sector and recession risk kept spreads around 450 basis points. Investment grade credit returned 0.7 per cent for April but has lost 1.9 per cent over the year.

AUSTRALIAN FIXED INTEREST

- Similar to global bonds Australian bond yields traded in a relatively tight range, ending the month at 3.35 per cent from 3.3 per cent. The Bloomberg composite bond index returned 0.2 per cent for the month and 2 per cent for the quarter, taking the annual gain to 2.1 per cent, solidly outperforming global bonds. Inflation linked bonds gained 0.3 per cent in April and have returned a solid 4.2 per cent for the 12 months.

- Over the course of the month the market became increasingly confident that the RBA would hold rates steady for the second consecutive meeting in early May. The RBA had earlier signalled that at 3.6 per cent the cash rate was already in "restrictive territory" and that the board had been discussing the lags in monetary policy, the effects of the large cumulative increase in interest rates since May 2022 and the difficulties that higher interest rates were causing for many households.

- However, in early May the RBA delivered a 25 basis point hike to 3.85 per cent. In doing so RBA governor Philip Lowe noted "While the recent data showed a welcome decline in inflation, the central forecast remains that it takes a couple of years before inflation returns to the top of the target range; inflation is expected to be 4½ per cent in 2023 and 3 per cent in mid-2025." Lowe also highlighted that the lack of productivity made the Australian economy inflation prone.

- In hindsight, markets had been "blinded" by this language and by the pause in April. Recent data on employment had been strong (up 53,000 in March and unemployment at 3.5 per cent) and the March quarter CPI data showed that although headline inflation dropped from 7 per cent to 6 per cent, core inflation and service sector inflation remains stubbornly high at above 6 per cent. House prices had also begun to recover, partly reflecting the belief that the hiking cycle was over. It appears markets had placed greater weight on wages growth, which had shown signs of steadying at lower than expected levels.

- The surprise move, and the reason given, suggests that the risk of a further hike cannot be ruled out. The RBA noted "Some further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe, but that will depend upon how the economy and inflation evolve." The RBA is signaling that it retains the option for further rate increases, while also acknowledging that it may be done hiking rates in this tightening cycle.

COMMODITIES

- The price of Brent crude oil rose to a high of US$87.25 a barrel in mid-April before falling to US$79.42 a barrel at month-end. The surprise decision in early April by several OPEC+ producers to voluntarily curb output by 1.6 million barrels per day until the end of the year pushed prices higher and led to bullish forecasts for oil in 2023. However, by month-end concerns over the broader growth outlook and uncertainty over the strength of the Chinese recovery in industry and property undermined prices.
- The price of iron ore has also been a casualty of the underwhelming Chinese industrial recovery. Prices declined 17 per cent in April to US$105 a tonne partly attributed to weaker than expected growth in construction in China, after an initial burst post-lockdowns.
- Gold managed to hold close to the US$2000 an ounce level and has been a major beneficiary of the large decline in real yields and the recent weakness in the USD. The price of gold is up more than 22 per cent since early November 2022. Over the same period the USD is down around 6 per cent and real yields have declined by close to 50 basis points.
- The price of copper declined more than 4 per cent as cyclical concerns outweighed the stronger structural story.

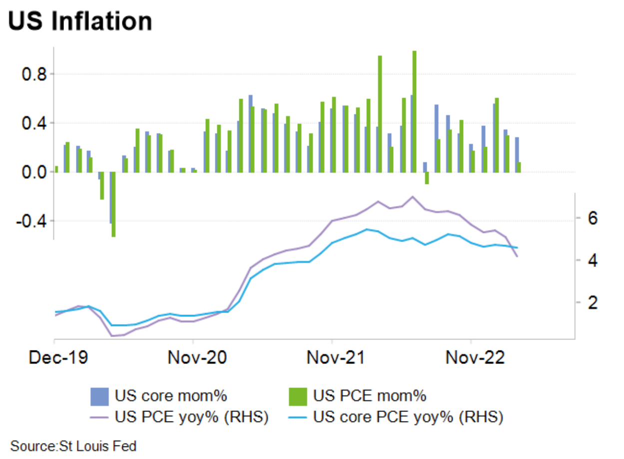
CURRENCY

- It was a mixed month for the USD, rising against the Japanese yen, the AUD and many EM currencies while softening against the pound and the euro. Markets moved to more confidently price in a May Fed funds hike and an ECB hike but expressed the view that the US rate cycle was closer to a peak than in Europe and the UK. The euro rose from 1.084 to 1.099 while the pound lifted to 1.25 from 1.23. The yen resumed a softer tone, partly reflecting the view that the new BOJ governor would maintain current easy policy settings. The yen ended the month at 137.08, a loss of almost 3 per cent.
- The AUD drifted back towards the 66 cent level as markets started to factor in no change in RBA policy and a hike in the US. Weaker iron ore prices and some softer industrial and property sector news in China did not help the cause. However, in early May, the surprise 25 basis point RBA hike saw the AUD jump more than 1 per cent.

2. Key Economic Releases

US INFLATION DECLINES

- The March core PCE price index rose 0.3 per cent in the month with the headline measure up just 0.1 per cent. On an annual basis core PCE prices are up 4.6 per cent, down from 4.7 per cent.
- The March CPI release showed a 0.1 per cent rise (annual 5 per cent). The core CPI, however, was up 0.4 per cent for a 5.6 per cent annual lift.
- The US PPI for March was a much weaker than expected -0.5 per cent.



IMF FORECASTS

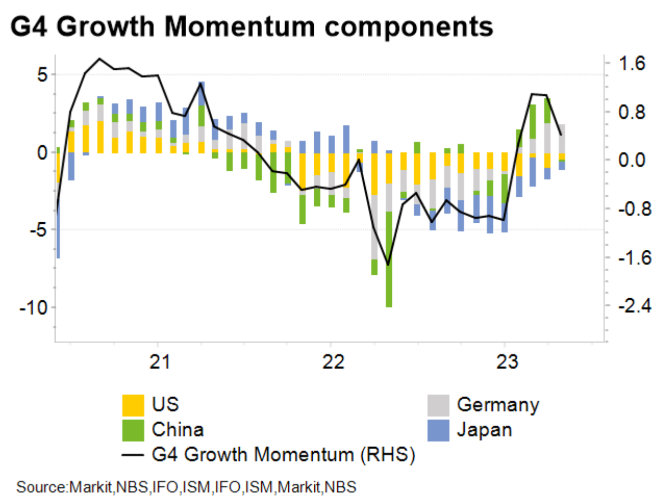
- The IMF updated its growth and inflation forecasts. GDP growth was revised down by just 0.1 per cent from its January forecasts with global growth of 2.8 per cent expected for 2023 and 3 per cent in 2024. US growth is expected to be 1.6 per cent on 2023 and just 1.1 per cent in 2024 while Europe bounces from 0.8 per cent in 2023 to 1.4 per cent. EM growth is projected at 3.9 per cent in 2023 (China 5.2 per cent) and 4.2 per cent in 2024 (China 4.5 per cent).
- Inflation continues to decline but in the US is still 4.5 per cent in 2023 and 2.3 per cent in 2024. All up, the IMF forecasts, while warning of hard landing, are essentially for a soft-landing.

GDP	**2022**	**2023**	**2024**
World	3.4	2.8	3
Advanced	2.7	1.3	1.4
US	*2.1*	*1.6*	*1.1*
Euro	*3.5*	*0.8*	*1.4*
Aus	*3.7*	*1.6*	*1.7*
Emerging	4	3.9	4.2

CPI	**2022**	**2023**	**2024**
World	8.8	6.5	4.1
Advanced	7.3	4.7	2.6
US	*8*	*4.5*	*2.3*
Euro	*8.4*	*5.3*	*2.9*
Aus	*6.6*	*5.3*	*3.2*
Emerging	9.8	8.6	6.5

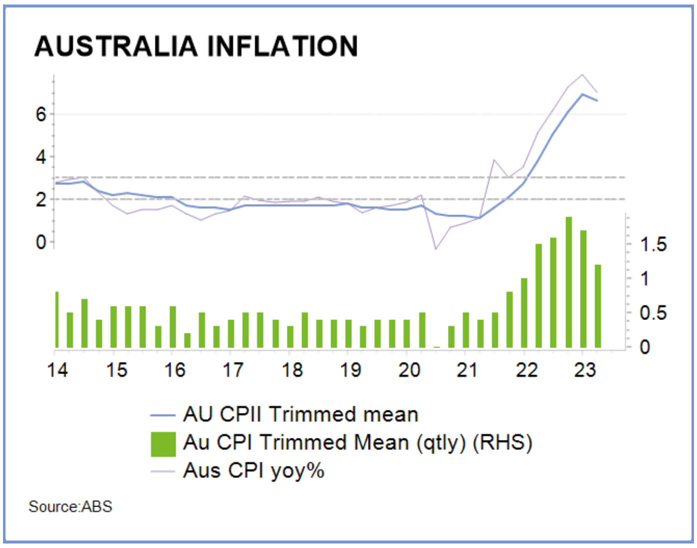
GLOBAL GROWTH MOMENTUM FALTERS

- Global growth momentum remained above zero in April after becoming positive for the first time since July 2021 in January 2023. However, momentum did slow somewhat in April, largely as a result of the drop in the Chinese PMI. US new orders were also soft.
- Nevertheless, global growth momentum above zero (which provides an early indicator of a bottom in the manufacturing cycle) is associated with positive 3-month global equity market performance 82 per cent of the time (average 4.9 per cent) as opposed to negative momentum which is associated with negative performance 54 per cent of the time (average -1.7 per cent).



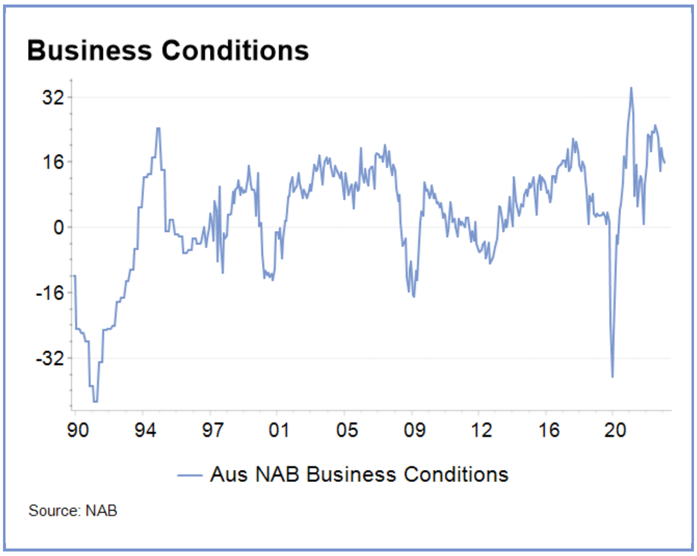
AUSTRALIAN INFLATION

- Australia's CPI for the March quarter was 7 per cent on a headline basis, down from 7.8 per cent. The trimmed mean CPI dropped to 6.6 per cent from 6.9 per cent. The quarterly increase of 1.2 per cent was the lowest since December 2021. The RBA is projecting a decline to 4.8 per cent by end-2023.
- Goods price inflation eased to 7.6 per cent from 9.5 per cent while services prices rose to 6.1 per cent from 5.5 per cent.



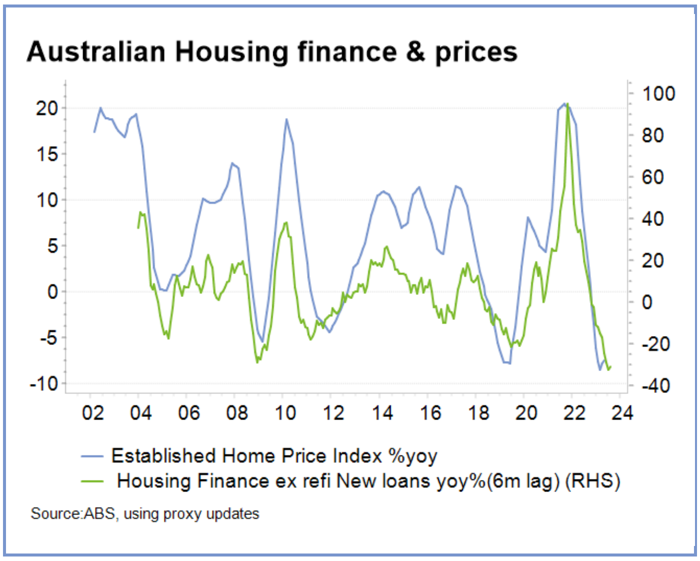
BUSINESS CONDITIONS STILL SOLID

- Overall NAB business conditions remain consistent with solid economic growth while business confidence is more pessimistic, sitting below average levels.
- The NAB surveys various measures of cost and price pressures continue to ease, including purchase costs. Labour costs and prices. However, the capacity utilisation level remains extremely high, indicative of higher inflation.



BOTTOM IN HOUSING FINANCE AND PRICES?

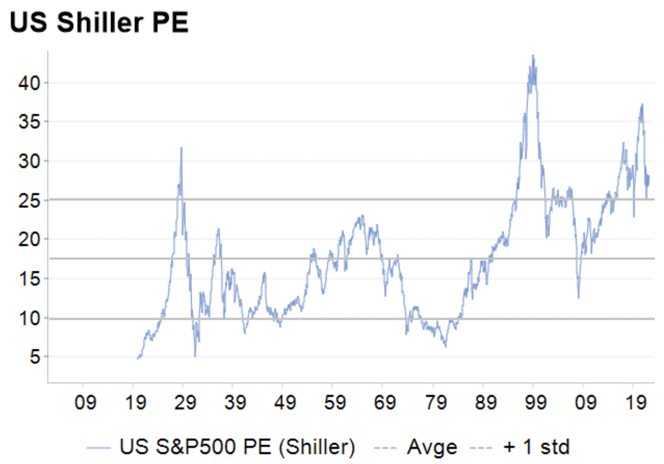
- After declining by just over 9 per cent between April 2022 and February 2023, Core Logic data says house prices have risen 1.2 per cent since February. There are also signs that the rapid downshift in housing finance over the past 12 months has started to stabilise, although it is down more than 30 per cent.
- The recent lift in house prices has been attributed to expectations of a peak in mortgage rates and strong underlying demand and constrained supply.
- However, the May rate hike and a slowing economy and labour market, could undermine the recovery.



3. Valuations: Overseas

LONG TERM CYCLICALLY ADJUSTED PE

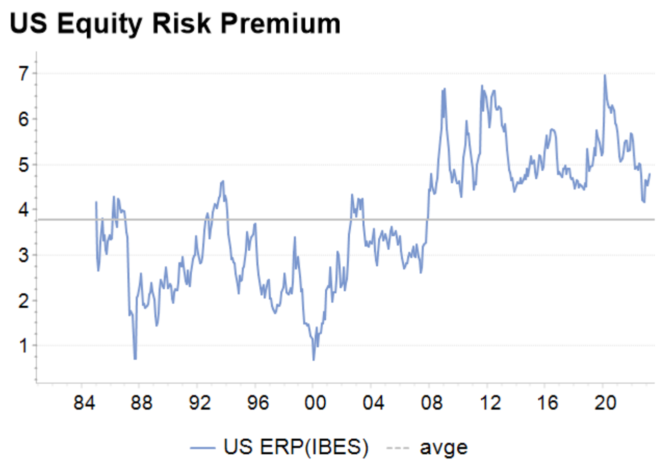
- The long term cyclically adjusted P/E is sitting at 28 times, well down from 37 times in late 2021 but is still well above average levels (17.7) and the low inflation regime average of around 23 times. The high inflation average is close to 15 times.



Source:S&P,St Louis Fed, using proxy updates

US EQUITY RISK PREMIUM

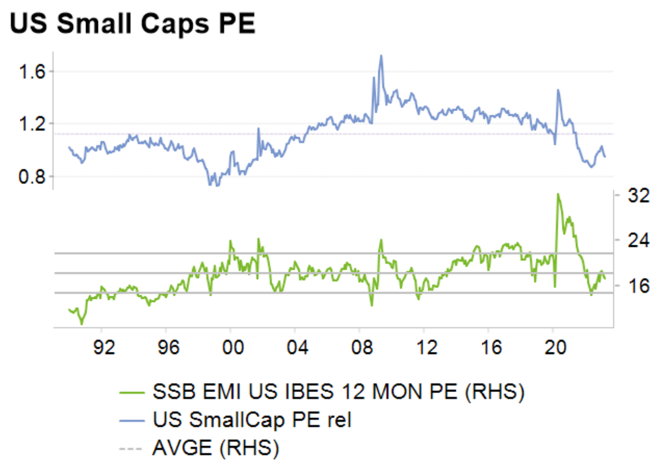
- The US Equity risk premium sits at 4.8 per cent. Earnings growth is softening, but bond yields have declined to 3.5 per cent. Using 10 per cent lower earnings produces an ERP of 4.3 per cent.



Source:RBA, using proxy updates

US SMALL CAPS

- With a PE of around 17 times, US small caps are trading close to the 30-year average.
- Relative to US large cap they are trading at a 6 per cent discount compared to an average 12 per cent premium.

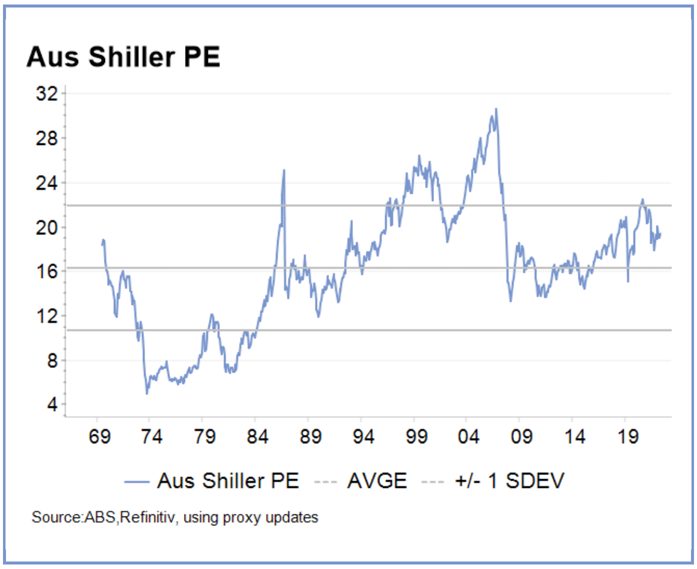


Source:Refinitiv,Refinitiv, using proxy updates

4. Valuations: Australia

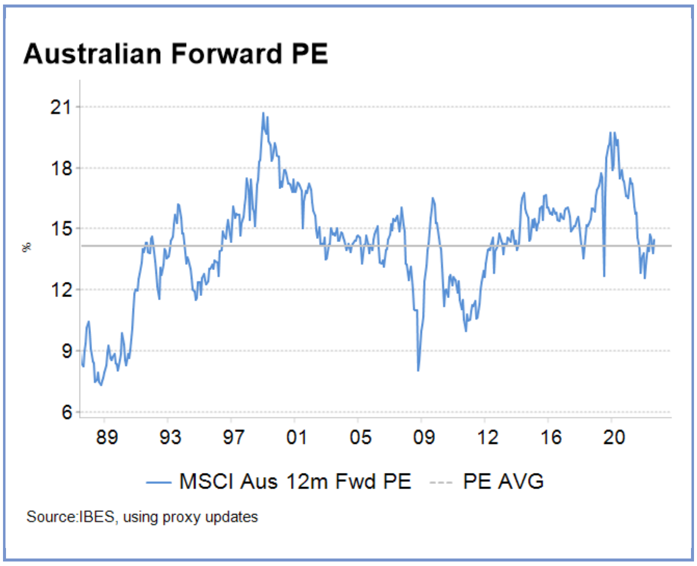
AUSTRALIAN LONGER-TERM VALUATIONS

- Using a Shiller method for calculating PE's the market is up to 19 times (compared with the average of 16).



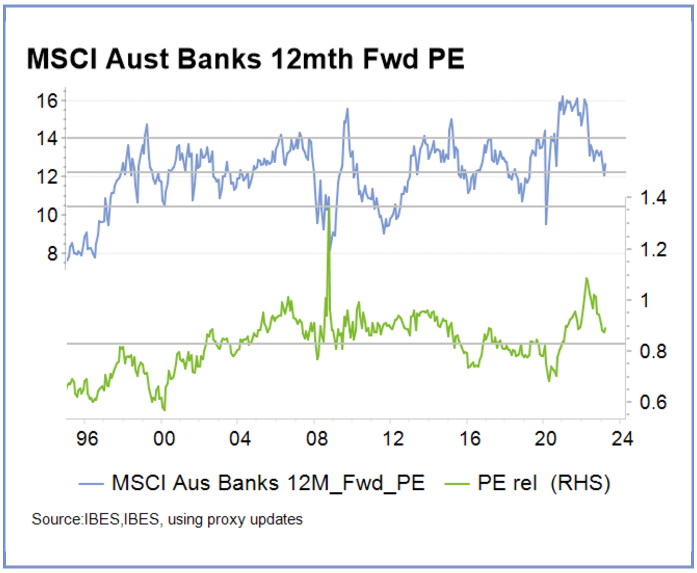
AUSTRALIAN PE

- The Australian PE sits at 14.5 times, close to the long-term average and well down on the recent 20 times in 2020.



BANKS

- The bank sector forward PE sits at 12.7 times, in line with the 30-year average. Relative to the broader market the sector trades at a 12 per cent discount, compared with the average 18 per cent discount.



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