# Economic Snapshot

## FMD Financial - Economic Snapshot – October 2023

### SUMMARY

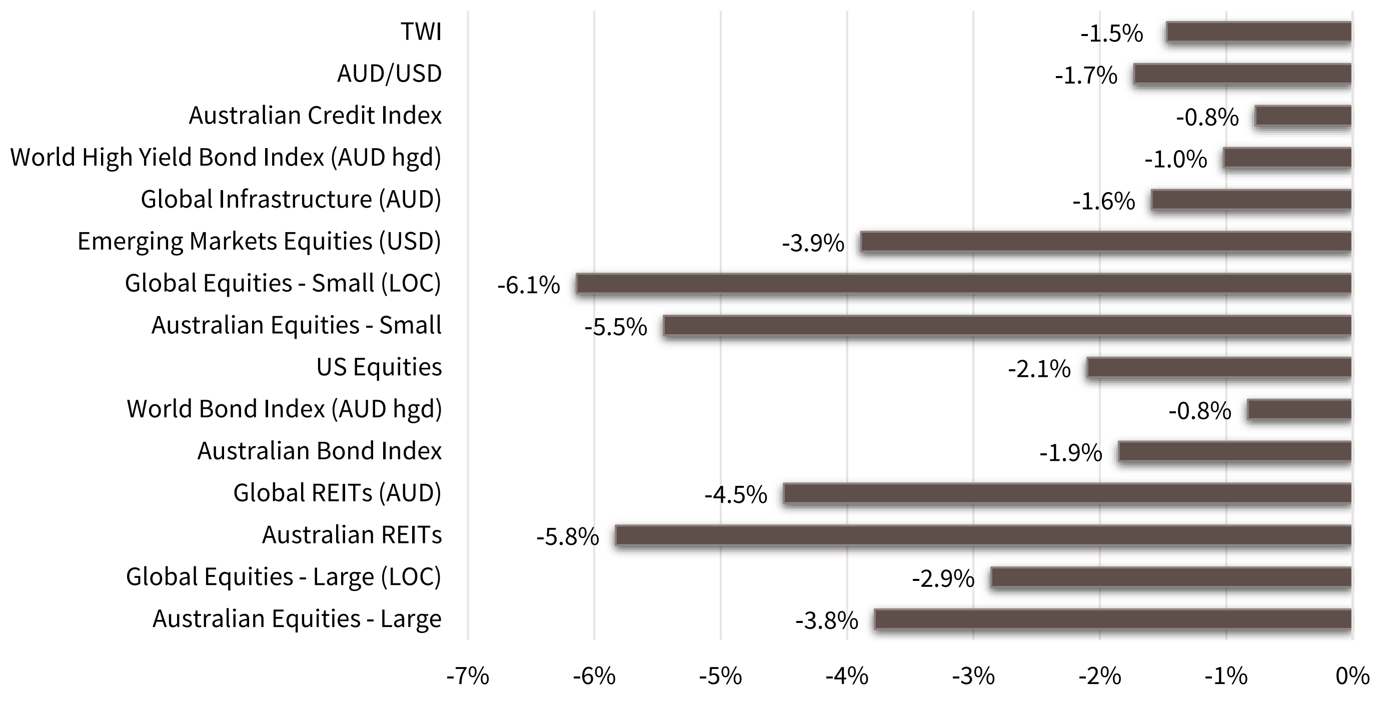
The RBA chose not to lift rates at the September and October meetings as it gave itself more time to assess the impact of the four percentage points of interest rate hikes delivered since May 2022.

Global equity markets dropped a further 2.9% in October taking the year-to-date return to 8.2%. Bond yields continued to climb, undermining valuations across a range of assets, while the Israel-Hamas conflict added to uncertainty and risk aversion.

The Australian equity market lost 3.8% in the month and is now down marginally for the year to date. Healthcare stocks sold down 7.1%, while financials and REITs were down 3.7% and 5.7% respectively.

Global bond yields continued their march higher in October, against the backdrop of a more resilient economy. Australian bond yields sold off more aggressively than their US and global counterparts, as markets priced in another RBA tightening in November following the higher-than-expected September quarter CPI (inflation) result.

**Chart 1: Asset Class Returns - October 2023**




*Source: Zenith Investment Partners Pty Ltd, Monthly Market Report, Issue 116, October 2023* fmd financial

## GLOBAL DEVELOPED EQUITIES

In October, global equity markets declined by 2.9%, bringing the year-to-date return to 8.2%. Bond yields rose, affecting valuations, and the Israel-Hamas conflict added uncertainty.

US bond yields reached 5%, causing a “bear market flattening”. Earnings exceeded expectations, particularly in communication services, consumer discretionary, and financials, with the consensus predicting over 10% growth for the next year. The Israel-Hamas conflict initially impacted markets but as it didn’t escalate to a broader regional conflict it has not yet had a sustained impact.  However, the situation remains fluid.

The Bank of Japan (BoJ) moved toward ending Yield Curve Control and exiting negative interest rate policies. Although they refrained from totally abandoning the program, BoJ did relax the “cap” on 10-year yields. However, Japanese rates remain well below global rates.

Despite a decline in inflation, the resilient global economy reduced expectations for easing in 2024 and 2025. The US outperformed major regions, while Italy and Denmark led for the year, and Hong Kong, New Zealand, and Israel lagged.

Quality stocks outperformed, down 1.7%, while Value stocks lagged at 3.4%. IT and communications services were up, while healthcare and banks declined for the year.

## AUSTRALIAN EQUITIES

In the last month, the Australian stock market fell by 3.8%, making it slightly negative for the year. As was the case with global trends, the market faced challenges from higher bond yields and reduced price-to-earnings ratios. However, the outlook for Australian company earnings is weak, with the market anticipating a 1% fall in growth in earnings per share for the next 12 months across the market.

Healthcare stocks experienced a 7.1% decline, contributing to a 14.7% decrease in 2023. Financials dropped by 3.7%, and Real Estate Investment Trusts (REITs) fell by 5.7%, largely due to increased real bond yields.

A recent NAB economic survey indicated that business conditions, while softer, remain above average. Despite slightly softened job growth statistics, the labour market is still tight. Inflation concerns led to market expectations of another rate hike by November, following a higher-than-expected September quarter Consumer Price Index (CPI) showing 1.2% inflation. The Reserve Bank of Australia (RBA) chose not to raise rates in September and October, allowing time to assess the impact of the previous 4% interest rate hikes since May 2022. Market pricing implied a high probability of another rate hike to 4.35%, subsequently delivered, with the possibility of another by June 2024.

## EMERGING MARKETS

Emerging markets declined by 3.9% in USD terms in October, bringing the year-to-date performance to a 2.1% decrease, trailing global developed equities by approximately 10%. The Chinese equity market faced challenges due to a weak property market and limited policy response, resulting in a 4.3% drop for the month and an 11.2% decline for the year.

China's economic data showed a better-than-expected 4.9% GDP expansion in Q3 and stronger retail sales, but October PMI readings fell below the critical expand/decline level of 50 suggesting the manufacturing sector remained sluggish. Other regions were all largely weaker with the MSCI Asia index down ~4% and Latin American falling by 4.8%.

While emerging markets appear inexpensive compared to developed markets, a catalyst such as rate cuts from the Federal Reserve or additional Chinese stimulus, may be needed for sustained outperformance.

## PROPERTY AND INFRASTRUCTURE

In September and October, rising real yields negatively impacted infrastructure and REITs. Despite REITs already factoring in property value declines, a 65-basis point increase in real yields led to a 5.8% decline in October, adding to the 8.6% drop in September. Year-to-date, REITs are down 5%. Global REITs also fell by 4.5%, totalling an 8.6% loss for the year. Global infrastructure declined by 1.6% in October, following losses of 4.2% in September and 4.7% in August, influenced by a 100-basis point rise in US 10-year Treasury Inflation Protected Securities (TIPs) yields since July.

## FIXED INTEREST – GLOBAL

Global bond yields continued to rise in October, with the US 10-year yield reaching 4.88%, up more than 120 basis points since June. The Barclays Global Aggregate (AUD hedged) index declined 0.8% in October and nearly 15% since the end of 2020. Despite a resilient US economy growing at a 4.9% annualized pace in Q3, higher inflation, a growing fiscal deficit, and increased treasury issuance led to rising yields. The term premium, the reward for holding long-term fixed returns, increased from -0.75% in June to 0.5%.

The Bank of Japan moved closer to ending Yield Curve Control, acknowledging its untenable defence of the 1% Japanese cash rate. In Europe, with inflation at 2.9%, the ECB is expected to maintain steady rates. US credit spreads widened to 442 basis points, raising concerns over corporate refinancing risks, but attractive yields make the corporate bond sector appealing to income investors that understand these risks.

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## FIXED INTEREST – AUSTRALIA

Australian bond yields surged to 4.95% in October, up from 4.5%, outpacing global counterparts. US 2-year yields held at 5.06%, while Australian 2-year yields rose to 4.46%, anticipating further RBA tightening. September CPI exceeded expectations, with core inflation at 5.4%, challenging the RBA's 3.9% forecast by end-2023.

In early November, the RBA raised the cash rate to 4.35%, the first increase in four months, acknowledging persistent inflation. Australia's unemployment rate dipped to 3.6%, but the underemployment rate rose to 6.4%, signalling potential labour market softening. The NAB business conditions index remains above average. With expectations aligning Australian cash rates with US Federal Reserve funds by 2025 to around 4.5%, the AUD gained recent support.

## COMMODITIES

The price of Brent crude oil initially dropped in early October due to weak demand, reaching $93.26 on October 19 amid the Israel-Hamas crisis. Prices later eased to $87.42 as the situation remained contained. Underscoring the potential economic impact of the crisis, the Middle East supplies almost a third of the world's oil and 20 per cent of the world's oil is shipped through the Strait of Hormuz.

Geopolitical tensions boosted gold prices by 7% to $1997.6 per ounce, despite rising real yields. Iron ore rose to $122 per tonne, influenced by positive Chinese growth data and stimulus plans.

## CURRENCIES

The Australian Dollar (AUD) initially dropped to 62 cents in October due to US interest rates but recovered as markets anticipated a Melbourne Cup Day rate hike following higher-than-expected inflation.

The Bank of Japan refrained from totally abandoning its Yield Curve Contral program. While it did relax the "cap" on 10-year yields, Japanese rates remain well below global rates, adding to further downside pressure on the yen, which ended the month at 151.7 to the USD.

The Euro remained stable at 1.06.