Soft landing or no landing

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MONTHLY ECONOMIC & MARKETS OVERVIEW
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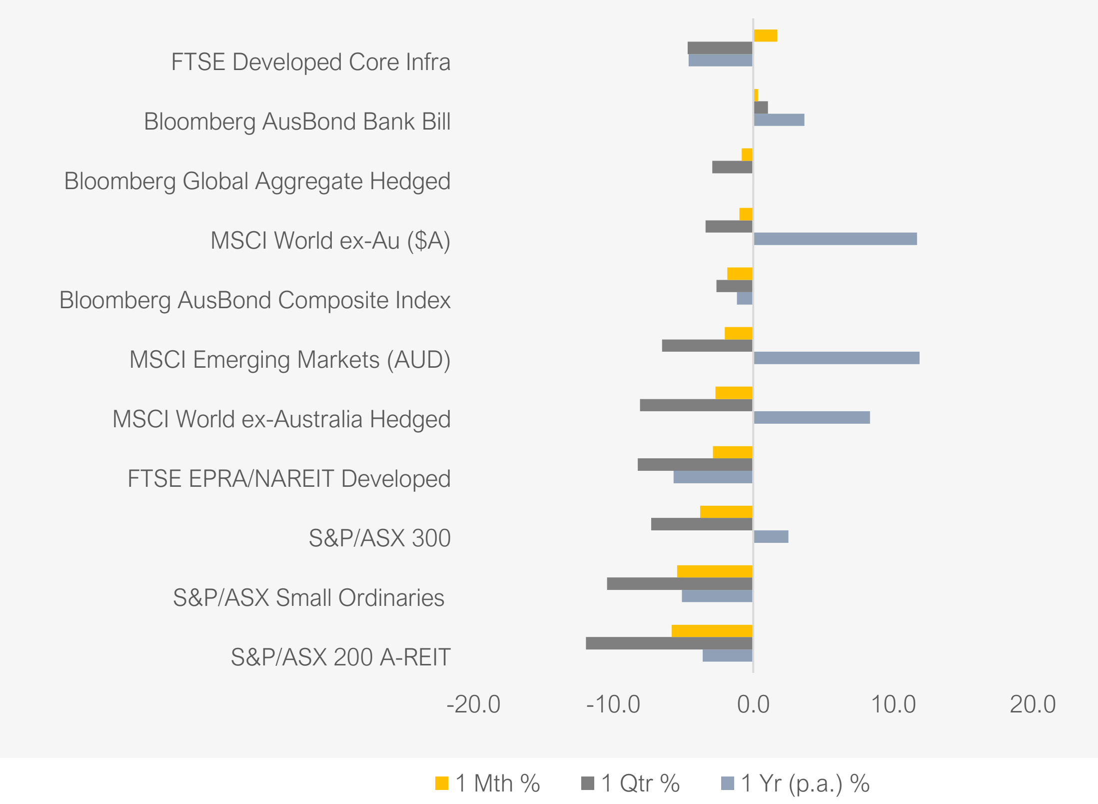
ECONOMIC & MARKETS COMMENTARY & OUTLOOK

- **Markets wrap up** – In October, most major asset classes posted negative returns except for the Infrastructure asset class, which reported a positive return of 1.71%. Australian shares lagged behind international shares, posting a negative return of -3.80%. Australian mid-caps had a challenging month in October, returning -6.94%. International shares returned -0.98%, with international small caps posting the largest detraction within the asset class, returning -4.26% for the same period. Both Australian and International REITs also had a difficult month, returning -5.83% and -4.52%, respectively.
- **The US labour market remains robust** – In October, the unemployment rate remained steady at a historically low 3.9%, with the economy adding 150,000 jobs during the same period. Initial jobless claims for the week ending November 18 decreased, but recurring claims continued to rise.
- **The US' inflation continues to decelerate** – October's US Consumer Price Index (CPI) remained unchanged and showed a 3.2% increase from a year ago. Core CPI, which excludes volatile food and energy prices, saw a modest month-on-month (MoM) increase of 0.2% and a year-over-year (YoY) rise of 4%, slightly below expectations.
- **The US economy continues to display resilience** – The US' Gross Domestic Product (GDP) expanded by 2.9% during the twelve months leading up to Q3 2023.
- **A prevailing sense of pessimism among businesses and consumers in the US** – US consumers persist in demonstrating pessimism, evident in their moderate decline in confidence during October. Retail sales fell by 0.1% in October driven by the decline in motor vehicle purchases and spending on hobbies. Meanwhile, US business confidence, as measured by manufacturing PMI, also experienced a decline during the same period.
- **US' Q3 earnings season is close to completion** – 92% of the S&P 500 companies have reported their Q3 earnings growth. Of which, 82% reported positive earnings surprises, above its long-term average of 76%.
- **Labour market in Australia has started to cool** – The unemployment rate in Australia rose by 0.2% to 3.7% in October. However, the economy added 55,000 jobs in the same period. Meanwhile, wages growth increased by 1.3% quarter-over-quarter (QoQ) to a 26-year record high of 4% in September.
- **Cup Day rate rise** – The Reserve Bank of Australia (RBA) increased its interest rate by 25 basis points to 4.35%, marking a rise after halting hikes since June 2023. Based on recent RBA minutes, more interest rate increases might be on the horizon.
- **Australia's persistent elevated inflation is showing signs of easing** – Australia's annual inflation rate dropped to 5.4% in Q3 2023, primarily due to a slowdown in goods and services inflation. However, the trimmed mean CPI increased by 5.2%, indicating that it remains considerably above the RBA's target range of 2%-3%.
- **Australian consumer confidence dips into gloomy territory** – Australian consumer sentiment has plummeted to deeply pessimistic levels once again in November, following the Cup Day rate hike. Prior to the rate hike, reports indicated that retail sales surged at the fastest pace in eight months in September.

MARKET INDICES PERFORMANCE

INDEX Period ending 31 October 2023	Mth %	Qtr %	1 Yr %	3 Yrs. % p.a.	5 Yrs % p.a.	10 Yrs % p.a.
Australian Shares						
S&P/ASX 300	-3.80	-7.29	2.51	8.68	7.15	6.57
S&P/ASX Midcap 50	-6.94	-12.39	-4.19	6.24	7.78	10.18
S&P/ASX Small Ordinaries	-5.45	-10.45	-5.10	0.52	2.55	4.26
International Shares						
MSCI World ex-Australia	-0.98	-3.42	11.72	11.98	10.80	12.10
MSCI World ex-Australia Hedged	-2.70	-8.11	8.34	8.29	7.44	8.76
MSCI World ex-Australia Small Cap	-4.26	-8.89	0.23	7.80	6.35	9.72
MSCI Emerging Markets	-2.03	-6.52	11.90	-0.29	3.91	5.34
Listed Property & Infrastructure						
S&P/ASX 200 A-REIT	-5.83	-11.97	-3.62	2.72	1.90	6.41
Global Real Estate Index: FTSE EPRA/NAREIT Developed	-2.88	-8.25	-5.69	3.54	0.93	6.10
Global Real Estate Index: FTSE EPRA/NAREIT Dev Hedged	-4.52	-12.76	-8.52	0.08	-2.15	2.86
Infrastructure Index: FTSE Developed Core Infrastructure	1.71	-4.70	-4.63	5.51	6.15	9.00
Infrastructure Index: FTSE Developed Core Infrastructure Hedged	0.26	-9.29	-7.09	1.62	3.04	5.83
Australian Bonds						
Bloomberg AusBond Composite 0+ Years	-1.85	-2.63	-1.18	-4.61	-0.13	2.11
International Bonds						
Bloomberg Global Aggregate Hedged	-0.83	-2.92	0.07	-4.82	-0.36	1.97
Australian Cash						
Bloomberg AusBond Bank Bill	0.33	1.04	3.66	1.47	1.31	1.75

RELATIVE PERFORMANCE – OCTOBER 2023



INVESTMENT OUTLOOK

- **Our outlook & portfolio positioning remain cautious** – While we don't share the same level of pessimism as the consensus, we recognise the growing risk of a recession due to the current and anticipated higher interest rates and stricter lending standards. We also appreciate the strength seen in global growth, employment figures, and equity markets. However, our outlook remains cautious, and we have adjusted our portfolio positioning accordingly.
- **Valuations of equity markets are showing signs of being elevated, although not excessively so** – In the United States, current valuations stand at 19 times earnings, slightly above the long-term average of 17 times. On the other hand, the Australian equity market is currently in alignment with its long-term average valuation of 15 times earnings. These valuations suggest a degree of optimism in the market, but they are not at extreme levels.

INVESTMENT OUTLOOK (cont'd)

- **Anticipated lower earnings expected through CY 2023** – Global company earnings have been trending down throughout 2023, driven by increasing input costs, supply chain disruptions, and rising labour costs. Earnings expectations for CY 2023 are forecasted to increase by 1.2%, which is significantly below their 5-year average earnings growth rate of 12.0% and 10-year average earnings growth rate of 8.5%. Meanwhile, earnings are expected to be -2.9% YoY for the second quarter of 2023, but with a projected earnings growth of 0.2% YoY for the third quarter. More broadly, with top-line earnings growth expected to be more challenging in 2023 compared to 2022, we anticipate that corporates will place a stronger emphasis on cost control and expenditure management. This includes adopting a more stringent approach toward staffing costs in order to sustain earnings and margins.
- **The global economy is anticipated to worsen in the second half of 2023** – Global central banks tightening policies may continue to hurt the global economy, with signs of a possible recession in the US and Australia. If a recession happens, it's likely to be mild due to healthy household and corporate finances, strong consumer spending, and the ability to handle higher unemployment and wage growth. Stock markets, which look ahead, may have already accounted for much of the 2023 challenges, but a severe recession remains a possibility.
- **The declining economic indicators in China are adding more challenges for emerging market equities** – Despite stimulus being generously handed out by the Chinese government to induce growth post lengthy COVID lockdown, its economic recovery has been disappointing thus far with slowing consumer consumption and manufacturing production, credit growth, falling exports as well as a weakened property sector.

INVESTMENT STRATEGY

- **Below-trend growth, elevated recession risks, high inflation, and tightening credit conditions warrant caution in our asset allocation positioning** – Currently, we believe portfolios should be positioned closer to neutral with a slight defensive tilt. During this period of market volatility and macro adjustments, maintaining a well-diversified approach within asset classes is prudent. Due to the current market uncertainty, the potential for varying returns outcomes is high.
- **The importance of staying nimble and seizing opportunities while managing risks** – In this highly volatile market environment, it is crucial to maintain an active and nimble asset allocation strategy. This enables us to capitalise on favourable opportunities and mitigate risks promptly. Currently, we lean towards holding above-normal cash levels in most portfolios, allowing us to capitalise on real and attractive opportunities as they arise.
- **Transitioning towards a more neutral approach to value and growth styles for investment managers** – Value stocks have demonstrated stronger performance in environments characterised by increasing prices and interest rates, in contrast to growth stocks. Additionally, high-quality companies having pricing power can effectively transfer inflationary price pressure to their customers due to their higher cash flows and robust balance sheets.
- **Maintaining exposure to Emerging Markets at a near-neutral position** – While the strength of the USD and fears of a global recession may pose challenges for the Emerging Markets equities asset class, there is a potential for a strong recovery if the proposed stimulus in China materialises and interest rate easing slows down. Consequently, adopting a more neutral exposure to the Emerging Markets asset class offers the potential for upside in portfolio returns.
- **Maintaining a slight underweight exposure to small-caps** – The small-cap sector has delivered weak returns in the past 12 months, coinciding with a risk-off period characterised by slowing growth and rising interest rates. As of August 2023, the S&P/ASX Small Ordinaries index declined by -1.1% over the past year, significantly underperforming the broader large-cap index (ASX/S&P 300) which returned 9.0% during the same period, resulting in a difference of 10.1%. Despite the ongoing headwinds of slowing global growth and rising interest rates, the substantial underperformance of the small-cap and micro-cap sectors over the past year has made them more appealing, presenting potential for upside and recovery in the short-to-medium term.
- **Maintaining a nominal exposure to the Global infrastructure asset class** – Maintaining exposure to the listed infrastructure asset class remains crucial for diversification within a well-rounded portfolio. Infrastructure assets offer appealing investment characteristics, such as long-life assets, returns linked to inflation, lower risk of capital loss compared to other equity investments, and a low correlation with other asset classes. Furthermore, infrastructure investments have demonstrated their ability to provide downside protection to multi-asset portfolios.
- **Prefer a material exposure to uncorrelated assets** – Uncorrelated asset classes, such as private equity, have demonstrated their ability to offer downside protection during recent months, whilst also delivering attractive returns in upward-moving markets over the medium- to long-term.
- **Gradually increasing portfolios' bond exposure** – Bond returns have been notably disappointing over the past year-and-a-half, with poor bond yields as well. Multi-asset portfolios have greatly benefited from maintaining an underweight position in bonds over the past 18 months. However, the persistence of elevated inflation has compelled Global Central Banks to maintain their hawkish stance in tightening the interest rate cycle. Consequently, the future trajectory of bond yields has become a guessing game.

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