Count
The confidence to look ahead

Market **Wrap**

October 2023

Economic and market overview

- October was another difficult month for financial markets, partly reflecting an acceptance among investors that interest rates are likely to remain high for longer than was previously anticipated.
- Geopolitical risk ramped up too, following conflict in Israel and Palestine.
- Australian shares were down nearly 4% over the month and overseas stock markets closed lower too, not helped by a third consecutive monthly decline in the S&P 500 Index in the US.
- Rising government bond yields once again acted as a headwind for fixed income. Major bond indices closed October lower, both in Australia and offshore.
- The gold price also highlighted investors' general risk aversion, rising in value by more than 7%. Historically, gold prices have tended to rise during periods of heightened uncertainty.
- Cryptocurrencies also tended to fare well, again highlighting their low correlation with other financial assets. Bitcoin values rose nearly 30% over the month, for example, and have now more than doubled in the calendar year to date.

- **US**: The US economy remains resilient and appears reasonably unaffected by significant increases in interest rates. The economy grew at its fastest pace in nearly two years in the September quarter, boosted by higher consumer spending.
- The labour market in the US remains buoyant, which appears to be supporting confidence levels and discretionary expenditure.
- Non-farm payrolls increased by 336,000 in September, which was nearly double the consensus forecast and the highest monthly total since January.
- Consumer prices in the US are still rising at an annual pace of 3.7%, which is above the Federal Reserve's target. Officials maintain that inflation is still too high and that further increases in official interest rates cannot be ruled out.

- **Australia**: Speaking at her first public event since taking over as the Governor of the Reserve Bank of Australia, Michele Bullock suggested Australians might not have seen the end of the interest rate hiking cycle.
- Minutes from the Reserve Bank's latest meeting were similarly sobering, noting that the "*Board has a low tolerance for a slower return of inflation to target than currently expected*". Investors interpreted this to mean that policymakers are considering a further 0.25% increase in official interest rates on Melbourne Cup day on 7 November.
- The CPI print for the September quarter (+5.2% year-on-year) showed a moderation in inflation from the June quarter, but came in above consensus forecasts. Again, this was concerning given the link between inflation and monetary policy settings.

- **New Zealand**: Attention was focused on the political scene in New Zealand, after Christopher Luxon's National Party won 39% of the vote in the general election.
- Luxon was in talks with other parties – including the ACT Party and the New Zealand First Party – in the remainder of the month to try and form a coalition government.
- Annual inflation for the three months ending 30 September showed a moderation from the June run-rate and also came in below consensus forecasts. No further increases in interest rates in New Zealand are currently anticipated.

- **Europe:** Borrowers were relieved to see a further moderation in inflation in the Eurozone, as it reduced the likelihood of further interest rate hikes in the region.
- Consumer prices rose 4.3% in the year ending 30 September. This was the slowest pace for nearly two years, albeit still more than double the European Central Bank's 2% target.
- Some of the latest economic indicators in Germany improved. Factory orders rose by a better-than-expected 3.9% in August, raising hopes that overall activity levels in Europe's largest economy could be rising. A negative GDP growth reading for the calendar year remains a possibility, however, which would undoubtedly dampen the growth rate in the broader Eurozone.
- Despite the ongoing economic weakness in Germany, the country looks likely to replace Japan as the world's third-largest economy by the end of this year. According to the International Monetary Fund, Germany's GDP will exceed Japan's in USD terms in 2023, partly owing to weakness in the Japanese yen against the US dollar.
- At a rate of 6.7% year-on-year, inflation in the UK remained stubbornly high in September. This prompted suggestions that the Bank of England might need to raise interest rates further.
- There were mixed signals on the labour front in the UK. Overall employment fell by more than 80,000 in the three months to the end of August, but wage growth continued to quicken and is now outpacing inflation, in turn increasing the purchasing power of employees.

- **Asia/EM**: Chinese GDP growth data for the September quarter were released during the month and were somewhat better than anticipated. This was encouraging for the outlook for the world's second-largest economy.
- The Chinese economy grew at an annualised rate of 4.9% during the three-month period, boosted by an improvement in consumer spending and retail sales.
- Notably, electricity consumption rose nearly 10% during the quarter, suggesting activity levels in the manufacturing sector might also have picked up.
- That said, problems in the property sector are persisting and some of the country's largest developers have defaulted on their debt repayments. The knock-on effects of these failures could have an adverse influence on the economy and might jeopardise the official annual GDP growth target of 5%. With that in mind, we could see a further easing in policy settings in the months ahead as authorities in Beijing try to ensure their growth targets are achieved.
- Elsewhere, reports suggested the Bank of Japan is preparing to announce additional spending of around 22 trillion yen (more than AUD200 billion). It appears that authorities are trying to cushion the impact of rising inflation on households and stimulate economic activity levels.

Australian dollar

- With the 'risk off' tone extending across most markets globally, the Australian dollar continued to weaken against the US dollar.
- The AUD declined by a further 1.5% – or around 1 US cent – against the USD, closing the month slightly over 63 US cents.
- The AUD performed similarly poorly against a trade-weighted basket of international currencies (-1.5%), but was little changed against selected Asian currencies including the Japanese yen.

Australian equities

- AGM season kicked off for ASX-listed companies, but like in other major share markets globally sentiment was adversely affected by escalating geopolitical uncertainty in the Middle East. The S&P/ASX 200 Accumulation Index ended the month 3.8% lower.
- Utilities (+1.7%) was the only sector to finish the month in positive territory, partly thanks to a solid contribution from Origin Energy (+4.0%). Origin's share price rose after the Australian Competition and Consumer Commission approved a proposed takeover by a consortium led by Brookfield Asset Management. Shareholders will vote on the potential acquisition during November and a 75% majority is required for the deal to proceed. There are no guarantees of success, particularly as media reports suggest some large shareholders could be preparing to vote against the proposal.
- The Materials sector was another relative outperformer, falling 'only' 0.8%. Gold miners including Silver Lake Resources (+24.3%), Gold Road Resources (+17.0%) and Regis Resources (+16.1%) benefited from the rising gold price. Gold has historically been perceived as a 'safe haven' asset and can appreciate during periods of economic and/or geopolitical uncertainty.
- Mixed earnings results from large US tech names dampened sentiment towards the IT sector (-7.6%). Weebit Nano (+4.1%) was the only stock in this area of the market to make positive progress – the announcement of a new commercial agreement with DB HiTek and the company's first quarter activities report were well received by investors. The stock had been promoted to the S&P/ASX 200 Index in September.
- All Healthcare (-7.2%) stocks in the ASX 200 fell over the month. Telix Pharmaceuticals and Healius were among the worst performers, both falling by more than 20%.
- Small caps typically underperformed their large cap peers, with the S&P/ASX Small Ordinaries Index falling 5.5%.
- The Small Financials sector (-13.1%) was the worst performing area of the market, partly owing to disappointing performances from Credit Corp, Tyro Payments and Magellan. All three of these stocks lost around a third of their value.

Global equities

- Persistent talk of a slowdown in economic growth rates as higher interest rates are digested is hindering share markets.
- The MSCI World Index declined by 1.0% in Australian dollar terms, although was supported by the weaker AUD. Returns were worse still in local currency terms.
- In the US, the S&P 500 Index fell 2.1% – the third consecutive monthly decline. The Index has not had such a long losing run since March 2020, around the beginning of the Covid pandemic.
- The S&P 500 Index has not fallen for four consecutive months for more than a decade and will hopefully avoid repeating this with a positive return in November.
- Generally speaking, third-quarter earnings released by listed companies in the US were underwhelming. This added to concerns over potential implications of fresh conflict in the Middle East and saw investors rein in their appetite for risk.
- It was a similarly downbeat story elsewhere, with most large share markets in Asia and Europe closing the month between 3% and 4% lower.
- In Japan, the Nikkei registered its fourth consecutive monthly drop – again the first time this has occurred for more than a decade – and Chinese shares fell in both China and Hong Kong.
- Switzerland was the worst performer in Europe, with the SMI closing the month down more than 5%.
- The weakness extended to emerging regions too. The MSCI Emerging Markets Index lost nearly 4% of its value in local currency terms and returned -2.0% in AUD.

Listed property

- Global property securities struggled in October, consistent with weakness in broader share markets.
- The FTSE EPRA/NAREIT Developed Index returned -4.5% in Australian dollar terms.
- Concerns that inflation will be sticky in nature and see interest rates remain higher for longer dampened sentiment towards REITs. The latest CPI data in the UK and Canada, for example, highlighted the general persistence of inflationary pressure in key regions.
- The increase in geopolitical tensions was also unhelpful and all major markets saw declines over the month.
- Spain (-1.6%), and France (-2.4%) fared better than most. Generally speaking, European markets held up relatively well given the encouraging moderation in inflation in the region.
- J-REITs in Japan also outperformed most global peers.
- Laggards over the month included Canada (-7.4%), Singapore (-6.4%) and Hong Kong (-6.3%).

Global and Australian Fixed Income

- The sharp sell-off in global fixed income markets continued as bond yields trended higher in all major regions.
- Yields on 10-year government bonds in the US breached the 5% threshold in mid-October, for the first time since 2007 before the Global Financial Crisis. Treasury yields closed the month up 0.36%, to 4.93%, as investors accepted that borrowing costs are likely to remain high for an extended period.
- The upward move in Treasury yields acted as a strong headwind for the performance of global bonds. The Bloomberg Global Aggregate Index (AUD hedged) returned -1.9%.
- Yields on 10-year Japanese Government Bonds rose 0.18% over the month. Since yields were just 0.76% at the beginning of October, this was an extraordinarily large move.
- By month end, yields were hovering not too far below the Bank of Japan's revised 1.00% upper limit. The central bank might therefore be required to intervene and support the bond market if selling pressure persists and if yields continue to rise.
- Sovereign bond markets in Europe were more stable, with benchmark 10-year yields rising only 0.07% in the UK and closing the month slightly lower in Germany.
- Moves in the Australian market were even more extreme than in the US. Yields on 10-year Australian Commonwealth Government Bonds rose 0.44% over the month, following the release of generally resilient economic data and the high inflation print for the September quarter.
- Yields on shorter-dated bank bills rose too, which lifted the prospective returns from cash and other AUD-denominated short-term investments.

Global credit

- Economic indicators remain quite resilient in most regions, which augurs well for activity levels and corporate profitability. On the other hand, there is still a risk that interest rates could be raised further, in turn increasing borrowing costs for companies.
- Combined with some lacklustre quarterly earnings releases from US-listed firms, concerning developments in the Middle East saw investors moderate their risk appetite. Credit spreads widened against this background, which was a headwind and prevented corporate bonds from making more meaningful progress.
- Global credit still managed to generate a small positive return, however, thanks to the receipt of regular coupon income.
- Combined with credit spreads that have been reasonably stable recently, higher risk-free rates have significantly increased prospective returns from credit. As a result the asset class has enjoyed inflows from income-oriented investors, in particular.