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Market Wrap

March 2023

Economic and market overview

- March was an eventful month for financial markets globally.
- Banking failures in the US and Europe caused panic among investors and saw equity markets weaken and credit spreads widen. Calm had been restored by month end, although the events provided a reminder that there will likely be some unintended consequences of central banks' actions over the past year or so. Interest rates have been increased significantly since the start of 2022; by 3.5% in Australia and 4.75% in the US, for example. Rarely before have borrowing costs been raised so meaningfully in such a short period of time.
- Despite persistently high inflation, investors revised their interest rate forecasts lower during the month. Generally speaking, there were assumptions that the banking failures would have caused unease among policymakers globally and that they might now be inclined to slow the pace of their interest rate tightening cycles. Inflation remains worryingly high in most key regions, but policymakers must surely now be focused on maintaining stability in the financial system too.
- These evolving interest rate forecasts saw bond yields fall significantly worldwide – nowhere more so than in Australia – and meant fixed income markets generated favourable returns.

- **US**: Federal Reserve policymakers raised official interest rates by 0.25% as anticipated in mid-month, although many investors are now suggesting borrowing costs may have peaked.
- In fact, consensus forecasts are now suggesting interest rates will have been lowered by the end of this year, assuming inflation continues to come off the boil and as policymakers respond to an anticipated slowdown in economic activity levels.
- The latest release of inflation data – for the month of February – showed a further moderation in pricing pressures, suggesting that the increases in interest rates over the past year or so are having their desired effect.
- Labour market trends remain problematic for central bank officials. American firms continue to add staff quite aggressively – another 300,000+ workers were hired during February – which could feed through to inflation over time. Average earnings in the US have also increased 4.6% over the past 12 months; below the rate of inflation, but well above the long-term average.
- Consumer confidence appears to be holding up reasonably well against this background, although a survey of businesses painted a gloomier picture and suggested operating conditions are worsening. Another data release highlighted a further deterioration in factory activity and showed output has fallen to its lowest level in nearly two years. This suggests higher borrowing costs are starting to bite and that businesses and consumers might be reining in their discretionary spending.

- **Australia**: The Reserve Bank of Australia raised interest rates by a quarter of a percentage point early in the month as anticipated, taking the official cash rate to 3.60%.
- Like in the US, consensus forecasts suggest this may be the peak in borrowing costs in this cycle.
- This view was bolstered when the latest inflation data was released, which showed a meaningful moderation in pricing pressures. Consumer prices rose 6.8% in the 12 months ending 28 February 2023 – still a high reading, but well below the January level and also below expectations.
- Policymakers subsequently left interest rates unchanged at the Reserve Bank's meeting on 4 April.
- The persistence of inflation and the tone of other data releases will determine the future interest rate path.
- For now, overall conditions in Australia remain reasonably buoyant. More than 64,000 new jobs were created in February, for example, and the unemployment rate has fallen to 3.5%; close to the lowest ever level.

- **New Zealand**: The latest GDP data suggested the country might be flirting with recession sooner than the central bank had expected. The economy shrank by 0.6% in the final quarter of 2022, even worse than the -0.2% reading anticipated by a group of forecasters.
- This means New Zealand will be in recession if the economy fails to expand in the cyclone-affected March quarter.
- The latest home loan indicators also painted a bleak picture of overall conditions. Mortgage arrears have now increased for seven consecutive months, as homeowners struggle against rapidly rising repayment costs.

- **Europe**: The high-profile failure of Swiss banking giant Credit Suisse was the main development and focus in Europe.
- As rumours of the firm's stability surfaced, the Swiss central bank affirmed that Credit Suisse continued to meet stringent liquidity and capital requirements. Nonetheless, a loss of confidence led to deposits and collateral posted with Credit Suisse being withdrawn, threatening the stability of the bank and the European and global financial system more broadly.
- To limit contagion risk and to restore calm, the Swiss National Bank and the local regulator hastily arranged for UBS to acquire Credit Suisse for a fraction of what the bank was worth just weeks previously. The loss was absorbed by shareholders and bondholders of Credit Suisse, as well as by the Swiss Government. Positively, the move appeared to satisfy the market and helped alleviate contagion risk, at least in the near-term. By month end, a sense of calm had returned.
- In other news, the European Central Bank and Bank of England raised interest rates by a further 0.50% and 0.25%, respectively.
- Unlike in the US, further rate hikes are anticipated in both the Eurozone and the UK as policymakers try to get inflation under control.

- **Asia/EM**: As part of the 2023 National People's Congress, Chinese authorities confirmed they are expecting GDP to rise at least 5% this year. Officials pledged "forceful" measures to boost the manufacturing sector and plan to increase military spending by more than 7%. Both should provide a tailwind for growth.
- At the same time, the US introduced fresh export curbs on several Chinese firms, citing security concerns. Relations between the world's two largest economies still seem strained.

Australian dollar

- The Australian dollar was little changed against the US dollar over the month.
- The AUD closed March at around 67 US cents, close to its average level over the past six months.

Australian equities

- Australian equities proved quite resilient, despite turbulent conditions in major offshore markets and given concerns about potential banking crises. The S&P/ASX 200 Accumulation Index closed the month just 0.2% lower.
- The Materials sector (+4.1%) was the best performing area of the market, following a particularly strong rally in the last week of the month. Index heavyweights including BHP Group (+7.6%), Rio Tinto (+5.7%) and Fortescue Metals Group (+5.1%) benefited the sector, although gold miners including Northern Star Resources (+19.9%), Regis Resources (+19.5%), Gold Road Resources (+16.0%) and Evolution Mining (+14.7%) also fared well given investors' preference for perceived 'safe-haven' assets.
- Communication Services (+1.6%) also posted solid gains, supported by positive contributions by Domain Holdings Australia (+13.2%) and REA Group (+13.0%).
- Although largely insulated from the banking turmoil overseas, Australian major banks nonetheless succumbed to selling pressures. All four of the majors fell between 2% and 8%, which weighed on the overall Financials sector (-5.1%). Insurance companies such as Insurance Group Australia (+0.9%) and Steadfast Group (+0.3%) were more resilient.
- Energy stocks (-6.9%) were hampered by a lower oil price. WTI Crude fell below US$70/barrel for the first time since late 2021 in mid-March, although had recovered to around USD75/barrel by month end.
- Small Caps modestly underperformed their larger peers, with the S&P/ASX Small Ordinaries closing the month 0.7% lower.
- Meaningful falls in the IT (-8.3%) and Financials (-8.0%) sectors did most of the damage.

Global equities

- Global shares advanced in March, with the MSCI World Index returning nearly 4% in AUD terms.
- The month saw a fair amount of volatility, however, particularly in the middle of the month following the failure of SVB Financial Group; a small bank in the US. This was the second-biggest bank failure in the US in more than 20 years and caused panic in markets globally. The Federal Reserve hastily announced a new Bank Term Funding Program to arrest market fears about potential contagion affecting other US banks.
- Later in the month, Credit Suisse – a much larger bank based in Switzerland, with 167 years of history – also ran into financial difficulty. The bank was subsequently acquired by rival UBS for a bargain-basement price to prevent its collapse. Other major banks in Europe – including Deutsche Bank, Commerzbank, and Societe Generale – experienced significant share price weakness as the news reverberated around the region.
- Thankfully, fears of a potential 'Global Financial Crisis II' had abated by month end, with confidence gradually being restored.
- In spite of the weakness in the Financials sector, European share markets made progress on the whole. Favourable performances from German and French stocks enabled the Euro Stoxx 50 Index to advance 1.8%.
- Returns were mixed in Asia. Share markets in Japan and Hong Kong fared well, adding 2-3%, but Chinese shares closed the month slightly below their end-February level.
- US shares were the standout performers, with the S&P 500 Index closing the month 3.7% higher. Interest rate forecasts were revised sharply lower during the month, which helped support sentiment towards share markets.
- Technology stocks in the US fared particularly well, which enabled the NASDAQ to gain 6.7%.

Listed property

- Global property securities struggled, with the FTSE EPRA/NAREIT Developed Index falling 2.4% in Australian dollar terms.
- In general, the shock waves seen in the broader Financials sector, following the failures of SVB Financial Group and Credit Suisse, dampened sentiment towards property stocks.
- With a return of -26.8%, Germany was comfortably the worst performing market. Others in Europe underperformed too; property stocks in both Spain and Sweden closed the month around 11% lower, for example.
- Collectively, property markets throughout Asia were more resilient than those in the Americas and Europe.
- Hong Kong (+0.6%) was the only market where property stocks registered positive returns, although the Singapore (-0.2%) and Japanese (-2.8%) markets also outperformed in a relative sense.
- Asian markets are continuing to benefit from the relaxation of Covid-related restrictions in China and the associated increase in mobility in the broader region.
- Locally, A-REITs closed the month nearly 7% lower. All constituents except PEXA (+13.9%) and Stockland (+3.6%) reported negative returns.
- Charter Hall Group, HMC Capital and Cromwell Property Group fared the worst, falling 17.4%, 16.5% and 14.5% respectively, despite a lack of material company-specific updates.

Global and Australian Fixed Income

- The banking issues is the US and Europe prompted investors to recalibrate their future interest rate expectations. In general, there are now expectations that the end of the policy tightening cycle is approaching in most major regions. This resulted in significant falls in government bond yields worldwide, which translated into strong returns from fixed income. The Bloomberg Global Aggregate Index returned more than 2% in AUD terms over the month.
- In the US, 10-year Treasury yields closed 45 bps lower. Yields on shorter-dated securities dropped even more significantly, although the yield curve remained inverted with 2-year yields still above those on longer-dated bonds. Some observers continue to suggest this is cause for concern, as curve inversions have historically been reasonably reliable indicators of economic recessions. For now, activity levels appear to be holding up reasonably well, but it seems likely that conditions will deteriorate as higher interest rates are digested.
- Government bond yields moved lower in Europe too, as investors revised their interest rate expectations lower. Yields also fell in Japan, where Japanese Government Bond yields are often relatively stable.
- The most significant falls in yields were seen locally. Yields on 10-year Australian Commonwealth Government Bonds closed the month 55 bps lower, at 3.30%. Australian fixed income funds typically fared well against this background – the Bloomberg AusBond Composite 0+ Year Index, against which many local bond funds are benchmarked, returned 3.2%.

Global credit

- Credit securities were hampered by the sell-off in equity markets and the general risk aversion caused by the baking failures in Europe and the US.
- Credit spreads widened sharply in mid-month, but regained around half of this lost ground later as panic eased and as equity markets settled.
- Nonetheless, spreads closed the month wider in both the investment grade and high yield sub sectors, thereby hampering returns from the asset class.

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