September 2023

GPS Wealth

GPS Wealth Monthly Market Update

Higher for Longer

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 13 OCTOBER 2023

Financial markets witnessed another bond sell-off in September, as prices in the US continued to fall on the back of the realisation that short term interest rates would be higher for longer. This tipped into share and property markets with international shares as represented by the MSCI World ex- Australia index falling by -4% and the ASX 200 index falling by -2.8%. The bond market took its toll on Australian listed property trusts which fell -8.7% and global property suffered a -6.1% fall. The US Federal Reserve raised the Fed Funds rate (short term interest rates) to a 22-year high of 5.5% in July and investors in both bond and share markets have been waxing and waning as to whether the peak has been reached for this cycle. **Bond investors clearly had doubts in September. The 10-year bond in the US ended at 4.57% having peaked at 4.68% which was the highest level seen since 2007.** The return from hedged international fixed interest was -1.8% in September whilst the Australian market suffered a decrease of -1.5%. In early October, the trend in bond yields continued following another strong US labour market report and despite cracks appearing in the rest of the world.

The US Nonfarm Payroll report delivered a strong positive surprise in September. Job gains accelerated from 187 thousand to 336 thousand – significantly above expectations of a slight decline to 170 thousand. In addition, the increase in the prior two months was revised up by 119 thousand. The unemployment rate remained unchanged at 3.8%. The report indicated that the unemployment rate is not yet facing upside pressure reinforcing the higher for longer view for interest rates. **The oil price increased by 9.8% in September, fuelling concerns that central banks will have to maintain tight monetary policy for longer.** Prices of industrial metals also managed to rise despite the lack of evidence of a meaningful Chinese economic recovery. Global risk off sentiment boosted the performance of the US dollar, which also profited from the relative resilience of the US economy. The stronger US dollar alongside rising interest rates dented the performance of gold.

In Australia the Cash rate was maintained at 4.1% by the RBA Board. The decision was widely anticipated however the issue for markets was whether new Governor Bullock would decide to send different messages than had been signalled in previous Statements under Governor Lowe. The narrative however was consistent particularly the forecast that inflation to be back in the 2-3% range in late 2025. The decision not to shift the language in the Statement accompanying the October Board decision was significant. It sent a clear signal to markets that the RBA's reaction function and forward guidance has not changed under the new Governor.

Emmanuel Calligeris
Chairman of the Investment Committee

In economic data, the Commonwealth Bank Household Spending Insights series (HSI) index has stabilised at 0.5%-0.6% since June this year, which is up from an average increase of 0.2% per month from February to May. Recent household spending data has been more resilient than expected. Part of this is price driven, but part of this is still a preference to spend given strong household income growth and previously accumulated savings.

> The effects of the RBA's rate hikes to date, is reflected in a slowdown in the pace of annual change in household spending compared to 2022.

The HSI was running at 8.3% per annum to May 2022 when the RBA started its rate hiking cycle. The current 1.8% annual pace in September 2023 clearly shows some moderation from this pace. However, given the recent lift in the monthly pace of household spending, near term upside risks remain to the RBA cash rate from a spending perspective. Australia's trade surplus bounced notably in August. This was largely a consequence of strength in gold exports which nearly doubled in the month as imports essentially halved, leading to a remarkable $2.4bn improvement in the gold balance. Excluding gold, the detail was broadly as expected, exports rising 0.3% as imports gained 0.7%. The latter in part reflects the impact of a weaker Australian dollar and higher global oil prices.

The Bank of Japan voted unanimously to keep the policy rate at -0.1% and the central bank maintained Yield Curve Control (YCC) on 10-year JGB yields. However as reported last month the BoJ made an important tweak to its YCC program allowing for greater flexibility in managing the program such that it tolerates higher yields on the 10-year bond.

> It effectively prepares markets that a tightening of monetary policy is on the cards if inflation sustains the Bank's 2% target.

Although headline and core consumer price inflation (which excludes energy) recorded 3.2% and 3.1% respectively, it seems that nominal wage growth is preventing a higher inflation rate. Wage growth decelerated sharply to 1.3% and the pace of decline in real wages accelerated to -2.5% over the year to July. Furthermore, the Purchasing Manager's Index for manufacturing and for services, suggests that the tailwind to services from pent-up demand during the pandemic is easing and that although the global manufacturing downturn is bottoming, it is not meaningfully reaccelerating. Hence it's not a lay down misère that inflation will maintain the 2% target.

In Europe, the services Purchasing Manager's Index (PMI) increased in September however remains in contraction. The PMI is an index of the prevailing direction of economic trends in the manufacturing and service sectors. It summarizes whether market conditions are expanding, staying the same, or contracting as viewed by purchasing managers. Notably, the French services PMI is now at its lowest level since late-2020. Similarly, the UK measure also surprised to the downside as it fell deeper into contraction. German manufacturing remains depressed as too does French manufacturing.

> In China, fiscal and monetary responses to its sluggish economic growth have been modest.

The last month delivered data that suggest that the economy is reaching a plateau rather than spiralling downwards. New loans picked up in September and aggregate financing volumes were also higher. Furthermore, lending will be helped by the 0.25% reduction in banks' reserve requirements (RRR) which allows them to lend more. Of the more subdued data releases, exports continue to decline in year-on-year terms, but the rates of decline are decreasing. This troughing was also seen in the manufacturing and industrial production figures which edged up slightly in year-on-year terms. Recent PMI data has also edged out of the contraction zone, though for the non-manufacturing sector, buoyant expectations are doing a lot of the heavy lifting. Retail sales, recovered slightly after undershooting their historical trend. Lastly, the inflation rate, edged back above the zero line, due to the expiry of base effects from falling food prices as was highlighted last month.

The key driver for markets over the next year will undoubtably be the path of inflation, the way central banks response and the subsequent impact on growth. The broad environment is still supportive for growth assets and credit markets, although the path of inflation and central bank policy needs to be monitored closely in case a resurgence in core or headline inflation results in a round of further hikes that could derail growth.

> Market narratives have been in flux all year - from recession and sharp rate cuts to soft landing hopes over the summer to more recently - a higher-for-longer rates backdrop.

This will underpin a volatile few months to the end of 2023.

Returns

30th September 2023

ASSET CLASS RETURNS ARE BASED ON

Australian Cash
RBA Bank accepted Bills 90 Days

Australian Bonds
Bloomberg AusBond Composite 0+ Yr TR AUD

International Bonds Hedged
BarCap Global Aggregate TR Hdg AUD

Australian Listed Property
S&P/ASX 200 A-REIT TR

International Property Hedged
FTSE EPRA/NAREIT Dv REITS TR Hdg AUD

Australian Shares
S&P/ASX 200 TR

International Shares
MSCI World Ex Australia NR AUD

Emerging Market Shares
MSCI EM GR AUD

RETURNS TO THE 30TH SEPTEMBER 2023

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Australian Cash	0.33	1.04	2.02	3.66	1.51	1.32	1.74
Australian Bonds	-1.53	-0.28	-3.22	1.61	-3.92	0.34	2.29
International Bonds Hedged	-1.84	-2.14	-2.44	0.53	-4.55	-0.24	2.17
Australian Listed Property	-8.58	-2.93	0.37	12.49	4.68	2.48	7.33
International Property Hedged	-6.13	-6.22	-5.06	0.12	3.04	-0.41	4.85
Australian Shares	-2.84	-0.77	0.24	13.46	11.00	6.67	7.43
International Shares	-4.01	-0.43	7.16	21.64	11.92	9.80	12.49
Emerging Market Shares	-2.28	0.12	1.64	11.28	1.77	2.88	5.93

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