ARRIVE
WEALTH MANAGEMENT

INVESTMENT AND ECONOMIC SNAPSHOT

MAY 2023

MARKET HIGHLIGHTS

- Global financial markets retreated in May. After a relatively strong start to the second quarter of the year, most major financial assets we monitor generated below-average returns last month.

- The S&P500 (USD) performance was flat but would have fared a lot worse if it was not for the strong performance of a small cohort of tech mega-caps (Nvidia in particular).

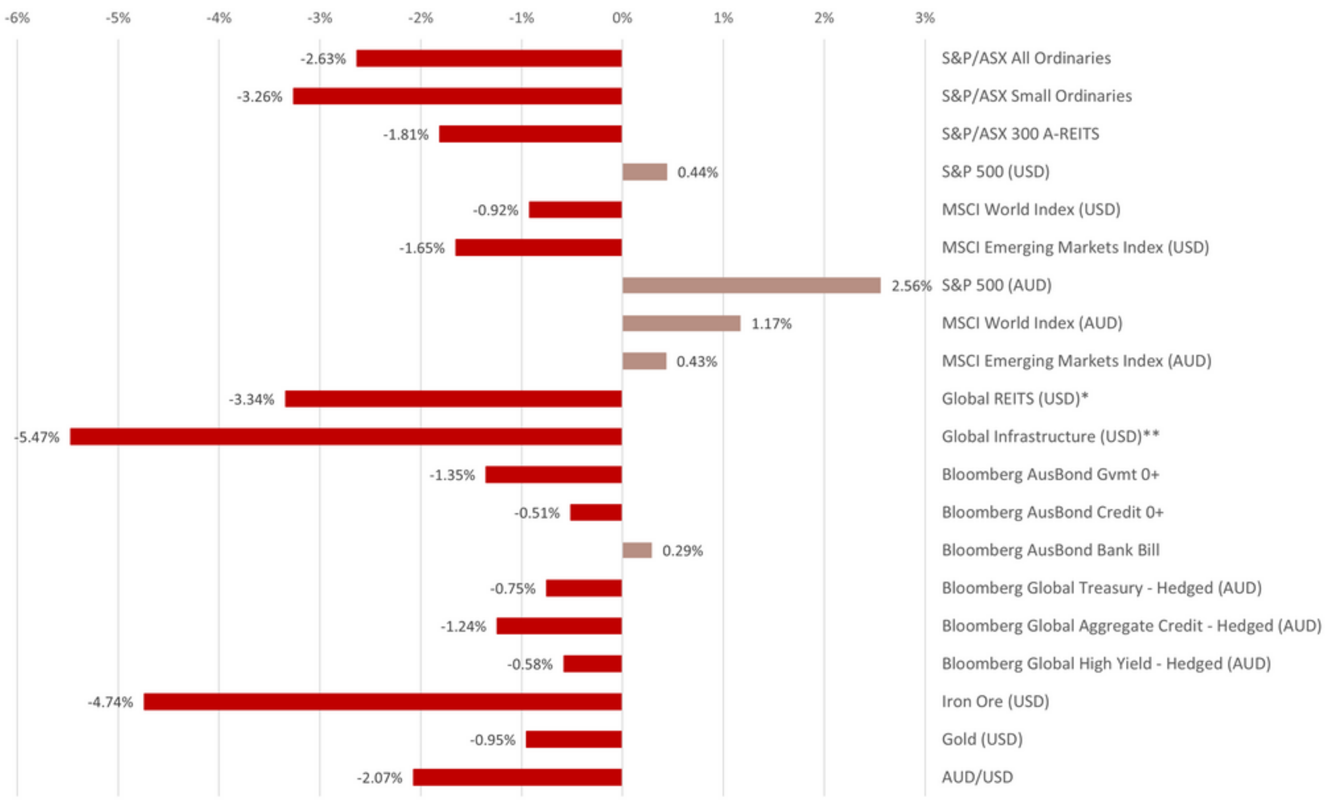
- Chinese economic data releases continued to show the post-lockdown recovery losing steam.

- Australia increases the cash rate by 25 basis points to 4.1% in early June to bring persistently high inflation (currently 7%) to target (2-3%).

- President Joe Biden signed the debt ceiling bill into law, averting a potentially catastrophic default by the US Government.

- US Treasuries sold off as investors revised their expectation of a swift Fed pivot towards cutting interest rates later this year, and instead shifted to betting on further rate hikes over the coming months.

SELECTED MARKET RETURNS MAY 2023



Sources: *Refinitiv G-7 Diversified REIT Index, **FTSE Global Core Infrastructure 50/50 Index

KEY MAY DEVELOPMENTS

FINANCIAL MARKETS

Global financial markets deteriorated in May after a relatively strong start to the quarter. 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 weighed on global assets this month. Japan's Nikkei was a notable exception, however, rising to its highest level since July 1990. It was buoyed by relatively easy monetary policy settings, optimism over a US debt ceiling deal, and a weaker yen supporting export revenue.

In Australia, a higher-than-expected inflation print to close the month dragged the Australian market lower, closing -2.6%. At a sector level, four of the 11 equity market sectors rose (Energy, Technology, Real Estate, and Telecommunications).

Across US equity sectors, Communications (Alphabet, Netflix, Meta), Technology (Microsoft and Nvidia), and Consumer Discretionary (Tesla, Amazon) stocks extended their recent outperformance, while Financials, Energy, and Healthcare continued to lag. US Treasuries sold off as investors revised their expectation of a swift Fed pivot towards cutting interest rates later this year. Instead, they shifted to betting on further rate hikes over the coming months.

US 'DEBT CEILING' HITS THE ROOF

The US Senate passed bipartisan legislation at the 11th hour, signing the debt ceiling bill into law, and averting a default by the US Government. Markets rejoiced at the news as a default would be catastrophic for capital markets, the credibility of the US, and the strong US dollar. It would also have added a massive risk to already fragile global markets. Interestingly, the US Treasury now needs to restore its balance sheet, typically undertaken by issuing bonds. The magnitude of the capital raising will complement existing quantitative tightening measures – adding additional headwinds to the US economy.

WHAT'S NEXT FOR GLOBAL INTEREST RATES?

As expected, the Fed delivered a 25bps rate hike this month. However, Chair Jerome Powell's post-meeting remarks signalled that this increase may mark the end of the tightening cycle. Powell revealed that while there was a strong consensus behind the 25bps increase, policymakers did discuss the possibility of pausing at the next meeting. That said, Powell noted that if inflation evolves according to the Fed's forecast, then rate cuts would not be appropriate in the second half of the year. He once again highlighted that core services ex-housing inflation have not yet rolled over. The RBA meanwhile lifted rates by a further 25bps in early June, citing high inflation was still top of mind and that further tightening may be required to ensure that inflation returns to target in a reasonable timeframe.

PATCHY GLOBAL GROWTH

During the first three months of the year, the global economy was starting to crack as the aggressive policy tightening by central banks gained traction. However, the second quarter has illustrated the resilience of the economy as it bends rather than breaks in the face of these stresses. Most recently, the PMI figures for major developed economies surprised to the upside. This has led markets to second-guess the outlook for rates and growth heading into the second half of the year. Better growth could mean inflation is slower to fall and central banks potentially squeeze in a few more hikes. This would negatively impact re-rating in equity markets this year placing downward pressure on stocks.

KEY MAY DEVELOPMENTS CONT.

CHINA'S MANUFACTURING ACTIVITY SHRINKS

The Chinese manufacturing index (PMI) recently dropped 2.7 points to 49.2, below expectations of a marginal decline to 51.4. The April update is the first sub-50 reading this year. Moreover, the deterioration was broad-based across all the manufacturing survey's 13 components. Both the New Orders and New Export Orders series fell below 50 to 48.8 and 47.6, respectively, indicating that both domestic as well as foreign demand for Chinese goods slumped. These indicators confirm the lack of a significant Chinese economic recovery. Similarly, the underperformance of Chinese equities relative to their global counterparts and falling industrial metal prices reflect disappointing momentum.

AUSTRALIA'S UNEMPLOYMENT RISES

The Australian unemployment rate rose to 3.7% in April with 4,000 jobs lost over the month. Despite the increase in unemployment, the jobs market remains very tight given the economic backdrop. When combined with the moderate rise in wage growth in the past year there is little evidence of the feared wage price spiral emerging in Australia. This should give the RBA some comfort that the pressures around the rise in services-driven inflation may not be persistent and that the lagged impact of the nearly 400 basis point rise in cash rates in the last year is having an impact. The RBA expects the unemployment rate to rise to 4% this year and the trend so far is consistent with their view.

OUTLOOK

Based on our analysis, the most likely environment in which equities and credit could produce strong returns over the next year would be where inflation falls back to target without there being a recession. This is possible but would be unprecedented in history given recent economic data prints. For now, underlying inflation remains sticky at around 4% in the US and 7% in Australia, and the more resilient growth of the past few months shows signs of faltering. We still expect a US recession to start around the end of this year, with Australia following close behind. We note that the recent equity rebound is not untypical of bear-market rallies. Market breadth and the poor performance of other assets such as commodities do not point to a sustainable pick-up.

MAJOR MARKET INDICATORS

	31-May-23	30-Apr-23	31-Mar-23	Qtr change	1-year change
Interest Rates (at close of period)					
Aus 90 day Bank Bills	3.90%	3.66%	3.64%	+44.0	+290.0
Aus 10yr Bond	3.50%	3.34%	3.47%	-21.4	+11.9
US 90 day T Bill	5.26%	4.95%	4.68%	+54.0	+413.0
US 10 yr Bond	3.63%	3.43%	3.48%	-28.1	+78.9
Currency (against the AUD)					
US Dollar	0.647	0.661	0.670	-4.03%	-9.79%
British Pound	0.524	0.530	0.542	-6.21%	-8.07%
Euro	0.607	0.600	0.616	-4.44%	-9.21%
Japanese Yen	90.58	90.15	88.75	-1.28%	-2.03%
Trade-Weighted Index	59.80	59.80	60.30	-2.61%	-5.38%
Equity Markets					
Australian All Ordinaries	-2.6%	1.8%	-0.2%	-1.1%	2.0%
MSCI Australia Value (AUD)	-3.6%	1.2%	0.0%	-2.5%	1.9%
MSCI Australia Growth (AUD)	-1.7%	3.3%	-0.7%	0.8%	4.0%
S&P 500 (USD)	0.4%	1.6%	3.7%	5.7%	2.9%
MSCI US Value (USD)	-4.1%	1.3%	-0.7%	-3.5%	-5.5%
MSCI US Growth (USD)	5.0%	1.2%	7.9%	14.7%	10.9%
MSCI World (USD)	-0.9%	1.8%	3.2%	4.1%	2.6%
Nikkei (YEN)	7.0%	2.9%	3.1%	13.6%	15.9%
CSI 300 (CNY)	-5.6%	-0.5%	-0.5%	-6.4%	-5.0%
FTSE 100 (GBP)	-4.9%	3.4%	-2.5%	-4.1%	1.7%
DAX (EUR)	-1.6%	1.9%	1.7%	1.9%	8.9%
Euro 100 (EUR)	-2.9%	1.6%	0.9%	-0.5%	9.2%
MSCI Emerging Markets (USD)	-1.7%	-1.1%	3.1%	0.2%	-8.1%
Commodities					
Iron Ore (USD)	-4.7%	-17.3%	0.8%	-20.6%	-27.4%
Crude Oil WTI U$/BBL	-11.3%	1.4%	-1.7%	-11.5%	-40.6%
Gold Bullion $/t oz	-1.0%	0.7%	8.2%	8.0%	6.8%

Source: Quilla and Refinitv

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