View from the hill

NOVEMBER 2023

HILLROSS

Market update

The table below provides a summary of investment returns for the major asset classes for the month ending 30 October 2023.

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	-3.8	-7.2	3.0	8.9
Smaller companies	-5.5	-10.5	-5.1	0.5
International shares (unhedged)	-1.0	-3.4	11.7	12.0
International shares (hedged)	-2.6	-7.9	9.6	9.6
Emerging markets (unhedged)	-2.0	-6.5	11.9	-0.3
Property - Australian listed	-5.7	-12.0	-3.9	2.9
Property - global listed	-4.5	-12.0	-6.8	1.6
Infrastructure - global listed	0.3	-9.1	-6.4	2.5
Australian fixed interest	-1.8	-2.6	-1.2	-4.6
International fixed interest	-0.8	-2.9	0.1	-4.8
Australian cash	0.3	1.0	3.7	1.5

Past performance is not a reliable indicator of future performance.

Overview & Outlook

- October marked the 3rd consecutive month of declines in the major stock indices.
- Price pressures have abated somewhat however still robust labour markets are keeping rates markets on edge (and in turn equities) as it means central banks will potentially be slower to cut rates than many market participants had expected. There is also the possibility that rates rise further still.
- Investors also continue to keep an eye on geopolitics in light of the Hamas/Gaza-Israel unrest. Oil has given back its gains since the unrest began on October 7 however the situation is fluid and the potential for escalation remains, which could pose another shock to inflation via oil.
- Credit spreads have widened and China's piecemeal approach to stimulus has failed to ignite a recovery. That said, corporate earnings expectations have generally remained in check and recent declines in the major asset classes have boosted their appeal on valuation grounds.
- In terms of outlook, so long as the global jobs market remains strong, corporate profits will be supported which has a circular effect of boosting wage growth, consumer spending, corporate profits and so forth. This dynamic will continue to pose two-way risks for global equities and bonds with the risk of higher interest rates on one side (acting as a drag) and optimism around growth prospects on the other.

Equities

Equity sector returns - Global	1m	3m	12m
MSCI World/Utilities	+0.8	-8.5	-1.9
MSCI World/Information Tech	-0.7	-8.8	+26.2
MSCI World/Consumer Staples	-1.4	-7.7	-0.4
MSCI World/Comm Services	-1.8	-5.6	+27.3
MSCI World/Materials	-2.7	-8.3	+8.5
MSCI World/Financials	-3.0	-7.0	+4.8
MSCI World/Industrials	-3.7	-9.6	+10.3
MSCI World/Energy	-3.8	+2.2	+2.0
MSCI World/Health Care	-4.0	-6.5	-2.7
MSCI World/Consumer Disc	-4.5	-11.0	+10.3

Equity sector returns - Australia	1m	3m	12m
S&P/ASX 200 Utilities	+1.7	-4.1	+27.9
S&P/ASX 200 Materials	-0.8	-4.6	+17.3
S&P/ASX 200 Resources	-1.3	-3.8	+16.1
S&P/ASX 200 Telecom Svcs	-1.5	-8.3	+1.1
S&P/ASX 200 Fincl Ex A-REIT	-3.6	-5.9	-2.0
S&P/ASX 200 Consumer Staples	-4.0	-8.7	-0.9
S&P/ASX 200 Cons Discretionary	-4.8	-3.1	+5.0
S&P/ASX 200 Energy	-5.1	-3.0	+6.8
S&P/ASX 200 Industrials Sector	-6.4	-11.3	+1.3
S&P/ASX 200 Health Care	-7.2	-13.9	-13.8
S&P/ASX 200 Info Tech	-7.6	-16.6	+10.8

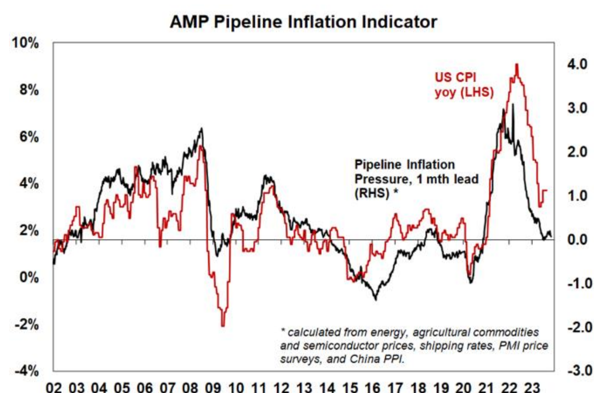
Australian Shares fell 3.8% to a one year low with International Shares (hedged) fell 2.6%. Both the S&P and Nasdaq entered a technical correction phase in October after falling over 10% from their July highs. The underperformance in Australian Shares stems from stronger economic data domestically putting some additional upward pressure on interest rates, coupled with ongoing concerns around the Chinese economy.

At a global sector level, most sectors saw a decline with the exception of Utilities which rose by 0.84%. Consumer Discretionary, Health Care and Energy led the way down recording negative 4.49%, 3.98% and 3.86% respectively.

In Australia, Utilities also outperformed strongly growing 1.7% while Information Technology, Health Care and Real Estate led the way down recording negative 7.55%, 7.22% and 5.83% respectively.

The key driver for equity markets continues to be the theme of higher-for-longer interest rates. This has the effect discounting forward earnings, increasing the risk of a deceleration in growth due to tighter financial conditions and reducing the appeal of equities versus fixed interest and cash markets.

The higher-for-longer theme is predicated on central banks concern or belief than a still robust jobs market risks a second inflationary wave. So despite evidence of falling global price pressures (US headline inflation fell from 4.3% to 4.1%, and the AMP Inflation Pipeline Pressures index fell from 0.8 to 0.4 – see chart below), the memory of 1970's inflation looms large among the central bank elite who have continued to err on the hawkish side. The broader economic growth picture has been mixed. The US retail sales control group came in at 0.6% month-over-month for September versus expectations of 0.1%, while the University of Michigan consumer confidence index fell to 63 from 68.1, however the hard data (in US retail sales, jobs etc.) has been trumping the soft forward looking (survey-based) data of late.



The third-quarter US earnings season got underway mid-October. Earnings growth generally surpassed expectations (82% beat vs historical average of 76%) however it was not enough to offset the overall negative tone of markets and the concerns around higher interest rates. There were still 20% of companies left to report as of October month end.

Fixed Income

Change in key interest rate, basis points				
Interest rate	Aus	US	Eurozone	UK
Cash rate	0	0	0	0
2yr Govt bond	38	4	-19	-12
10yr Govt bond	44	36	-3	7

As previously noted, rates markets were in the driving seat again this month and October was notable for US 10 year government bond yields breaching the 5% mark. Moves in the longer end of the rates curve continued to be driven by a combination of supply-demand (high US Treasury issuance swamping buy-side interest), buyers being deterred by the risk that yields move higher, still strong labour markets and even the potential for cash rates remaining on-hold by the major central banks is a catalyst for higher longer term rates as it fosters stronger growth than might otherwise be the case.

Australian Fixed Interest markets fell 1.8% with International Fixed Interest down 0.8% with Australian rates markets weighed by an unexpected rise in quarterly inflation (+1.2% quarter-over-quarter vs. expectations of +1.0%).

The odds of another hike by the Reserve Bank of Australia (RBA) at its November meeting increased during October due to higher-than-forecast inflation data. However, it should be noted that the inflation numbers were heavily influenced by petrol prices (7.2%) and electricity prices (4.2%). The Q4 inflation numbers, due out in late January, are expected to be between 0.7% and 1%, suggesting a moderating inflation pattern to under 4%.

At this juncture it would appear the cycle of cash rate hikes is at or near an end as policymakers assess the impacts of the rate hikes already enacted. Markets expect a series of rate cuts throughout developed

economies commencing in 2024; mid-June for the US, Eurozone and the UK, albeit with Australia set to hold or increase rates one more.

Property & Infrastructure

All Property indices fell in October. Australian Listed Property fell 5.7%, International Listed Property fell 4.5%. Global Listed Infrastructure was the largest outperformer in October up 0.3% due to strong performance in the Utilities sector.

Although higher interest rates have been weighing on the property sector, Australian Listed Property is now a lot more compelling from a valuation standpoint on a medium-term timeframe. Australian Listed Property also has some more favourable structural dynamics including superior asset quality, balance sheets and higher occupancy levels versus their international counterparts.

Global Listed Infrastructure remains attractive on a long-term basis. Global Listed Infrastructure has historically outperformed global equity markets in recessionary environments due to cash flow stability and maintaining higher margins in inflationary environments due to cost pass through.

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