

GPS Wealth Monthly Market Update

The slowdown continues

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 11 SEPTEMBER 2023

The Australian share market returned -0.73% over the month of August having been down by almost 5% around the middle of the month following the lead from the US. The US share market declined by -1.46% in August which was off the low point for the month. **The weakness early in the month was on the back of fears that interest rates would rise further in the US and economic weakness in China.** The 10-year Treasury yield rose to over 4.30% which was the highest level since 2007 as investors worried that the recent firm US inflation data meant the Federal Reserve would not only raise rates further but keep them there for longer. Global bonds had a poor month and year returning -0.27% and -1.17% respectively. The Australian bond market index did not follow its global counterpart, focusing on the weaker consumer and sputtering Chinese economy. Australian bonds returned +0.74% over the month to be 1.78% higher over the year.

In the US, the Federal Reserve Chairman reiterated it was “the Fed’s job to bring inflation down to our 2% goal, and we will do so”. This reinforced the impression that the central bank would retain its hawkish stance until clearer signs emerge that core inflationary pressures are subsiding – especially wage and service price inflation. However, a softer US employment report supported the view that the Fed probably does not need to hike rates again. The interest rate futures market is now pricing in a 94% chance that US central bank holds rates steady in September and 65% chance of a hold in November. **The consensus view has shifted from a shallow recession to a soft landing,**

goldilocks scenario. Under this scenario, consumption and housing soften further and the unemployment rate increases. Despite real personal spending growth remaining upbeat to date, headwinds associated with a lower savings rate, resumption of student loan repayments and run-down of pandemic excess savings suggest strong personal consumption growth will not be sustained.

In Australia, the economy grew by a subdued 0.4% in the second quarter to be 2.10% higher over the year. The year-on-year outcome was slightly stronger than expected thanks to revisions to previous quarter’s data. Consumer spending was flat with incomes squeezed by high inflation, higher interest rates and additional tax obligations. Domestic demand grew by 0.7%, led by business investment (inventories) and government spending. Domestic demand excluding inventories was very weak. GDP per capita contracted by -0.30% bringing the annual rate to -0.30% also, with population growth running at 2.4%. Lifting the headline GDP total was a big positive swing in the net export position, mainly a positive boost from exports, with only a small offsetting drag from imports. Consumption is likely to weaken further in the second half of the year as the impact of higher interest rates continues



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Chairman of the Investment Committee

to bite. Offsetting this, will be a large pipeline of state and federal spending.

Monthly inflation in Australia recorded an increase of 4.9%, down from 5.4% in June. Softness was largely driven by more volatile items. Excluding these, inflation picked up in July, driven by higher electricity prices and housing purchase-price inflation. The detail around housing still reflects an uncomfortable mix, with rental inflation continuing to accelerate as the moderation in new dwellings persists.

➤ In China recent economic data showed a few downside surprises and suggests policy will be eased further in the near term.

Perhaps the worst of the data was the meagre 2.5% year-on-year growth in retail sales. This has declined sharply from an admittedly inflated 18.4% growth rate in April as the re-opening briefly led to a retail sales surge. However, the idea of a consumer-spending-led recovery is now looking vulnerable. Local government debt is high and it is difficult to see increased government spending as a means of lifting growth. Hence, the economy is likely to see a period of sub-trend growth while it restructures this debt and alleviates some of the debt-service cost strains that are weighing on some local government financing vehicles. Although the target growth rate is circa 5%, it may present a challenge for policymakers to achieve. This forecast weakness is likely to keep inflation subdued. News headlines have highlighted that that inflation is negative however, much of the recent decline in overall inflation is due to falls in food price inflation, which spiked up to more than 10% in July last year on the back of swine fever-affected pork prices. Adjusting for this, it looks like the price level rose by about 0.3% month-on-month in each of the last two months. Temporary base effects are doing most of the damage to inflation data currently. It is expected to have passed by November 2023.

Despite yet another hot summer and surge in tourism in Europe, the economy looks set to fall back into anaemic growth once again. Recent business and consumer confidence figures have been disappointing and the construction sector looks set to slow as demand falls. In Germany, industrial production dropped for the third

consecutive month in July, providing more evidence of an elevated recession. A stagnating some that the economy was improving. However, the full batch of hard macro data for July suggests that the risk of recession is high again. Retail sales, exports and now industrial production all dropped in July, giving the German economy a very weak start to the third quarter. Across the broader eurozone, money growth has been falling, as demand for borrowing weakens and the ECB embarks on quantitative tightening. On a positive note, however, the trend remains gradual.

➤ This means that the impact of higher rates on the economy continues to happen gradually and without shocks (so far).

Still, weaker lending will result in lower investment down the line. With economic activity already stagnating, tight monetary policy is set to contribute to a weak economic environment for the quarters ahead.

Both the US and Australia wrapped up their profit reporting seasons at the end of August. In the US, according to Factset, 79% of S&P 500 companies reported a positive earnings per share (EPS) surprise and 64% of S&P 500 companies reported a positive revenue surprise. For the second quarter of 2023, the blended (year-over-year) earnings decline for the S&P 500 was -4.1%. The second quarter marks the third straight quarter of earnings declines reported by the index. At June 30, the estimated earnings decline for the second quarter was -7.0%. So things were less bad! The forward 12-month P/E ratio for the S&P 500 is 18.8. This P/E ratio is in line with the 5-year average (18.7) and slightly above the 10-year average (17.5). In Australia we wrapped up a volatile reporting season with one in eight stocks moving more than 10 per cent up or down – nearly double the average. This was despite results that were largely in line with expectations and earnings revisions no bigger than normal. Whilst the Australian and US share markets look fairly valued, risks remain skewed to the softer side as interest rates are likely to remain higher for longer.

ASSET CLASS RETURNS ARE BASED ON

Australian Cash

RBA Bank accepted Bills 90 Days

Australian Listed Property

S&P/ASX 200 A-REIT TR

International Shares

MSCI World Ex Australia NR AUD

Australian Bonds

Bloomberg AusBond Composite 0+ Yr TR
AUD

International Property Hedged

FTSE EPRA/NAREIT Dv REITS TR Hdg
AUD

Emerging Market Shares

MSCI EM GR AUD

International Bonds Hedged

BarCap Global Aggregate TR Hdg AUD

Australian Shares

S&P/ASX 200 TR

RETURNS TO THE 31ST AUGUST 2023

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Australian Cash	0.35	1.05	1.99	3.55	1.40	1.29	1.72
Australian Bonds	0.74	-0.72	1.38	1.78	-3.09	0.56	2.50
International Bonds Hedged	-0.27	-0.47	1.49	-1.17	-3.84	0.06	2.46
Australian Listed Property	2.26	6.13	2.34	6.32	7.31	3.97	8.41
International Property Hedged	-2.91	2.95	-2.25	-6.21	4.21	0.41	5.94
Australian Shares	-0.73	3.92	3.00	9.56	10.68	7.01	7.97
International Shares	1.60	6.96	15.97	22.62	13.34	10.82	12.95
Emerging Market Shares	-2.36	3.39	7.89	7.18	3.07	3.23	6.32



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