WARNECKE & Co.
Chartered Accountants
Business Advisors
Financial Planners

Count

Market Wrap

February 2023

Economic and market overview

- Inflation in the US did not moderate as much as anticipated and the latest payrolls data confirmed that the American labour market shows no signs of slowing.
- Together, these developments led to suggestions that US interest rates could be raised further this year and, potentially, remain elevated for an extended period.
- These evolving projections set the tone for global markets during February, dampening sentiment towards equities and resulting in most major share markets losing ground.
- Geopolitical risk also reared its head again, as alleged spy balloons were shot down in US airspace.
- Fixed income markets also struggled, as evolving interest rate forecasts saw government bond yields rise quite sharply.

- **US**: Inflation in the US is proving stickier than policymakers had hoped. The annual rate of headline inflation was 6.4% in January, only down modestly from 6.5% in the previous month.
- The latest payrolls data were also unequivocally strong. Observers believed US firms likely employed an additional 189,000 workers in January, but in fact more than half a million new jobs were created over the month. New job numbers for the previous month were also revised higher, by an additional 37,000. The unemployment rate ticked lower, to 3.4%, equalling the lowest level since the early 1950s.
- This was important for investment markets, as ongoing strength in the labour market suggests wage pressures are unlikely to ease in the near term. In turn, this could add to inflationary pressure and might mean interest rates need to remain higher for longer than was previously thought.
- The Federal Funds rate was raised by a quarter of a percentage point during February, and further rate hikes are anticipated. Perhaps even more importantly, borrowing costs are now expected to remain elevated for a more prolonged period. Consensus forecasts currently suggest the Federal Funds rate will be around 5.3% by year end, up from previous forecasts of around 4.5%.

- **Australia**: The Reserve Bank of Australia lifted local interest rates by a further quarter of a percentage point, to 3.35%; the highest level in more than a decade.
- Higher borrowing costs are undoubtedly worrisome for Australians, particularly as around a quarter of all home loans will roll off fixed rates and onto higher variable interest rates in the remainder of this year.
- Consumer confidence has dipped against this background, which does not augur well for discretionary spending or for the overall Australian growth outlook.
- Backward-looking data confirmed the local economy grew at an annual rate of 2.7% in the December quarter. This was in line with expectations, although investors are more concerned with the growth outlook for 2023 and beyond.
- More than 25,000 jobs were lost in December and January combined and the Australian unemployment rate has ticked back up to 3.7%, from 3.5% at the beginning of 2023.
- Wages are still rising at more than 3% per year, but the rate of increase could conceivably slow if conditions in the labour market continue to deteriorate.

- **New Zealand:** A State of Emergency was declared in New Zealand – just the third in the country's history – following a cyclone. This could cause some volatility and cloud the Reserve Bank of New Zealand's view on prevailing economic conditions.
- More positively, the labour market appears to be holding up reasonably well. Job vacancies remain quite buoyant, suggesting firms still have an eye on growth.
- Both business and consumer confidence levels rose from the previous month, albeit remain at subdued levels relative to longer-term averages.
- As anticipated, cash rates in New Zealand were raised by a further half percentage point, to 4.75%. Further hikes are anticipated too; consensus forecasts suggest interest rates will have been raised to around 5.5% by the third quarter of 2023.

- **Europe:** Interest rate forecasts continued to rise in the Eurozone. Consensus forecasts now indicate the European Central Bank will have lifted official borrowing costs to 3.75% before the end of 2023. This would match the record peak in Euro-wide interest rates, equalling the level from 2001 not long after the introduction of the euro.
- In other news, GDP data showed the German economy shrank in the December quarter. Another negative reading is forecast for the first quarter of 2023, which would tip Europe's largest economy into a technical recession (two consecutive quarters of negative GDP growth).
- The growth outlook for the Eurozone as a whole has brightened a little, however, partly owing to the region's reduced reliance on energy supplies from Russia. European countries have actively diversified their supply agreements, meaning there is less chance of supply disruptions going forward and a lower likelihood of associated factory shutdowns.
- In the UK, the Bank of England raised cash rates by half a percentage point, to 4.00%. Interest rates are now expected to peak at 4.75% towards the end of 2023.

- **Asia/EM:** Indications suggest the rebound in the Chinese economy is gathering pace. The latest survey of manufacturers showed the strongest conditions in the sector for more than a decade. Encouragingly, activity levels in the services and construction sectors in China have also rebounded higher as Covid-related restrictions have been lifted.
- In Japan, there was a focus on candidates to replace Haruhiko Kuroda as the Bank of Japan's governor. Kuroda has held the post for more than a decade, but will stand down in early April.

Australian dollar

- The general 'risk off' market tone was a headwind for the Australian dollar, particularly against the US dollar which was the strongest currency among G10 countries over the month. The 'Aussie' declined in value by 4.6% against the USD in February, closing a little above 67 US cents.
- The AUD depreciated by 1.6% against a trade-weighted basket of other currencies, essentially giving back January's gains.
- This move increased the cost of imported goods in AUD terms and raised the cost of overseas travel for Australians, but also had the effect of lifting monthly returns from investments in offshore markets.

Australian equities

- Most ASX-listed companies reported their financial results for the six months ending 31 December during the month. Given ongoing uncertainty regarding the economic outlook, investors paid particular attention to firms' outlook statements.
- The S&P/ASX 200 Accumulation Index ended February 2.4% lower. In most cases, companies whose earnings fell short of consensus expectations performed particularly poorly.
- Utilities (+3.4%) was the best performing sector, buoyed by a 9.4% rally in Origin Energy. The company attracted a revised takeover bid from the Brookfield Asset Management and MidOcean consortium, allaying concerns that the proposed energy price cap could jeopardise the acquisition.
- The Materials sector struggled (-6.9%), as labour shortages and higher costs continued to weigh on earnings for major miners including BHP Group (-8.5%) and Rio Tinto (-7.8%).
- Shares in gold miner Newcrest Mining soared early in the month following a takeover proposal from Colorado-based Newmont, but gave back most the earlier gains in the second half of February after management dismissed the offer and as the gold price fell.
- The Financials sector (-3.8%) was hindered by negative returns from all four of the major banks. Insurers including AUB Group (+17.4%) and QBE Insurance (+9.8%) fared much better, with financial results benefiting from rising premiums.
- The Small Materials sector was the biggest laggard in the small cap space, and helped drag the S&P/ASX Small Ordinaries Index 3.7% lower over the month.
- E-commerce furniture store Temple & Webster Group (-39.6%) was the worst performer among small caps, reflecting a normalisation of demand following the Covid-related stay-at-home bubble and a deteriorating outlook for the local residential property market.

Global equities

- Global shares struggled in February, with the MSCI World Index falling 1.6%. That said, AUD weakness meant returns were positive for Australian-based investors.
- Evolving interest rate forecasts were a headwind for US share markets. The bellwether S&P 500 Index closed the month 2.4% lower in USD terms.
- The tech-heavy NASDAQ also lost ground (-1.1%), following underwhelming financial results from influential stocks like Apple, Amazon, and Alphabet – the owner of Google.
- Cost cutting remained a consistent theme among US-listed firms. Media giant Disney announced plans to axe 7,000 staff, for example, adding to more than 60,000 job cuts in the wider US technology sector so far this year.
- Asian markets also generated disappointing returns on the whole. Hong Kong's Hang Seng – which has been particularly volatile in the past year or so – was the worst performer, losing 9.4%.
- Stocks in China and Singapore typically closed the month between 2% and 3% lower. Returns were better in Japan, however, with the Nikkei 225 Index gaining 0.4%.
- With the exception of Switzerland, most European markets fared much better. The Euro Stoxx 50 – which measures the performance of 50 leading stocks from 11 countries in the Eurozone – rose 1.8%.
- Performance was supported by particularly strong contributions from Spanish and Italian stocks, although those in France and Germany also made progress.
- The general deterioration in investor sentiment towards risk assets hindered stocks in emerging regions. The MSCI Emerging Markets Index closed February 6.5% lower, although currency movements helped cushion the losses for Australian investors.

Listed property

- Global property securities struggled in February, consistent with moves in broader equity markets. The FTSE EPRA/NAREIT Developed Index closed the month 3.6% lower in Australian dollar terms.
- Sentiment towards property stocks continued to be affected by macroeconomic factors, particularly commentary from Federal Reserve officials that suggested further interest rate hikes are likely in the US.
- The best performing markets in local currency terms included Spain (+1.8%) and France (+1.4%). Laggards included Hong Kong (-6.1%), Germany (-6.1%) and the US (-4.8%).
- The Japanese property market also fared relatively well, outperforming global peers as increases in inbound travel to the country were deemed beneficial. This helped the market rebound from weakness in January.

Global and Australian Fixed Income

- In the US, 10-year Treasury yields rose 41 bps, to 3.92%. This move set the tone for other major bond markets globally and resulted in disappointing returns for fixed income investors.
- The Bloomberg Global Aggregate Index (AUD hedged) returned –1.8%. This was the worst February return from the Index since its inception in 1990.
- The main focus was the release of US inflation data and subsequent comments from central bank officials regarding the interest rate outlook.
- It remains challenging to accurately call the peak in US interest rates, but it has become clear that borrowing costs are likely to remain high for longer than was previously anticipated. Suggestions that inflation could prove sticky in nature pushed Treasury yields higher across the curve.
- There were meaningful moves in government bond yields in Europe too. Ten-year yields rose by 49 bps and 37 bps on UK gilts and German bunds, respectively. Energy prices have come off the boil in the region, but strong inflationary pressures are still being seen across a wide range of other categories and in services sectors, in particular.
- Yields on Japanese Government Bonds were almost unchanged over the month. At 0.50%, yields on 10-year securities remained at the very top of the Bank of Japan's prescribed -0.50% to +0.50% range.
- Locally, yields on 10-year Australian Commonwealth Government Bonds rose 30 bps over the month, to 3.85%. Again, this reflected increasing interest rate forecasts and suggestions that the Reserve Bank could continue raising official borrowing costs to combat persistently high inflation.
- This move resulted in subdued returns from the domestic fixed income sector. The Bloomberg AusBond Composite 0+ Year Index closed February 1.3% lower, giving back around half of the gains made in January.

Global credit

- Credit securities held up relatively well in February, despite a broad-based sell-off in equity and credit markets.
- Credit spreads were little changed in both the investment grade and high yield sub-sectors, meaning the receipt of coupon income was the main driver of returns from the asset class.
- Corporate bonds continue to offer prospective yields over and above those on offer from government bonds, underlining the appeal of credit among income-oriented investors.
- Generally speaking, the issuance of new securities did not cause any indigestion in the market. Most new deals were well supported by investors, particularly in Europe where credit securities performed slightly better than those in the US.

This material has been prepared and issued by First Sentier Investors (Australia) IM Ltd (ABN 89 114 194 311, AFSL 289017) (Author). The Author forms part of First Sentier Investors, a global asset management business. First Sentier Investors is ultimately owned by Mitsubishi UFJ Financial Group, Inc (MUFG), a global financial group. This material contains general information only. It is not intended to provide you with financial product advice and does not take into account your objectives, financial situation or needs. Before making an investment decision you should consider, with a financial adviser, whether this information is appropriate in light of your investment needs, objectives and financial situation. Any opinions expressed in this material are the opinions of the Author only and are subject to change without notice. Such opinions are not a recommendation to hold, purchase or sell a particular financial product and may not include all of the information needed to make an investment decision in relation to such a financial product. To the extent permitted by law, no liability is accepted by MUFG, the Author nor their affiliates for any loss or damage as a result of any reliance on this material. This material contains, or is based upon, information that the Author believes to be accurate and reliable, however neither the Author, MUFG, nor their respective affiliates offer any warranty that it contains no factual errors. No part of this material may be reproduced or transmitted in any form or by any means without the prior written consent of the Author. In Australia, 'Colonial', 'CFS' and 'Colonial First State' are trademarks of Colonial Holding Company Limited and 'Colonial First State Investments' is a trade mark of the Bank and all of these trademarks are used by First Sentier Investors under licence.

Count Financial Limited ABN 19 001 974 625, AFSL 227232 (Count). Count is 85% owned by CountPlus Limited ACN 126 990 832 (CountPlus) of Level 8, 1 Chifley Square, Sydney 2000 NSW and 15% owned by Count Member Firm Pty Ltd ACN 633 983 490 of Level 8, 1 Chifley Square, Sydney 2000 NSW. CountPlus is listed on the Australian Stock Exchange. Count Member Firm Pty Ltd is owned by Count Member Firm DT Pty Ltd ACN 633 956 073 which holds the assets under a discretionary trust for certain beneficiaries including potentially some corporate authorised representatives of Count Financial Ltd. 'Count Wealth Accountants' is a business name of Count. Count advisers are authorised representatives of Count. While care has been taken in the preparation of this market update, no liability is accepted by Count, its related entities, agents and employees for any loss arising from reliance on this market update.

WARNECKE & Co.
Chartered Accountants
Business Advisors
Financial Planners