ARRIVE
WEALTH MANAGEMENT

# INVESTMENT AND ECONOMIC SNAPSHOT

## FY2022/2023 IN REVIEW

# HIGHLIGHTS

**JULY 2022**

The US Federal Reserve raised rates by another 75bps, with Fed Chair Jerome Powell noting that inflation is still a major concern. Likewise, the RBA hiked the cash rate by a further 50bps in response to a higher than expected inflation read of 6.1%, the highest year ended CPI inflation reading since the early 1990s. Global markets take the news in its stride, rebounding strongly following June's heavy sell off.

**AUGUST 2022**

Intense market speculation that the Fed was on the cusp of a 'Fed pivot' are abruptly put to bed following a key speech at 'Jackson Hole' where Chair Jerome Powell reiterated that the Fed remains doggedly determined to bring inflation under control, even at the price of the economy slowing significantly. Other than Australian equities (+1.3%), most major global markets finished August lower in response.

**SEPTEMBER 2022**

September lived up to its reputation as an extremely poor month for global equity markets. The MSCI World (USD) Index sold off heavily, falling -9.3% with emerging markets leading the race to the bottom, plummeting -11.7%. Bond markets were not spared either, with short term yields rising rapidly. Credit spreads also widened as the outlook for credit markets worsened. Headline inflation is currently 9.1% in Europe, 9.9% in the UK, and 6.1% in Australia with expectations that this could rise to 7.75% by year-end.

**OCTOBER 2022**

Most global financial assets wake from their slumber following two months in the doldrums. The RBA surprised markets with a less than expected 25bps rate hike. Australia was also the first among developed market economies to slow its pace of hikes despite elevated inflation. Meanwhile, Chinese President Xi claimed a record third, five-year term as the Chief of China's Communist Party.

**NOVEMBER 2022**

Global equities and emerging markets benefit from preliminary signs that inflationary pressures are gradually falling and that tough Chinese COVID-19 lockdowns may soon be a thing of the past. The Fed's comments that labour market conditions are still too tight for the central bank to start thinking about cutting rates, fail to dampen the market's enthusiasm for risky assets. The RBA eased off the interest rate brake with another 'down sized' 25bps hike.

**DECEMBER 2022**

The performance of major financial assets was mixed in December. Global bonds, global equities, and the US dollar were among the worst performers. Chinese equity indices were the main exception, as they continued to profit from improving investor sentiment following the relaxation of strict COVID-19 policies. The calendar year comes to a disappointing end for investors. The US dollar, crude oil, and cash were the only major financial assets that generated positive gains in a volatile world dominated by inflation and hawkish central bank policies.

JANUARY 2023

News that inflationary pressures are starting to wane in the US, caught the attention of investors, triggering strong, speculative buying, with high hopes that central banks are nearing the end of their tightening cycles. Industrial metals especially iron ore, surged higher on expectations that China's reopening will meaningfully lift demand and prop up the ailing global manufacturing cycle.

FEBRUARY 2023

February proved to be a stern reminder that the bear market may have further to run and that the recent rally may be running out of steam. Global bond yields rose materially, amid concerns that better than expected economic data raises the risk that central banks will need to respond more forcefully with higher interest rates to keep elevated inflation at bay. In the US, the 10-year Treasury yield is now hovering around 4.0%, its highest level since November last year.

MARCH 2023

The collapse of US regional banks Silicon Valley Bank, Signature Bank and European heavyweight, Credit Suisse, dominated the headlines this month, sending shockwaves through financial markets. Government bonds proved extremely popular with yields in March falling materially, as investors sought safe harbour during the global banking tempest. Similarly, the price of gold also attracted attention, surging +8.2%, ending the month just below $2000/oz. The US dollar weakened amid expectations that the deteriorating economic outlook would prompt the Federal Reserve to cut interest rates in the second half of the year.

APRIL 2023

Global financial markets finished the month on a positive note. European exchanges were at the forefront of the global equity rally with UK and Euro area equities boosted by strong gains in their currencies versus the US dollar. Meanwhile, Chinese investable and domestic stocks fell into the red, dragging down the emerging markets equity benchmark. Within the commodity complex, the prices of both gold and oil ended the month marginally higher.

MAY 2023

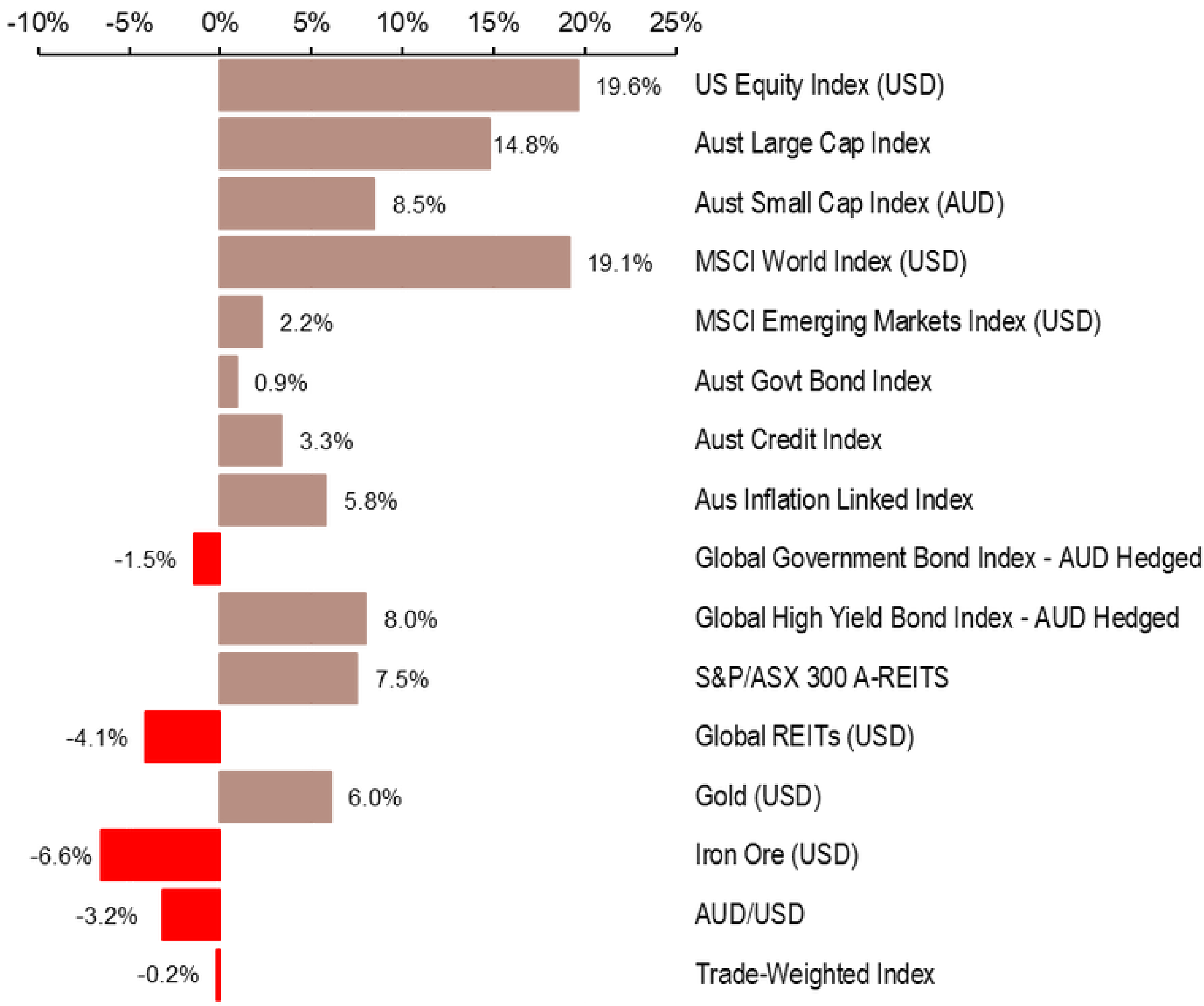
A shift in investor expectations for the path of the Federal Reserve funds rate, the resurfacing of US regional bank turmoil, debt ceiling concerns, and economic data disappointments all weigh on global assets this month. Japan's Nikkei was a notable exception, rising to its highest level since July 1990. The US Senate passes vital bipartisan legislation at the 11th hour, signing the debt ceiling bill into law, averting a default by the US government.

JUNE 2023

The performance of financial markets improved in June with most major financial markets posting better than expected results. The US equity rally which had been narrowly concentrated among tech stocks for most of the year broadened in June with all 11 equity sectors ending the month in the green. Yields on US 10-year treasurys reached the highest point since the early March banking turmoil. The RBA keeps the cash rate at 4.1% to buy itself more time to assess how the economy and inflation (currently at 7.0%) evolve from here.

# ONE YEAR RETURNS TO 30 JUNE 2023

After a sharp selloff in 2022, equity markets ended the year strongly.




Sources: Thomson Reuters, Bloomberg

# OUTLOOK

## POTENTIAL RISKS AHEAD

In a year characterised by its unpredictability, markets have managed to deliver solid results in what has proved to be a better year for economies than broadly expected 12 months ago. While manufacturing has suffered through the combination of weaker demand for goods and soaring costs, service sector activity remains remarkably robust. Notably, the US has successfully navigated various challenges, including the banking crisis and the debt ceiling deadline. These accomplishments, coupled with a strong labour market, have outweighed the drag posed by higher costs and interest rates.

However, amid this relative optimism, there are many warning signs in circulation pointing toward a potential downturn on the horizon. Historically reliable signals such as the US Conference Board Leading Economic Index (LEI) and the shape of the yield curve, clearly point to recession. Economic growth is slowing. Personal savings buffers are rapidly depleting. Household spending and sentiment have fallen substantially. Inflation is still too high and is likely to remain so for an extended period. One further negative consideration is liquidity, which is likely to deteriorate considerably as the Fed Reserve's balance sheet continues to contract. In short, financial conditions are tightening, amplifying the potential risks ahead.

## EQUITY MARKETS CHALLENGES

Equity markets face several headwinds that might hinder their continued growth. The S&P 500 is up 23% from its low in October but this has left equities trading expensive. The index's 12-month forward price/earnings (P/E) multiple has climbed to 19.2x, up from 15x at the start of the rally, driven by significant gains in some of the biggest technology stocks. That's a high P/E ratio, considering the 4.1% yield on a risk-free 10-year treasury bond. Higher inflation for longer coupled with further central bank rate hikes and falling liquidity could dampen equity performance given the high starting point for valuations. These factors alone could exacerbate market volatility and create uncertainty for investors.

## BEYOND THE US

Beyond the US, economic conditions in regions like Europe and China have shown worrying signs of weakness, further contributing to the uncertainty in global markets.

In Australia, the RBA's circumspect approach reflects their deep concerns surrounding the domestic economic outlook. While inflation has passed its peak, it remains at elevated levels, and consumer spending is facing major headwinds. Factors such as fixed-rate mortgage resets, rental increases, HECS repayments, and staples inflation all suggest that a material slowdown in consumer spending is already underway.

## A PRUDENT APPROACH TO PORTFOLIO POSITIONING

Given the potential risks and uncertainties in the market, a cautious approach to portfolio positioning on the 12-month investment horizon is highly recommended. Diversification and active risk management should be prioritised, considering the looming probability of a recession. This may involve underweighting equities and credit for the moment, overweighting government bonds, and holding cash both for defensive purposes as well as to take advantage of opportunities as and when they appear. Such an approach can provide much needed defensiveness to an investment portfolio subject to forecast volatile market conditions.

## IT'S NOT ALL BAD NEWS

Looking ahead, as inflation decelerates through 2023 and growth weakens, central banks may consider rate cuts to support economic recovery. This shift in monetary policy could make long-duration bonds more appealing to investors seeking attractive yields in a potentially lower interest rate environment.

## SUMMARY

While the current rally in equity markets may continue for a few more months, the underlying risks and uncertainties suggest caution. The potential for a recession, the narrowing breadth of the rally, and challenging global economic conditions warrant careful portfolio positioning. The importance of diversification, active risk management, and a focus on long-duration bonds becomes crucial in navigating the unpredictable financial landscape. By prudently managing risks and being prepared for various market scenarios, investors can position themselves for the challenges and opportunities that lie ahead over the coming months.

# MAJOR MARKET INDICATORS

| | 30-Jun-23 | 31-May-23 | 30-Apr-23 | Qtr change | 1 year change |
|---|---|---|---|---|---|
| **Interest Rates (at close of period)** | | | | | |
| **Aus 90 day Bank Bills** | 4.25% | 3.90% | 3.66% | +61.0 | +265.0 |
| **Aus 10 yr Bond** | 3.92% | 3.50% | 3.34% | +45.0 | +15.2 |
| **US 90 day T Bill** | 5.17% | 5.26% | 4.95% | +49.0 | +351.0 |
| **US 10 yr Bond** | 3.81% | 3.63% | 3.43% | +32.8 | +83.5 |
| **Currency (against the AUD)** | | | | | |
| **US Dollar** | 0.666 | 0.647 | 0.661 | -0.61% | -3.20% |
| **British Pound** | 0.525 | 0.524 | 0.530 | -3.05% | -7.42% |
| **Euro** | 0.610 | 0.607 | 0.600 | -0.93% | -7.44% |
| **Japanese Yen** | 96.10 | 90.58 | 90.15 | 8.27% | 2.64% |
| **Trade-Weighted Index** | 61.70 | 59.80 | 59.80 | 2.32% | -0.16% |
| **Equity Markets** | | | | | |
| **Australian All Ordinaries** | 1.9% | -2.6% | 1.8% | 1.0% | 14.8% |
| **MSCI Australia Value (AUD)** | 3.2% | -3.6% | 1.2% | 0.7% | 16.4% |
| **MSCI Australia Growth (AUD)** | 0.8% | -1.7% | 3.3% | 2.4% | 12.7% |
| **S&P 500 (USD)** | 6.6% | 0.4% | 1.6% | 8.7% | 19.6% |
| **MSCI US Value (USD)** | 6.2% | -4.1% | 1.3% | 3.2% | 9.2% |
| **MSCI US Growth (USD)** | 7.1% | 5.0% | 1.2% | 13.9% | 29.7% |
| **MSCI World (USD)** | 6.1% | -0.9% | 1.8% | 7.0% | 19.1% |
| **Nikkei (YEN)** | 7.6% | 7.0% | 2.9% | 18.5% | 28.6% |
| **CSI 300 (CNY)** | 2.1% | -5.6% | -0.5% | -4.0% | -12.2% |
| **FTSE 100 (GBP)** | 1.4% | -4.9% | 3.4% | -0.3% | 9.1% |
| **DAX (EUR)** | 3.1% | -1.6% | 1.9% | 3.3% | 26.3% |
| **Euro 100 (EUR)** | 4.4% | -2.9% | 1.6% | 3.0% | 23.5% |
| **MSCI Emerging Markets (USD)** | 3.9% | -1.7% | -1.1% | 1.0% | 2.2% |
| **Commodities** | | | | | |
| **Iron Ore (USD)** | 13.4% | -4.7% | -17.3% | -10.6% | -6.6% |
| **Crude Oil WTI U$/BBL** | 3.7% | -11.3% | 1.4% | -6.6% | -34.4% |
| **Gold Bullion $/t oz** | -2.8% | -1.0% | 0.7% | -3.1% | 6.0% |

Source: Quilla and Refinitv

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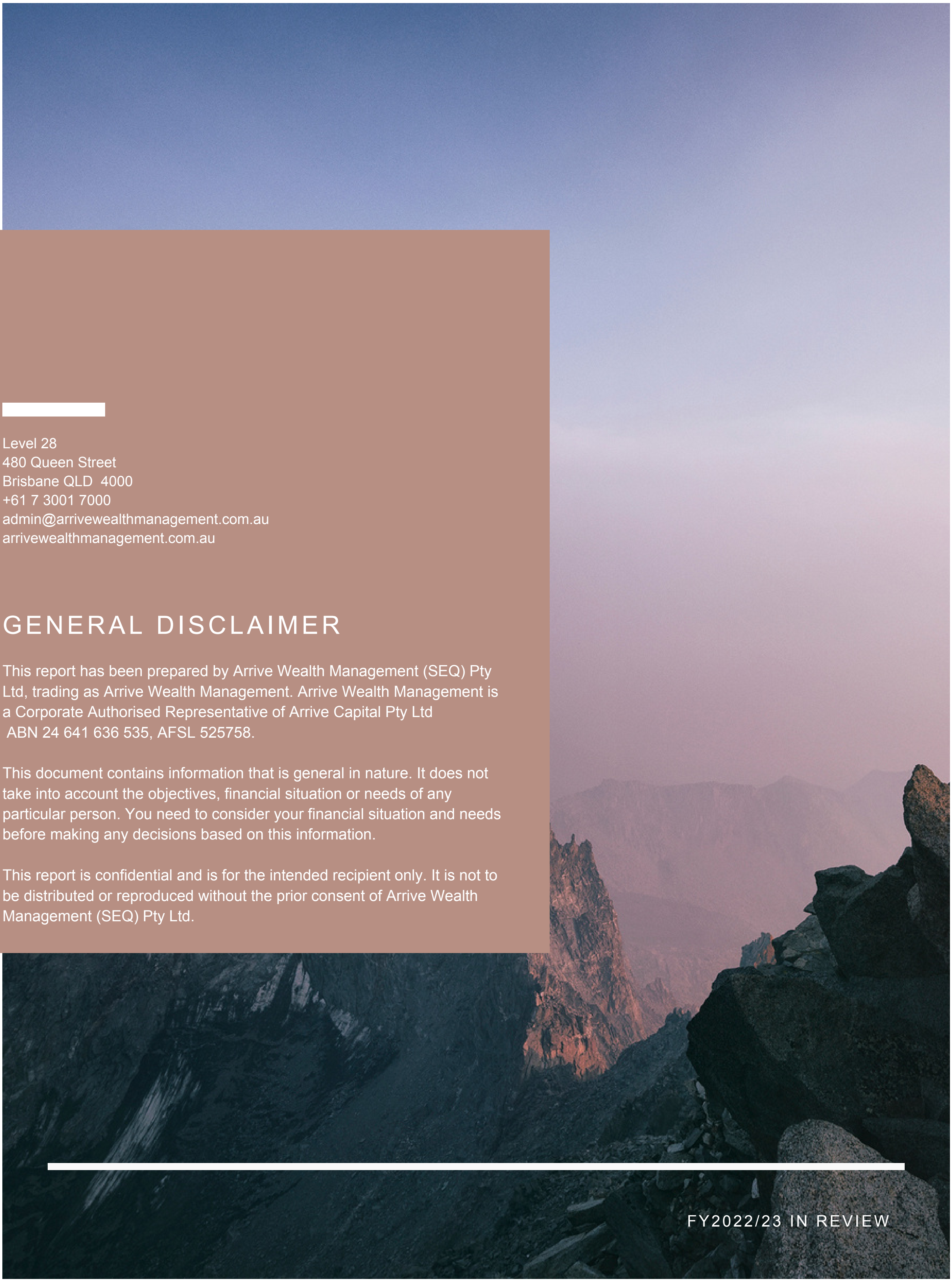

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