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Market Wrap

January 2023

Economic and market overview

- Risk assets performed strongly in January, following further indications that inflation may have peaked in key regions.
- Global economic growth forecasts were lowered by both the World Bank and the IMF, but investors appeared to brush off these concerns. Instead attention was focused on upcoming central bank meetings, to see whether interest rates would continue to be raised. The US Federal Reserve, Bank of England and European Central Bank all met within hours of each other on 1 and 2 February.
- Most global share markets added between 5% and 10% over the month, although strength in the AUD eroded returns from overseas exposures for Australian investors.
- Locally, the S&P/ASX 200 Index returned 6.2% and closed the month close to its all-time highs.
- Fixed income performed well too, with downward movements in government bond yields aiding returns from Australian and global bond markets.
- The generally strong risk appetite among investors also enabled credit to generate pleasing returns over the month.

- **US**: The annual rate of inflation in the US has now slowed for six straight months, suggesting Americans might have seen the worst of pricing pressures.
- In turn, there were suggestions that the Federal Reserve was preparing to slow the pace of its policy tightening cycle. As anticipated, interest rates were raised by a quarter of a percentage point on 1 February. This compared to the past six rate hikes, all of which saw borrowing costs increased by either 0.5 or 0.75 percentage points.
- Consensus forecasts suggest US officials might raise borrowing costs once or twice more in the next six months or so, but any further moves are expected to be modest. That said, policymakers have emphasised the need for interest rates to be held at elevated levels for an extended period. Despite this guidance, some forecasters are still suggesting interest rates will have been lowered again before the end of this year.
- In other news, US GDP growth slowed less than expected in the December quarter, to an annual rate of 2.9%. So far, the economy has been more resilient than anticipated following significant increases in interest rate hikes in 2022.
- Some other indicators were less encouraging. A closely-watched gauge of activity levels in services sectors deteriorated, for example. This suggests Americans might be moderating their discretionary spending, given higher debt repayment costs.

- **Australia**: Unlike in other regions, inflation still appears to be accelerating in Australia. Headline inflation rose at an annual rate of 7.8% in the December quarter, while the 'trimmed mean' – the favoured measure among Reserve Bank of Australia officials – quickened to 6.9% year-on-year. This was the highest level since the series was introduced in 2003.
- Prices for 'discretionary' items surged over the period, with particularly strong demand and prices seen for cars, clothing, and travel.
- Despite sluggish retail sales in December, the latest inflation data will almost certainly concern policymakers and suggest the Reserve Bank of Australia will continue to raise interest rates in the months ahead.
- **New Zealand:** The quarterly Survey of Business Opinions suggested firms are expecting profitability to collapse this year. This does not augur well for the investment and growth outlook.
- Consumer confidence is also subdued, owing to higher mortgage interest costs and general weakness in the residential property market. The volume of home sales was 39% lower in December from the previous year, and prices were down 7.2%.

- **Europe:** The weather in Europe in the Northern hemisphere winter has been milder than anticipated. This is important, as it has resulted in lower-than-expected demand for energy for heating and, in turn, seen wholesale energy prices trend lower. The outlook for inflation in the months ahead is therefore not as bleak as some observers had previously feared.
- Moreover, gas storage in Europe has risen quite sharply; from the lower end of the historical range a year ago when Russian gas was flowing freely, to the higher end of the historical range during a period when Russian supplies have almost entirely ceased. Again this has reassured investors, some of which had feared energy shortages and an associated adverse impact on economic activity levels.
- Lower energy prices are also feeding through to official inflation data. Consumer prices rose at an annual rate of 9.2% in the Eurozone in December; still a very high reading, but meaningfully below the double digit annual inflation rates seen in each of the previous three months.
- Nonetheless, European Central Bank officials remain steadfast in their fight against inflation and raised official interest rates by half a percentage point as anticipated on 2 February.
- The Bank of England raised borrowing costs by a further half percentage point on the same day, taking the base rate to 4.0%. UK interest rates are now expected to peak around 4.5%.
- In other news, the UK will be the only economy in the G7 group of nations to shrink in 2023, according to the IMF. Brexit-related issues are still weighing on activity levels, three years after the vote on whether the UK should leave the European Union.

- **Asia/EM:** The 'China reopening' story dominated attention in Asia. Officials finally appear to be softening their stance on Covid, removing a range of virus-related rules and restrictions.
- The Chinese economy grew 'only' 3.0% in 2022; the second-slowest annual growth rate since the 1970s and well below Beijing's 5.5% annual target.
- Activity levels could accelerate immediately following the Lunar New Year celebrations as restrictions are relaxed. This could be good news for neighbouring countries in the Asia Pacific region – including Australia – which tend to be reasonably reliant on growth in China to drive their own economies.

Australian dollar

- The general 'risk on' tone benefited the AUD. The currency strengthened by 3.6% against the US dollar, closing January above 70 US cents for the first time in nearly six months.
- The AUD has now appreciated by more than 10% against the US dollar in the past three months.
- The 'Aussie' also appreciated against other currencies, including the euro, the UK pound and the Japanese yen. Collectively, the AUD gained 1.6% against a trade-weighted basket of currencies, adding to strength from late-2022.

Australian equities

- Australian shares started 2023 positively, with all but one sector posting gains. As a whole, the S&P/ASX 200 Accumulation Index added 6.2%.
- A combination of moderating inflation expectations, lower bond yields both locally and offshore, and an increasing number of large international firms announcing cost-cutting initiatives helped spur a renewed sense of optimism and bullish sentiment.
- The Consumer Discretionary sector (+9.9%) was the strongest performer over the month, with gains led by Corporate Travel Management, ARB Corporation and Breville Group, all of which rose by more than 20%. Retailer JB Hi-Fi (+15.3%) posted a solid semi-annual trading update, with sales and gross margins both exceeding forecasts on the back of resilient consumer spending and the impact of seasonal promotions.
- Market sentiment towards mining stocks improved on expectations that an acceleration in growth in China will benefit demand for bulk commodities, such as iron ore. This supported index heavyweights like BHP (+8.2%), Rio Tinto (+8.8%) and Fortescue Metals Group (+8.4%). Strong performances from lithium companies including Sayona Mining (+36.8%) and Pilbara Minerals (+26.7%) also supported an 8.9% return from the Materials sector.
- Utilities (-3.0%) was the only sector to register a negative return in January. Among the larger firms, AGL Energy (-5.2%) fared the worst, followed by Origin Energy (-3.2%). The latter announced a further extension of its due diligence and exclusivity agreement with the Brookfield and EIG consortium, with the market suggesting the proposed government price cap on energy might be affecting the acquisition decision.
- Moderating coal prices seemingly impacted Energy stocks like New Hope Corporation and Whitehaven Coal, which fell 7.9% and 10.8%, respectively. These detractors were more than offset, however, by solid contributions from Paladin Energy (+21.4%), Ampol Limited (+7.8%) and Woodside Energy Group (+2.3%).
- Small caps outperformed their larger peers for the first time since October, with the S&P/ASX Small Ordinaries Index closing the month 6.6% higher.
- All sectors in the small cap index posted gains. The Consumer Discretionary sector was a standout, rising 11.2%, bolstered by robust gains from retailers including City Chic Collective (+35.8%), Adairs (+30.9%) and Kogan (+28.6%).

Global equities

- Overseas share markets fared well too. The MSCI World Index added 6.5% in local currency terms, although strength in the AUD reduced the return to 3.1% for Australian-based investors.
- The NASDAQ performed extremely well in the US, adding 10.7%. This was the best January return for the technology-heavy index in more than 20 years. Large tech stocks including Apple and Alphabet – owner of the Google search engine – will release their latest results in early February.
- The broader S&P 500 Index added 6.3%, essentially reversing December's weakness and closing around its end-November level.
- All of the major indices in Asia also posted positive returns. Hong Kong's Hang Seng was a standout, registering double-digit gains, although China's CSI 300 also added 7.4%. Both benefited from the 'China reopening' theme and enjoyed their best January performances in over a decade.
- There was a fair degree of dispersion among European markets, although all made positive progress. The MIB in Italy soared over 12%, while French and Spanish stocks rose between 9% and 10%. British and Swiss stocks were relative laggards, rising 'only' 4.3% and 5.2%, respectively.

Listed property

- Global property securities appreciated in January, consistent with the upward move in share markets globally. The FTSE EPRA/NAREIT Developed Index returned 8.0% in Australian dollar terms, comfortably outperforming wider equity markets.
- In general, sentiment was supported by moderating inflation expectations in key regions. In turn, there were hopes that we might be nearing the end of monetary tightening cycles in the US, Europe and Australia.
- The best returns from international property markets were found in Germany (+16.8%), France (+10.7%) and Sweden (+10.7%). Laggards included Hong Kong (+5.2%) and Spain (+6.0%).
- Japan was the only country to register a negative return (-1.6%), following a surprise change to the Bank of Japan's *yield curve control* policy in December.

Global and Australian Fixed Income

- Suggestions that inflation may have peaked – or being close to peaking – in major regions saw investors reassess their interest rate forecasts. In general, the peak in borrowing costs is now expected to be a little lower than what was anticipated before Christmas.
- These evolving expectations saw bond yields trend lower in most major regions, which supported gains from global fixed income. The Bloomberg Global Aggregate Index rose by more than 2% in AUD terms.
- Comments from Federal Reserve policymakers attracted the most scrutiny, especially since developments in the US tend to set the tone for other bond markets worldwide. Ten-year Treasury yields closed the month down 37 bps, to 3.51%; essentially at the lower end of a 3.5% to 4.2% range where they have been trading for most of the past five months.
- There were similar moves over the Atlantic. Ten-year yields on UK gilts and German bunds closed the month 34 bps and 28 bps lower, respectively.
- Japan was an outlier. Yields on 10-year JGBs rose 8 bps over the month, to 0.49%; very close to the upper end of the Bank of Japan's permitted -0.5% to +0.5% range following recent amendments to its *yield curve control* policy.
- Australian bond yields fell sharply; by 50 bps in the 10-year part of the curve. This aided returns from the local bond market. The Bloomberg AusBond Composite 0+ Year Index added 2.8%, clawing back some of its lost ground from 2022.

Global credit

- Credit spreads narrowed quite sharply over the month, which was consistent with gains in major share markets and with a general increase in risk appetite among investors.
- Spreads on investment grade securities closed the month 14 bps tighter, at 1.33%; their lowest level since April last year. In fact, investment grade issues enjoyed their best January performance since 1975.
- Spreads on high yield credit also narrowed sharply, which provided an additional tailwind for overall performance.
- We saw a good level of new corporate bond issuance over the month. More than US$160 billion of new corporate bonds were issued in the US alone, for example, which was among the highest January totals on record. Encouragingly, all of this new issuance was comfortably digested by the market. This underlines the demand for credit worldwide and signals that there may still be large amounts of money sitting on the side lines ready to be deployed in high quality, yielding investments.
- Early indications from the latest corporate earnings announcement season suggest most firms remain in healthy shape financially. This is encouraging, as it should help minimise defaults in the year ahead.

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