Good health has consequences

July 2023

Broader participation

FY23 ended as a surprisingly strong year for global equity markets

Global markets were strong in June with the MSCI World index rising by more than 5%. The US again topped the charts with technology and growth stocks continuing their recent charge. Notably in June there was broader participation in the market rally than was seen earlier in the year. The FY23 financial year saw stronger markets than anyone expected. The ASX200 recorded a total return of 14.8% over the last year while the US S&P500 returned +19.6% and the Nasdaq 26.1%.

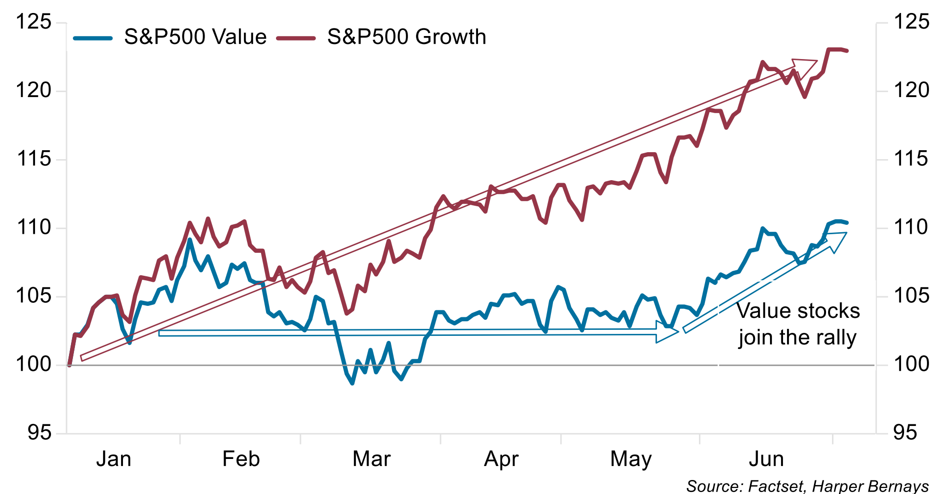
Figure 1 – Global markets very strong in June

Source: Factset, Harper Bernays

In June the participation In the rally broadened with cyclicals and value stocks joining the party

The first half of calendar year 2023 has seen very strong performance from the tech heavy Nasdaq, returning +32.3%. Performance was remarkably narrow with the 'Magnificent Seven' — Apple (AAPL), Alphabet (GOOGL, GOOG), Microsoft (MSFT), Amazon (AMZN), Meta (META), Tesla (TSLA), and Nvidia (NVDA) driving 84% of the Nasdaq's performance to the end of May. At that time US value stocks were broadly flat for the year. June saw much broader participation in the rally, driven at least in part by strong US economic data.

Figure 2 – Value stocks join the rally in June



Source: Factset, Harper Bernays

Good health and its consequences

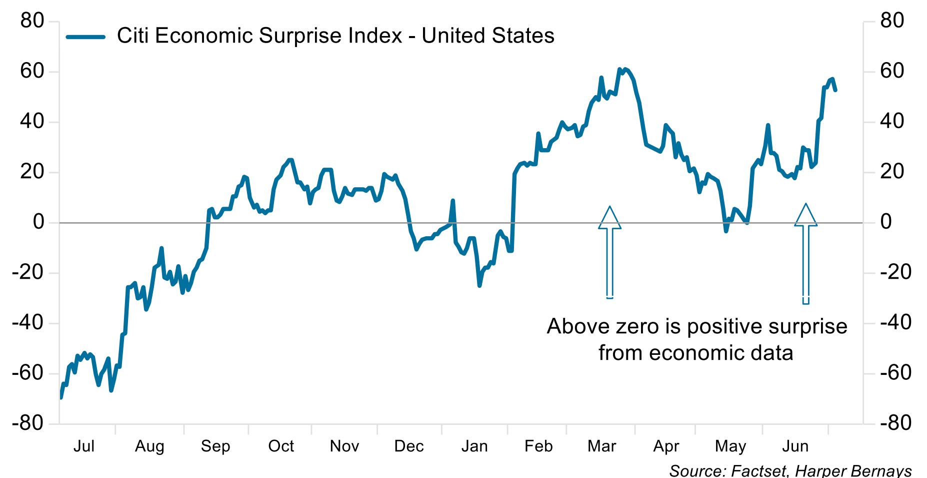
A key feature of the last twelve months has been the resilience of the global economy in the face of sharp interest rate increases. Better than expected economic health is often a good thing for investment markets, however, it becomes a double-edged sword when central banks around the world are fighting inflation and trying to slow economic growth. Expectations are shifting to a "higher for longer" interest rate cycle.

Positive economic data is a double-edged sword when central banks are trying to tame inflation

The US economy in particular has been extraordinarily resilient, helped by the $1.3 Trillion (yes Trillion!) of above normal government spend which we wrote about in May. This extraordinary spend while the Fed are trying to reign in inflation equates to a stimulus of almost 5% of GDP. The long-term (30yr) fixed rate construct of the US mortgage market also means that interest rate increases have a much less direct impact on the hip pocket of American's than is the case in Australia. The outcome is that the US has experienced fairly consistent positive economic surprise over the last nine months, as seen below.

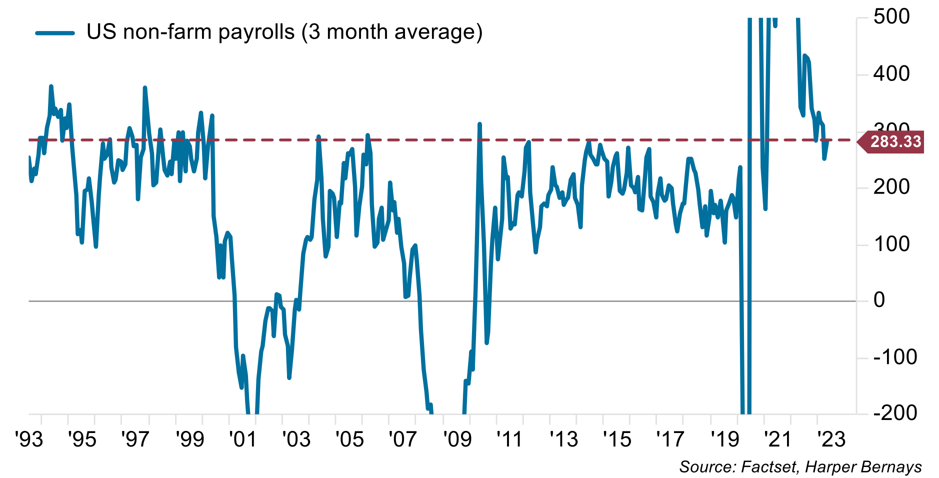
The US economy has remained particularly resilient

Figure 3 – US consistent positive economic surprise



The US job market has been particularly strong with unemployment remaining low and job creation (growth in non-farm payrolls) still at the highest level seen in over 20 years (outside of COVID that played havoc with the data). US housing has been showing signs of improvement with homebuilder sentiment rising and housing starts jumping significantly last month. Of course not all data in the US has been strong. According to a widely followed survey from the Institute for Supply Management the US manufacturing sector has been in contraction since October and keeps getting worse.

Figure 4 – US job creation still strongest in 20 years

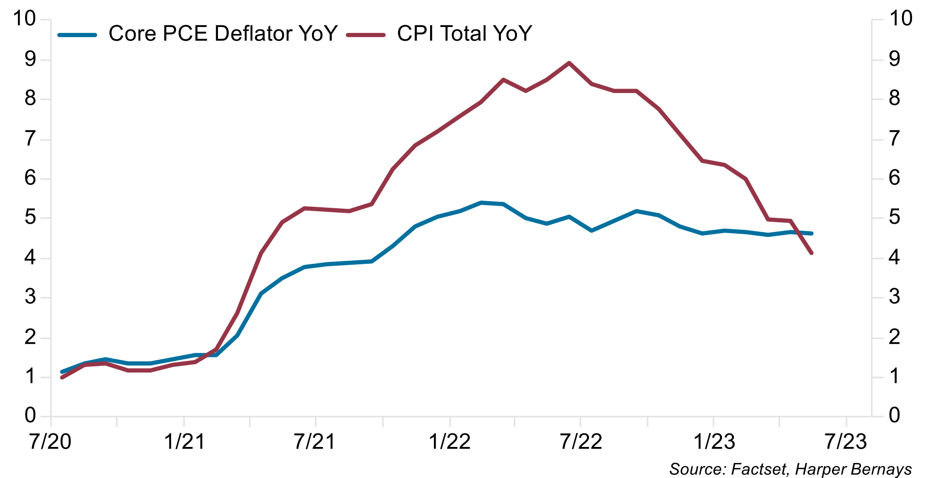


Source: Factset, Harper Bernays

Better than expected economic data is often a good thing for investment markets. However, it becomes a double-edged sword when central banks around the world are fighting inflation and trying to slow economic growth. Headline inflation has been declining as oil prices have come down and goods prices have stabilised. However, core inflation at this stage appears sticky as the services side of the economy remains strong.

While headline inflation is declining core Inflation appears to be sticky

Figure 5 – US Core inflation remains sticky



Source: Factset, Harper Bernays

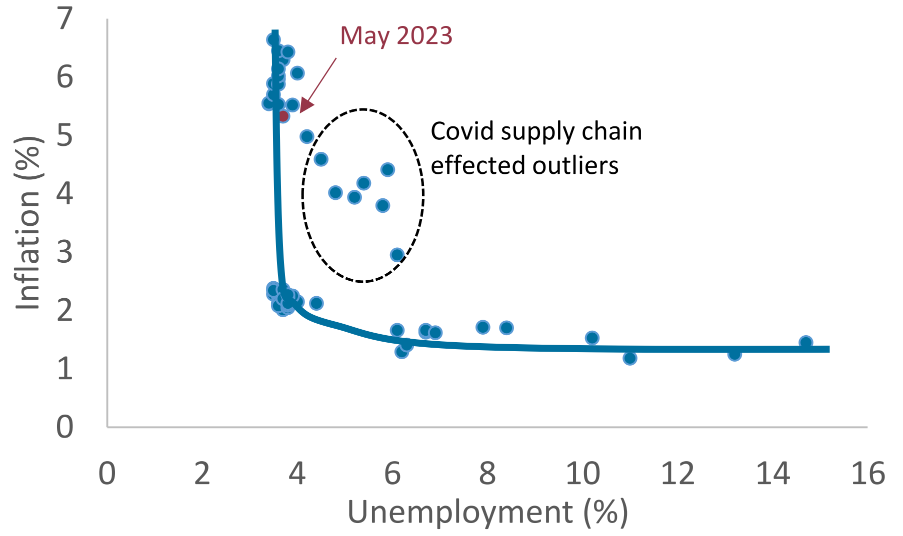
Higher for longer interest rates in the US are our central case.

The bulls point to the Phillips Curve (the relationship between inflation and unemployment) and highlight that recent data suggests the curve is kinked rather than smooth (see below). IF we follow the path of the kinked Phillips Curve it suggests that inflation could fall back towards 2% while unemployment remains low. This is a big "IF" and somewhat the Goldilocks scenario.

Our central case is that interest rates will need to remain higher for longer in the US to bring inflation down to acceptable levels. Australia is a slightly different story where data suggests the consumer is starting to feel the pinch. As short term fixed rate mortgages roll off in coming months the impact of the rate hikes already made will grow. We expect the RBA will pause, and likely be cutting rates, before the US. The A$ is

likely to remain soft in this scenario. As a result we currently favour offshore exposures.

Figure 6 – Kinked Phillips curve in the last 5 years



Market Movements

As at 30 Jun 2023

Country Indices (local FX)	Index	1 Mth	3 Mths	YTD	1 Yr	3y p.a.	5yrs p.a.	10y p.a.
		Index Returns (%)						
Australia S&P/ASX 200	7,203	1.8	1.0	4.5	14.8	11.1	7.2	8.6
US S&P 500	4,450	6.6	8.7	16.9	19.6	14.6	12.3	12.9
US NASDAQ	13,788	6.7	13.1	32.3	26.1	11.9	13.9	16.2
Hong Kong Hang Seng	18,916	4.5	-6.0	-2.7	-10.6	-5.3	-5.1	2.5
China Shanghai Composite	3,202	-0.1	-2.2	3.7	-5.8	2.4	2.4	4.9
MSCI World	2,318	5.7	7.3	15.5	18.9	13.4	10.2	11.0
MSCI Asia Pac ex Japan	607	2.9	0.0	4.6	3.4	4.4	3.3	6.4
MSCI Europe	1,868	2.5	2.1	11.1	17.7	11.8	6.8	8.1
MSCI Emerging Markets	59,844	3.5	1.8	5.8	3.8	4.3	3.4	6.1

ASX200 Sectors	Index	1 Mth	3 Mths	YTD	1 Yr	3y p.a.	5y p.a.	10y p.a.
Financials	6,220	3.1	3.1	0.4	13.1	13.7	4.6	6.7
Materials	18,032	4.8	-2.5	5.1	22.6	17.5	13.9	12.7
Health Care	41,290	-6.6	-3.2	0.4	5.7	0.5	7.8	14.1
Real Estate	3,044	0.0	3.5	3.6	7.2	6.8	2.1	7.3
Consumer Discretionary	2,944	1.8	-1.7	9.5	13.3	9.4	6.8	10.0
Industrials	6,797	0.2	3.8	10.7	12.3	8.8	6.0	10.2
Consumer Staples	13,294	2.9	-0.1	7.5	6.2	4.9	6.2	6.9
Energy	10,828	1.8	3.8	2.7	17.3	18.6	2.3	2.4
Communication Services	1,537	-1.0	1.4	10.9	16.8	12.9	13.4	3.9
Information Technology	1,830	3.5	21.1	30.9	38.1	6.0	11.2	12.4
Utilities	8,734	2.9	5.5	7.4	20.3	10.0	6.7	10.6

Fixed Income	Yield (%)	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs
		Change (bps)						
Australian 90 Day Bill	4.20	32	55	111	286	410	223	-
Australian 10 Year Bond	4.02	42	72	-3	36	315	139	27
US 10 Year Bond	3.81	18	32	-7	84	316	96	132
German 10 Year Bund	2.41	13	8	-13	103	288	204	71
UK 10 Year Gilt	4.41	23	89	75	210	426	303	187
Japan 10 Year JGB	0.39	-3	7	-3	17	37	36	-

Currency Market	Price	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs
		Change (%)						
A$/US$	0.67	2.9	-0.6	-1.8	-3.2	-3.3	-9.9	-27.3
A$/GBP	0.52	0.3	-3.3	-7.1	-7.5	-6.0	-6.4	-13.2
A$/EUR	0.61	0.5	-1.0	-4.0	-7.2	-0.5	-3.6	-13.4
A$/JPY	96.2	6.4	7.9	7.5	3.0	29.5	17.6	5.8
A$ TWI	61.7	3.2	2.3	0.5	-0.2	2.8	-1.4	-13.6

Commodities	Price	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs
Gold (US$/oz)	1,912	-2.7	-3.4	5.4	5.2	8.2	52.9	60.4
Iron Ore (US$/t)	113	7.2	-11.4	1.2	-13.4	9.4	73.8	-
Copper (US$/t)	8,210	2.4	-8.1	-2.1	-0.4	36.0	23.5	21.6
Zinc (US$/t)	2,363	6.1	-18.7	-21.9	-27.3	14.9	-19.8	29.6
Nickel (US$/t)	20,125	-1.6	-12.9	-33.9	-12.9	57.3	35.0	47.1
Aluminium (US$/t)	2,097	-7.0	-10.3	-11.2	-12.5	30.9	-4.0	21.1
Crude Oil (Brent US$/bbl)	74.31	3.2	-6.2	-10.3	-38.0	78.5	-4.0	-27.5

Source: Factset, Harper Bernays

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