APW Partners
AUSTRALIAN PRIVATE WEALTH

Quarterly Market Update
31 December 2023

Pivot Party

At the start of this year every market commentator and analyst seemed to be planning for the recession they were convinced was coming. Equities and bond yields would all tumble as the fastest interest rate increases in a generation would plunge the world into a recession.

But something else was going on. Artificial-intelligence shares were red hot and were taking the chip makers with them - the “Magnificent 7” large tech stocks dominated US equity gains. By the end of September world equity markets were up 17% (in AUD) but the global bond market looked like producing its third negative year in a row - the exact opposite of earlier predictions.

But then the last two months of 2023 saw a remarkable shift in sentiment. In October both the RBA and the Federal Reserve kept up the mantra that interest rates would stay “higher for longer”, but in November data showed U.S. and European inflation falling much faster than expected. Suddenly everything, everywhere, all at once changed.

Bond yields started plummeting – but not because of recession. The market now expected that the “terminal rate” for interest rates had been reached, and that the economy would glide into a “soft landing”. Global stocks, listed real estate and corporate bonds all surged higher.

The Fed then triggered fresh market excitement when it used its December meeting to state unequivocally that rate hikes were over. More telling though was the Fed's "dot plot" which envisaged three 25 bp cuts in 2024. The pivot party kicked into euphoric mode.

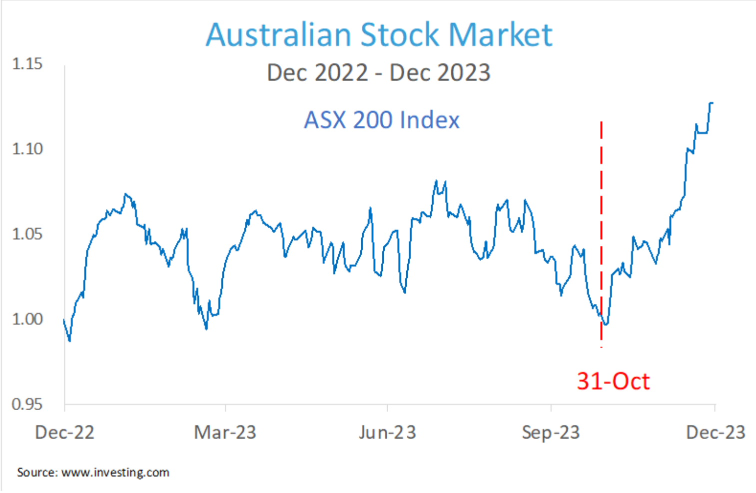
The last quarter of 2023 has ended on a high – but all parties must come to an end. Can global equities keep rallying based on optimism over Fed rate cuts, or will the slowdown in the global economy end up being more severe than currently envisaged? Are we really set for a “soft landing” and is inflation truly vanquished? Could global geopolitical relations deteriorate further?

How will markets respond to those risks? The coming year will provide answers to these questions – and no doubt present new risks and opportunities.

Equity and Bond Market Overview

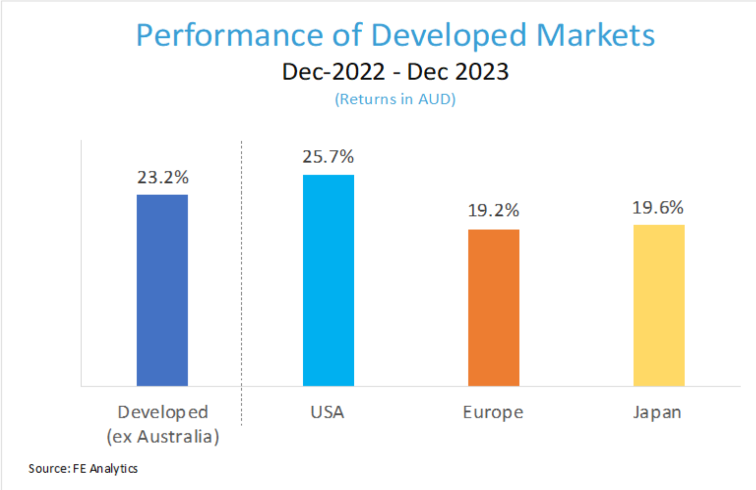
ASX FLYING HIGH IN Q4 AT THE PIVOT PARTY

The ASX spent most of the year in a holding pattern as concerns around where inflation would take interest rates dominated sentiment. By the end of October, the market was flat for the year, and the outlook was gloomy. However, with inflation data lower than expected, and with the Fed pivot, the ASX added a stunning 12% through November and December.



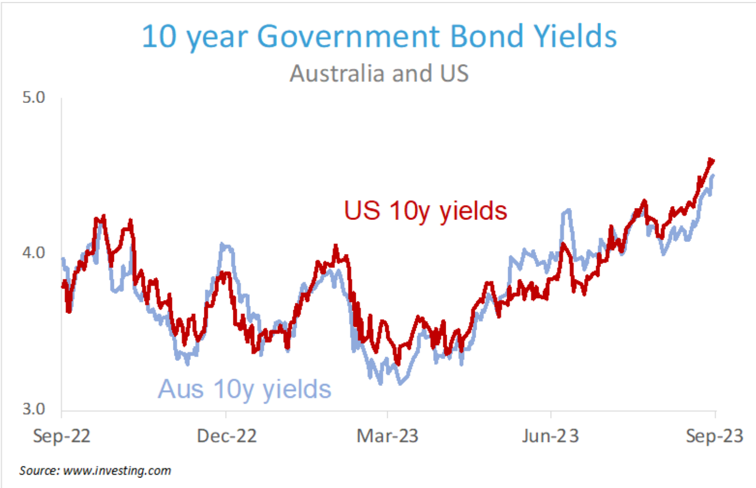
DEVELOPED MARKETS HAVE IGNORED HIGHER RATES.

This stock market rally in the first half of 2023 was built on the back of technology stocks. But now with the Fed pivot all sectors are booming, and Developed Markets are providing some of the best returns in years. The strong performance in international markets continues to reinforce the benefits of globally diversified portfolios.



YIELDS PLUMMET AS BOND MARKET EXPECTS RATES CUTS

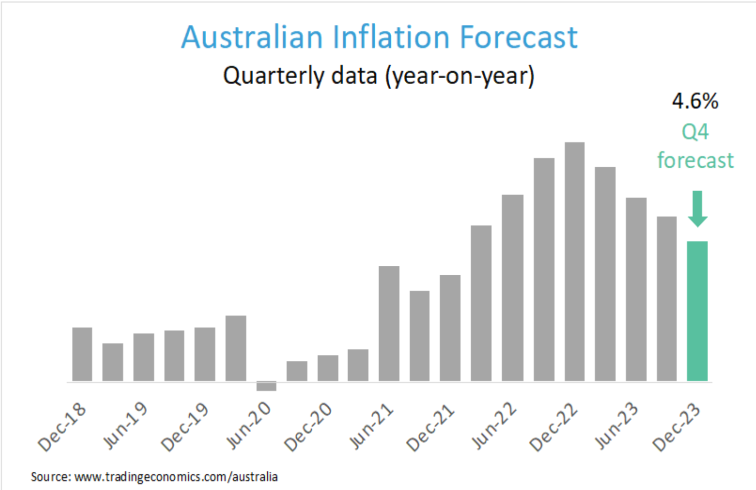
A huge two-month rally in bond prices has rescued fixed income markets from an historic third straight year of declines. The U.S. 10-year Treasury yield, the benchmark for borrowing costs globally, has dropped 100 basis points (bps) since November, the biggest fall since 2008.



Economic Review and Forecasts

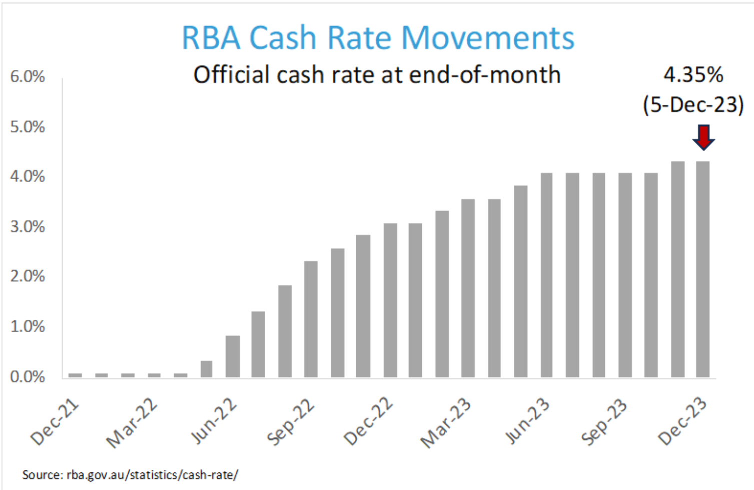
INFLATION CONTINUES TO FALL BUT REMAINS ABOVE TARGET

When the wave of inflation swept the globe in late 2021, Australia lagged by about six months. Given the rapid fall in inflation in the US, then Australia should follow a similar path. However, the RBA will be reviewing the data to see if there is a bigger structural issue at play keeping inflation – and interest rates – higher for longer.



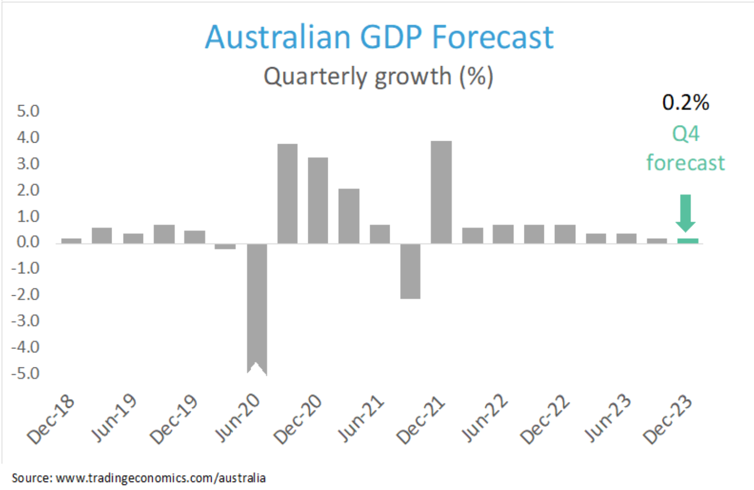
INTEREST RATES MOST LIKELY AT THE TERMINAL RATE

As inflation continues its downward trend, the RBA remains in a wait and see mode. While the RBA left the cash rate on hold at 4.35% at its final board meeting of 2023, the minutes of that meeting reaffirm another interest rate rise may be necessary, although the Fed's pivot has reduced the risk of any further increases.



AUSTRALIA REMAINS ON TRACK FOR A SOFT LANDING

The economy continued to slow throughout the year, with consensus expectations of GDP growth of 0.2% for Q4 2023. Soaring mortgage repayments, rising cost of living, falling real wages and higher taxes due to bracket creep all coalesced to hammer household budgets and consumption.



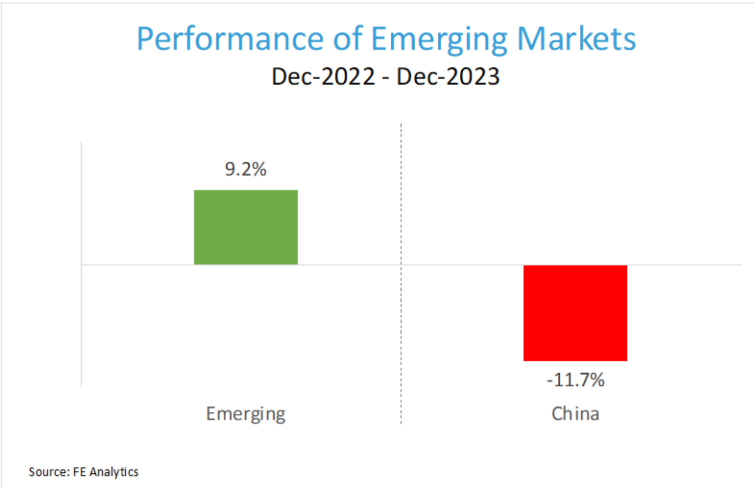
Market Returns

Asset Class	Year to Date	3 Months	1 Year	3 Year	5 Year	10 Year
Cash		1.1%	3.9%	1.7%	1.4%	1.8%
Australian Bonds		3.8%	5.1%	-2.7%	0.6%	2.6%
Global Bonds		5.4%	5.3%	-3.1%	0.5%	2.6%
Australian Equity		8.4%	12.4%	9.2%	10.3%	7.9%
Developed Markets		5.3%	23.2%	11.8%	13.6%	11.7%
Developed Markets (hedged)		9.4%	21.9%	7.4%	11.8%	9.6%
Emerging Markets		2.0%	9.2%	-1.1%	4.3%	5.5%
Australian REITS		16.6%	17.6%	5.7%	6.1%	9.2%
Global REITs		9.2%	9.5%	7.4%	4.8%	7.6%

- Global shares and bonds have enjoyed a strong rally in the past two months as traders priced in six rate cuts or more than 150 basis points of easing next year by central banks as inflation continues to slide.
- The US 10-year Treasury yield has fallen by more than 1% in the quarter resulting in the global bond index returning 5.4% in that period, and 5.3% for the year.
- The Australian sharemarket is up 12.4% for the year – its best return since 2021. Most of that performance came from the last quarter, which returned 8.4%
- The MSCI's World index, the broad gauge of global developed market equities, posted a 23.2% gain for the year, and a 5.3% gain for the quarter.
- The Aussie dollar rose sharply against the US dollar in the last quarter on the back of falling 10-year Treasury yields. Consequently, the hedged MSCI World index outperformed the unhedged index by 4.1% in the quarter.
- Emerging Markets continue to lag developed markets, principally because of the poor performance of China.
- Australian REITs outperformed the equity market in the quarter and over the year, although it was the reverse when looking at global REITs against global equities.

CHINA DRAGS DOWN THE EMERGING MARKETS

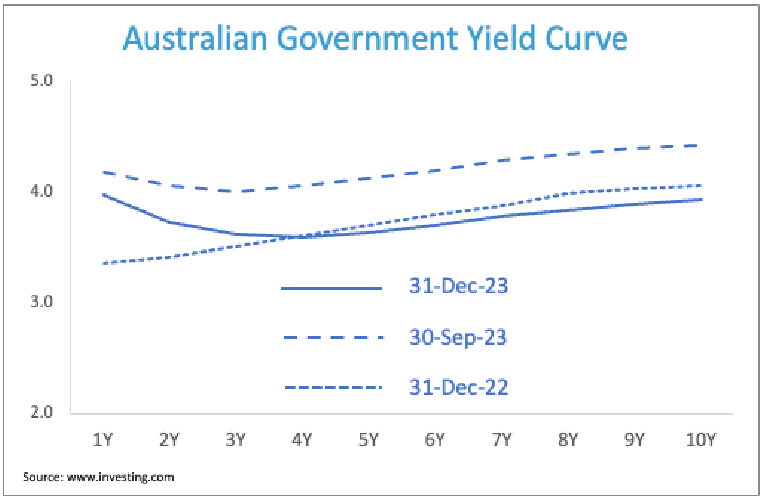
Emerging countries outside of China have had a similarly strong year as the developed markets However, China is around 35% of the EM index, and is facing a host of problems - including slow growth, high youth unemployment and a property sector debt crisis. The MSCI China index is down -11.7% for the year, and -9.4% for the quarter.



Yield Curves

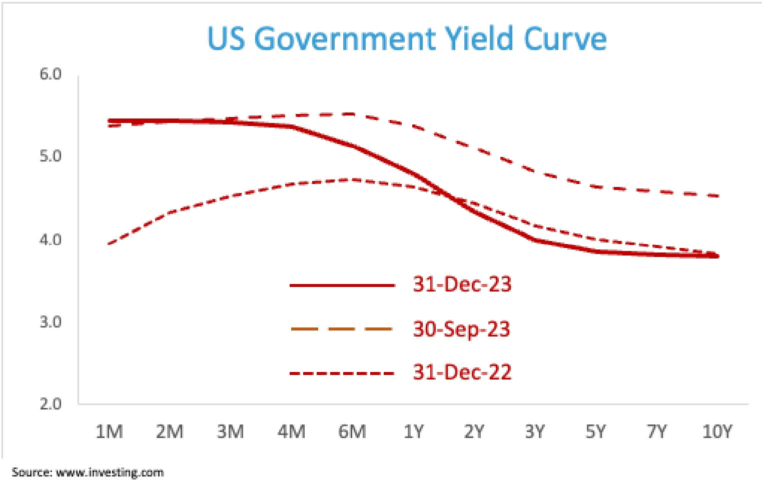
AUSTRALIA

Short end yields came down slightly over the quarter as the market continued to assess inflation data. However, 10-year government bond yields fell below 4%, hitting its lowest levels since the start of the year as the Fed pivot has led bond traders to price out any risk of another rate hike from the Reserve Bank of Australia.



UNITED STATES

The US yield curve remains inverted as the 10-year Treasury yield has fallen by 100 bps in the quarter. At the beginning of December, the Fed pointed to three interest rate cuts in 2024, with additional reductions anticipated in 2025 and 2026 due to the faster than anticipated decrease in inflation. Most economists now favour the soft-landing scenario as more likely than a recession.



Equity Factors - Small and Value Premiums

Asset Class	YtD	3 Months	1 Year	3 Year	5 Year	10 Year
Australian Large		9.0%	14.2%	10.5%	10.6%	8.1%
Australian Growth		9.0%	14.5%	6.4%	9.1%	8.4%
Australian Small		6.4%	6.8%	4.8%	9.9%	7.9%
Australian Value		9.0%	14.2%	14.2%	11.3%	7.2%
Global Large		5.4%	23.9%	12.3%	14.2%	12.3%
Global Growth		7.2%	37.0%	10.3%	17.2%	14.5%
Global Small		6.5%	16.0%	7.8%	11.0%	10.3%
Global Value		3.5%	11.7%	13.7%	10.4%	9.7%

Source: FE Analytics. See below for MSCI indices used to define Large, Small, Value and Growth

MSCI Australia TR	MSCI World ex Australia Index (ATR, AUD)
MSCI Australia Small Cap TR	MSCI World ex Australia Small Cap Index (ATR., AUD)
MSCI Australia Value TR	MSCI World ex Australia Value Index (ATR, AUD)
MSCI Australia Growth TR	MSCI World ex Australia Growth Index (ATR, AUD)

AUTRALIAN FACTORS

Factors are very volatile over short time periods. Looking over the course of the last 12 months, there is no significant style premium between value (lower relative price) stocks and growth (higher relative price) stocks. However, smaller companies continue to under-perform the broader market.

GLOBAL FACTORS

The global markets are dominated by the US, which accounts for approximately 70% of the MSCI World Index. The biggest driver of US returns in the last year has been the large growth tech stocks, resulting in value and small cap stocks underperforming the broader market. However, the MSCI World ex-USA index has delivered a value premium.

If you have any queries or would like to discuss your circumstances in more detail, please reach out to your APW adviser on 03 9826 6610.