BT Index Defensive Fund

Monthly report – 30 November 2022

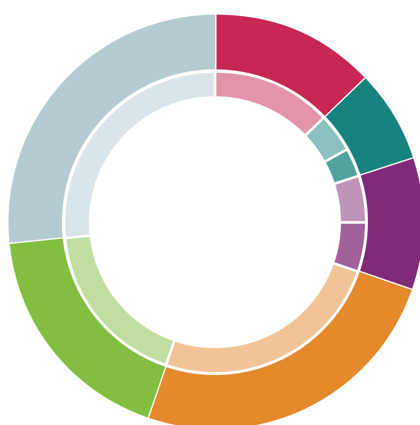
Fund overview

Inception date	1 August 2016
APIR code	WFS0588AU
Fund size (AUD millions)	$239.19
Investment objective	To provide investors with predominantly income and some growth returns, with a low probability of loss over the short term which tracks the overall return of a diversified portfolio of underlying investments.
Recommended investment timeframe	3 years
Minimum initial investment	$500,000
Distribution frequency	Quarterly
Management costs (%) pa[1]	0.34
Buy/sell spread (%)	0.06 / 0.06

Performance review[2]

Period ending 30 November 2022	1 month	3 months	1 year	3 years	5 years	Since inception
	%	%	%	% pa	% pa	% pa
Total return	2.50	1.14	(5.07)	0.34	2.65	2.81
Growth return	2.50	0.89	(8.30)	(3.09)	(0.79)	(0.52)
Distribution return	0.00	0.25	3.23	3.43	3.44	3.33

Actual asset allocation %[3]



- **Equity – Australian Listed – 13.06%**
  - BT Australian Shares Index Fund – 13.06%
- **Equity – International Listed – 7.18%**
  - BT International Shares Index Fund (Unhedged) – 3.97%
  - Blackrock Index Hedged International Equity Fund – 3.21%
- **Property – International and Australian Listed – 10.27%**
  - BT Property Securities Index Fund – 5.08%
  - Blackrock iShares Global Listed Property Index Fund – 5.19%
- **Fixed Income – Australian – 24.93%**
  - BT Australian Fixed Interest Index Fund – 24.93%
- **Fixed Income – International – 17.84%**
  - BT International Fixed Interest Index Fund – 17.84%
- **Cash – 26.73%**
  - Advance Cash Multi-Blend Fund – 26.73%

Please refer to the end of this report for the footnotes

Market update

Share markets continued their upward momentum over the month as investors weighed in on the debate over 'are we at peak rates and peak inflation yet?'. With support from strong employment data and a softening view on a global recession coming sooner than later, headwinds of house price falls, consumer sentiment waning, a cautious business community, and ongoing geopolitical forces centring around Europe and Asia, all seemed to take a back seat to investor concerns. As we look ahead to December, all eyes will be on the sustainability of this back-to-back monthly rally. Markets will be directing attention to data released for US payrolls, job openings, consumer spending, and the upcoming Fed meeting mid-month.

Australia

The Consumer Sentiment Index fell sharply to 78.0 in November from 83.7 in October. The read is now below the 79.0 recorded during the GFC and near the lows recorded during the deep recession of the early 1990s (64.6) and the initial phase of COVID (76.5).

Interestingly, the divergence between consumer confidence and consumer spending is still quite wide. While consumer sentiment has been deeply pessimistic for most of this year, retail spending has remained resilient, although is now showing subtle signs of slowing. The source of this resilience could include the strength of the labour market, savings accumulated during the pandemic, or a larger proportion of households with fixed-rate mortgages – who haven't yet felt the pinch of higher rates.

Either way, it ironically appears that consumers are socialising in busy retail and hospitality venues talking about how bad the economy is.

It should be remembered that monetary policy acts with long and variable lags. For example, it takes around two to three months for a cash rate increase to be reflected in higher minimum repayments for variable rate mortgage holders. Around 35% of Australian households are currently on fixed-rate mortgages and won't face higher repayments until their fixed-rate term expires, and the RBA expects around 60% of these fixed-rate mortgages to roll into higher variable rates by the end of 2023.

Households also take time to adjust their spending behaviour given higher rates, especially if they have savings to maintain spending levels. This contributes to the disconnect we have seen between what consumers say and what they do. However, retail spending data shows that while nominal spending has remained robust, real retail spending (spending adjusted for the impact of higher prices) has slowed considerably. A slowdown in spending has taken time to materialise, but spending is expected to continue to weaken through 2023. Indeed, the RBA is trying to take the 'wind out of the sails' of spending to help tackle inflation.

Business conditions have been very strong and were at their highest level since June 2021 this quarter. Businesses have been benefitting from strong household spending and robust demand, though they consistently point out that the challenge is meeting that strong demand amid a tight labour market and with capacity around record levels. However, the reopening boost has largely run its course and demand is beginning to slow as higher interest rates start to bite. Business confidence and conditions are likely to trend lower as the economy slows in 2023.

Private sector credit has been growing rapidly over 2022 underpinned by a surge in business credit growth, while housing credit has remained surprisingly strong. However, a gradual slowdown is now underway. Credit extended to the private sector in September rose 0.7%, decelerating from the 0.8% monthly pace in both July and August. Business credit growth is also expected to pull-back from some outsized increases over recent months.

The Wage Price Index shows that private sector wages have taken off, with around 50% of private sector jobs having renegotiated their salaries, recording an average wage increase of 4.3% in annual terms - the strongest increase in over a decade. Public sector gains were more modest with wages increasing 2.4% in annual terms. This was the strongest outcome in 9½ years and a step up from what was recorded in the pre-pandemic period. Around 38% of workers in Australia are on individual arrangements, and these individuals accounted for around 60% of the increase in annual wage increases recorded.

Around 35% of workers are on enterprise agreements, with these workers accounting for 28% of the annual wage increase. Finally, 23% are on awards, and these workers accounted for 15% of the annual wages increase, largely reflecting the higher minimum wage which flowed through in the quarter. As good as this may seem, real wages growth (wages adjusted for inflation) is still contracting.

Job gains accelerated in October, jumping by 32.2k – taking the level of employment to a record high. The unemployment rate declined to 3.4%, the lowest level in almost 50 years. Full-time job creation led the way as 47.1k full-time roles were created in October, taking full-time employment to a historic high and bringing the share of people employed in full-time roles to 70.0%. An exceptionally tight labour market and strong underlying momentum in inflation and wages will keep the RBA tossing and turning at night, as this data makes the case for another rate hike in December.

Construction work has been hampered by adverse weather and labour and materials shortages over the first half of 2022. Looking ahead, there remains a sizeable construction pipeline to be worked through, however, higher rates and costs mean that once this backlog is cleared, there is unlikely to be the same demand for construction, especially for housing. Building approvals have been exceptionally volatile over 2022 due to large swings in high density apartment approvals. However, an underlying slowdown is emerging. Notably, private sector house approvals posted a sharp decline in September as the rapid rise in borrowing costs and softer market conditions hampered demand for new developments. Dwelling prices have experienced a peak-to-trough fall of 6% nationally, which is modest compared to the 28.6% price rise throughout the pandemic.

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United States

In a speech on November 30th, Fed Chairman Jerome Powell signalled that the FOMC will likely slow the pace of rate hikes to 50bps in December: “The time for moderating the pace of rate increases may come as soon as the December meeting”. However, Powell stressed that “the timing of that moderation is far less significant than the question of how much further we will need to raise rates”. Indeed, the remarks suggested that borrowing costs will need to keep rising and remain restrictive for some time to bring inflation down.

Inflation eased by more-than-expected in October, where headline inflation rose by 0.4%. This was in line with the rise in September but was lower than consensus expectations of 0.6%. In annual terms, headline inflation eased to 7.7% for the month, down from 8.2% in September. This was also below consensus expectations of 7.9%. Core inflation, which removes the volatile items of food and energy and provides a better measure of underlying inflationary pressures, rose by 0.3% in October. This was down from 0.6% in September and below consensus expectations of 0.5%. This led to the annual pace slowing to 6.3%, from the peak so far in this cycle of 6.6% in September. This was also below consensus expectations of 6.5%.

Regarding jobs, employment jumped by 127k jobs in November, down from 239k in October. This was the slowest rate since January 2021 and came in well below expectations of another 200k gain, suggesting the labour market is continuing to cool off. Employment figures suggest that US firms are slowing hiring, which supports a down-shift in the pace of rate hikes in December.

Retailers discounted heavily over the Thanksgiving Black Friday sales to clear out surplus inventories, however, customer traffic was modest. Adobe Analytics estimates that e-commerce spending on the Friday rose 2.3% nominally year-on-year to US$9.12bn - not an excessive increase given the inflation over the past year. Retail sales climbed 1.3% in October, which was more than the consensus forecast of a 1% rise.

The University of Michigan Consumer Sentiment Index fell to 56.8 in November, from 59.9 in October. The fall was deeper than expected (59.5). The outcome remained the lowest in four months and well below average readings.

Durable goods orders jumped 1.0% in October, the strongest monthly increase since June. This followed a revised 0.3% gain in September and was materially stronger than consensus expectations which centred on a 0.4% rise. Promisingly, the gap between orders and shipments is now its narrowest since the pandemic began, a further sign supply chains are gradually normalising.

Industrial production, which includes manufacturing output as well as mining and utilities output, fell 0.1%. Consensus had predicted a rise of 0.2%. The figures suggest that manufacturing was slowly succumbing to the global slowdown. Coinciding with this, services activity also continued to contract in November. The services PMI fell to 46.1 from 47.8 previously. Consensus was for a mild increase in the index to 48.0, which was disappointing.

The Producer Price Index (PPI) for final demand increased by 0.2% in October, lower than the 0.4% increase the market was expecting. In annual terms, the PPI increased by 8.0% while the core PPI (which excludes volatile items) increased by 6.7%. This outcome provides further evidence that inflationary pressures are beginning to ease due to improving supply chains, softer demand, and a weakening in many commodities prices.

Asia

Ongoing nervousness about China’s zero-COVID policy (now called ‘dynamic zero-COVID policy’) led overseas investors to pull US$8.8 billion from Chinese markets over October, much worse than September’s US$2.1 billion. The Institute of International Finance data showed equities outflows were US$7.6 billion and bond outflows were US$1.2 billion.

Chinese authorities clamped down on COVID lockdown protests over November, asserting a heavy police presence in major cities and closing public spaces. Public demonstrations were reported in Shanghai, Beijing, Wuhan, and Xinjiang, where lockdowns were blamed for hampering rescue efforts in a deadly fire.

China’s regulators increased efforts to buoy the property sector by easing restrictions on major listed property developers, which previously prevented them from issuing new equity to fund debt payments and acquisitions. The Peoples’ Bank of China (PBOC) asked banks to stabilise lending to developers and builders, including “reasonable” extensions of existing loans. News reports also suggest the PBOC will provide 200bn yuan (~US$28 billion) interest-free to help restart stalled property projects.

Manufacturing and services activity slowed by more than expected in November as ‘dynamic’ zero-COVID policies and rising infections weigh. The manufacturing PMI fell to 48.0 in November from 49.2 in October. The services PMI also deteriorated, falling to 46.7 from 48.7, the weakest reading since February 2020 at the outset of the pandemic.

Industrial production expanded by 5.0% in annual terms to the end of October. The outcome is slower than the 6.3% annual growth recorded in September. This shows that the Chinese economy is losing momentum amid rising COVID cases, COVID-restriction measures, and the downturn in the property sector.

China’s trade surplus widened to US$85.2 billion in October. This was slightly up from a US$84.7 billion surplus in September. Exports declined 0.3% over the year to October, while imports fell 0.7% over the same period. This was the weakest annual growth in exports since May 2020 and the first annual decline in imports since August 2020.

In Turkey, the economy fared worse than expected last quarter with GDP growing 3.9% year-on-year after a revised 7.7% in the prior period. It seems that Erdogan Economics are not going to plan.

Over to Japan, core consumer prices in Tokyo, which are a leading indicator of nationwide trends, increased by 3.6% over the year to November, marking the steepest increase since 1982. This outcome was driven by higher energy prices and a weak Yen. The read exceeded the central

bank's 2% target for a sixth straight month, signalling broadening inflationary pressures.

Manufacturing activity contracted in November for the first time in almost two years. The manufacturing PMI fell to 49.4 in November, from 50.7 in October. The services PMI settled at 50.0 in November, the softest reading in eight months - down from 53.2 in October.

The current account surplus swelled to ¥909.3 billion in September, while August's surplus was revised up sharply to ¥694.2 billion from ¥58.9 billion previously. September's result was underpinned by a narrowing of the trade deficit alongside strengthening exports, while sizeable primary income flows persisted.

Europe

The European Central Bank (ECB) warned that the risks to Europe's financial system are mounting. The ECB mentioned high inflation, a growing likelihood of a eurozone recession, and rising financing costs 'posing increasing challenges' for indebted households, businesses, and governments, which could lead to bankruptcies and more volatility in financial markets.

Headline annual inflation in the eurozone declined for the first time in 1½ years in November. The consumer price index (CPI) rose 10.0% over the year to November, down from 10.6% over the year to October. Slower increases in energy and services underpinned the disinflation. Despite the slowing, inflation remains exceptionally elevated and there is still plenty of work for the ECB to do to bring inflation down to the target band. The softer reading, however, will likely ignite discussion regarding whether slowing rate hikes is appropriate at the ECB's December meeting. ECB president, Christine Lagarde, said she would be surprised if euro-zone inflation peaked last month and noted that borrowing costs still need to rise to levels that restrict growth. She caveated that "how much further we need to go, and how fast we need to get there, will be based on our updated outlook".

Consumer sentiment improved to a -23.9 reading in November, up from -26 in October. Notwithstanding the increase and the reading being the highest in five months, sentiment remains at a very low level and is well below its long-term average. Investor confidence in the eurozone also increased in November. The Eurozone Sentix Investor Confidence Index rose to -30.9 in November, up from -38.3 in October. However, despite the increase, investor confidence remains in the doldrums and deeply entrenched in negative territory. The index has remained in negative territory since February.

The Manufacturing Purchasing Managers' Index firmed to 47.3 in November but remained in contractionary territory for a fifth straight month. This follows a reading of 46.4 in October and beat consensus expectations for a further deterioration in manufacturing activity. The services PMI remained unchanged at 48.6 in November.

Over to the UK, the first fiscal update since Rishi Sunak took the helm of the UK government, revealed a vastly different policy framework to the short-term PM, Liz Truss. The update was focused on fiscal consolidation as opposed to growth and included the largest increase in taxes in 30 years – opposed to the Truss mini-budget's tax cuts which was viciously rejected by markets. The Office for Budget Responsibility estimates that the UK's tax take will rise to a post-war record of 37.1% of GDP, while the debt-to-GDP ratio is set to peak at 97.6% in 2025.

Despite the Bank of England's (BoE) aggressive rate hike of 75bps early in early November, the central bank pushed back against current market expectations for future interest rate moves, warning that the peak in rates will likely be "lower than is currently priced into financial markets". The BoE warned that such aggressive moves could induce a two-year recession, and it now predicts inflation to peak at around 11% in the final quarter of 2022 (down from 13% in its previous assessment).

The UK's consumer sentiment improved for a second consecutive month in November but remains deeply pessimistic. The GfK consumer sentiment index rose to -44 in November from -47 in October. The outcome was stronger than consensus expectation which centred on a reading of -46.

House prices fell by 1.1% in November, reversing October's 0.9% gain. The annual pace slowed to 7.2% in November, from 7.8% in October. The average property asking price across the UK was £366,999 in November. Prices in London averaged £682,422, after falling by 1.9% in November.

Please refer to the end of this report for the footnotes

Footnotes

1 The Management Costs included in this fact sheet are inclusive of the Management Fee and any Performance Fees and includes the effect of GST (net of RITC). They do not include other indirect costs. Refer to the Product Disclosure Statement and online disclosures for further information.

2 Past performance is not a reliable indicator of future performance. Performance returns are calculated net of management fees and costs. Growth and distribution returns may not equal the total net return due to rounding.

3 Allocations may not equal 100% due to rounding.

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