BT Investment Solutions

BT Index High Growth Fund

Monthly report – 31 December 2022

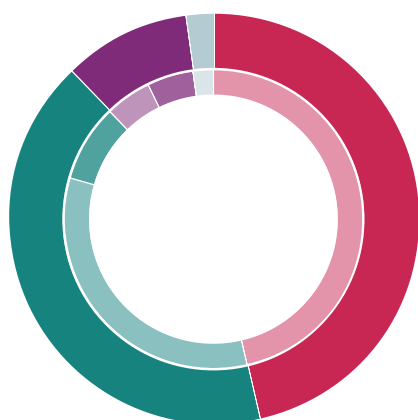
Fund overview

Inception date	1 August 2016
APIR code	WFS0592AU
Fund size (AUD millions)	$441.02
Investment objective	Seeks to deliver predominantly high growth returns, which tracks the overall return of a diversified portfolio of underlying investments.
Recommended investment timeframe	7 years
Minimum initial investment	$500,000
Distribution frequency	Quarterly
Management costs (%) pa[1]	0.34
Buy/sell spread (%)	0.08 / 0.08

Performance review[2]

Period ending 31 December 2022	1 month	3 months	1 year	3 years	5 years	Since inception
	%	%	%	% pa	% pa	% pa
Total return	(4.16)	6.92	(8.76)	4.72	7.10	8.06
Growth return	(4.61)	6.42	(17.36)	(2.05)	0.31	1.69
Distribution return	0.45	0.50	8.60	6.77	6.79	6.36

Actual asset allocation %[3]



- **Equity – Australian Listed – 47.20%**
  - BT Australian Shares Index Fund – 47.20%
- **Equity – International Listed – 40.78%**
  - BT International Shares Index Fund (Unhedged) – 32.79%
  - Blackrock Index Hedged International Equity Fund – 7.99%
- **Property – International and Australian Listed – 10.00%**
  - BT Property Securities Index Fund – 4.98%
  - Blackrock iShares Global Listed Property Index Fund – 5.02%
- **Cash – 2.02%**
  - Advance Cash Multi-Blend Fund – 2.02%

Please refer to the end of this report for the footnotes

Market update

2022 was a year unlike any other. It was initially predicted to be one of repair and recovery following the global pandemic, though it was found to be rather rife with political uncertainty, market volatility, interest rates, supply chain disruptions, and of course, resultant high inflation. As we move into 2023, indicators are that inflation may have peaked, with language from central banks now debating whether they will pivot or pause their rate hike strategies.

Australia

There is growing evidence the economy is starting to slow as the weight of this year's rate hikes take a toll. Data released in December indicated retail spending fell in October for the first time this year as consumers remain deeply pessimistic about the economic outlook. Moreover, November's inflation numbers unexpectedly showed an easing in price pressures. This data may be an early sign that inflation has started to roll over and that it will peak in the current quarter, as expected by policymakers. However, one month's number is not enough to constitute a trend. Also, the monthly inflation measure is not as important as the quarterly inflation measure that the RBA focusses on, although it has been providing reliable guidance.

Encouragingly, China has also further relaxed COVID-19 restrictions, supporting a further improvement in global-supply chain disruptions. Furthermore, the unemployment rate fell to its lowest in nearly 50 years and the wage price index reveals an acceleration is underway in wages growth.

The big news so far in December is the Albanese Government announcing its proposed intervention in the gas market. The policy is aimed at securing affordable domestic gas supply for households and businesses, while international prices, particularly in Europe, surge as a result of the Ukraine war and a colder winter in that region. The intervention includes a proposed AUD$12 per gigajoule price cap on new domestic wholesale gas sales for 12 months as well as the implementation of a mandatory code of conduct in the gas market and fast-tracked reform of the domestic gas security mechanism. The Federal Government also struck a deal with the New South Wales and Queensland state governments to cap the domestic price of coal at AUD$125 per tonne.

The Government recalled Parliament in December to work with cross benchers with the goal of passing the reforms before the end of the year. If passed, many of these measures would be expected to be introduced in the first half of 2023. The response from oil and gas producers was, as anyone would expect, very negative. Producers claim that the measures will lead to reduced investment in the energy sector and higher prices for households and businesses in the long-term. The Federal Treasury has estimated that an average family would be $230 better off in 2023 due to the impact of these policies. The measures aren't expected to reduce prices in absolute terms, but rather to slow the pace of future increases.

The Government expects that the inflationary impacts of its energy-cap measures will be limited, as subsidies are being provided through bill 'reductions' rather than direct cash subsidies. The savings that households and businesses would receive from reduced gas and electricity prices may actually be spent on other goods and services, which could potentially lead to increased inflationary pressures across other spending. However, households do tend to save a portion of their income. Therefore, if households choose to redirect these savings to mortgage repayments or other savings, inflationary pressures may not be as elevated. So, while the government providing subsides to gas and electricity may contribute to some downward pressure on inflation, the government would still be wearing these costs.

Company profits declined by 12.4% in the September quarter, the largest quarterly decline on record. However, corporate profits remain at an elevated level after surging a cumulative 35.2% over the 18 months to the June quarter of 2022. Leading the drop in economy-wide profits was an outsized fall across the mining sector as commodity prices came off the boil. When excluding mining, profits declined by 4.5% in the September quarter.

There are some signs businesses are using the inflationary environment to increase profit margins, with seven of fifteen industries reported higher profit margins in the quarter, and a further three were unchanged. However, the increases were small (1-3%) and only seven industries posted profit margins above their 10-year average.

Businesses continued to build up their inventories over the September quarter (a 1.7% increase). This was the fourth consecutive quarterly increase in inventories as supply chains improve and businesses increased stock as insurance against possible future supply disruptions.

The floods earlier in 2022 have also contributed to a rebuild of stock, with a notable rebuilding of inventories occurring in the mining industry after weather-related disruptions at ports and throughout the transport system. However, a large stock of inventories could drive heavy discounting to help clear stock if sales disappoint over the festive season.

Additionally, there are signs emerging of consumer spending slowing. As such, there is a risk wholesalers will need to move inventories en masse. Inventories are likely to have contributed 0.4 percentage points to economic growth in the September quarter.

While Consumer sentiment has been around recessionary lows throughout 2022 with a 78.0 read in November, it increased slightly to 80.3 in December. However, it will likely be some time before we see consumer sentiment making meaningful strides higher. The lagged impact of cash rate hikes on household cashflows could act as a ceiling on sentiment even after the RBA has finished its tightening cycle.

Please refer to the end of this report for the footnotes

The labour market remained incredibly strong throughout the quarter with the monthly CPI indicator suggested that some price pressures were easing across the economy. The September quarter national accounts, published on Wednesday December 7th, showed that economic growth remained robust in the quarter, despite some deceleration implying that growth is expected to slow considerably in 2023. Average earnings per hour worked increased by a massive 2.8% over the quarter suggesting the tight labour market is translating to higher wages, helping to fund household spending. This measure indicates there is a risk that wages are growing much faster than the Wage Price Index is currently suggesting.

The household savings ratio declined for a fourth consecutive quarter to the lowest rate since the pandemic began. Households appear to be saving less to offset higher inflation and interest rates, all while maintaining spending. This is the ironic notion we mentioned in last month's economic commentary where consumers seem to be hanging out in busy retail spending hubs like shopping centres and restaurants, all while discussing how bad the economy is.

After thirteen consecutive current account surpluses, Australia recorded a current account deficit of $2.3 billion in the September quarter. This reflected a $17.0 billion decline from the June quarter. The current account deficit was driven by an AUD$11.1 billion narrowing in the trade surplus and a AUD$6.4 billion widening in the primary income deficit. The widening in the primary income deficit mainly reflected a surge in profits paid to foreign investors from the mining sector.

Terms of trade, which is a ratio of export prices to import prices, fell 6.7% in the quarter - the largest fall since June quarter 2009.

The S&P/ASX300 Accumulation Index shed 3.29% over the month, bringing the 1-yr rolling return back into negative territory at -1.77%.

United States

The US headline CPI read for November came in lower than expected with a 0.1% increase (7.1% in annual terms). This was lower than the 0.3% monthly increase and 7.3% annual increase that the market was expecting. The prices of goods declined for a second consecutive month, after a flat read in September. Used cars and electronics saw a substantial drop in prices over the month. As supply chain disruptions become a thing of the past, the prices of goods should continue to print softer inflation reads.

The prices of services (including personal care, recreation, education, shelter etc.), which are most closely linked to wages and the state of the labour market, continue to increase strongly, notwithstanding the slight pull back over the month. This is the category Fed Chairman Powell is watching closely, given it reflects the strength in the US labour market and wages growth, which remain elevated for the time being.

Near-term consumer inflation expectations dropped to their lowest level since August 2021 in November. Expectations for inflation in the year ahead declined from 5.7% in October to 5.2% in November. Expectations for inflation over a longer horizon also pulled back, though by a smaller amount.

The producer price index (PPI) rose 0.3% in November, slightly above expectations for a 0.2% increase. This was unchanged from the monthly pace reported over both September and October. In annual terms, producer price inflation slowed to 7.4% from 8.1% in October. This was the fifth consecutive monthly fall in the headline measure but came in above market expectations for a sharper slowdown in the PPI.

The core measure, which excludes food and energy prices, rose 0.4% in the month and 6.2% in annual terms. Although producer price pressures remain elevated, the data points to a further normalisation in inflationary pressures as global supply disruptions ease.

The University of Michigan consumer sentiment index came in at 59.1 in December, up slightly from a reading of 56.8 in November. Despite recent improvements, consumer confidence remains deeply entrenched in pessimistic territory and around the levels struck during the GFC. A measure of short-term inflation expectations pulled back slightly in the survey, while medium-term inflation expectations remained anchored at 3.0%.

The number of Americans filing new claims for jobless benefits increased moderately in the first week of December, pointing to a still strong jobs market. Initial claims for state unemployment benefits (a proxy for layoffs) increased 4,000 to 230,000 for the week ended December 3rd. This increase was in line with consensus expectations. The four-week moving average of claims, which smooths out week-to-week volatility, rose by only 1,000 to 230,000. Jobless claims remain near historical lows.

The trade deficit widened for a second consecutive month as demand for US goods reduced amid a slowing in global economic growth. A strong US dollar has also impacted demand for US exports. The trade deficit widened to a four-month high of USD$78.2 billion in October. The outcome was stronger than the -USD$80.0 billion expected by consensus but was down from the -USD$74.1 billion deficit in September. The widening in the deficit reflected an increase in imports (0.6%) and a decline in exports (-0.7%).

The S&P500, NASDAQ, and Dow Jones reversing gains by finishing the month down 5.76%, 8.67%, and 4.09% respectively. These results brought the 1-yr rolling returns to a dismal -18.11%, -32.54%, and -6.86%.

Asia

Japan's current account swung from surplus to deficit in October, marking the first deficit since January. The deficit printed at -¥64.1 billion compared to a ¥909.3 billion surplus in September.

GDP for the September quarter was finalised at 0.2%, a slight improvement on the preliminary reading of -0.3%.

Household consumption and business investment were revised lower over the quarter, while an improved contribution from inventory buildup and the trade gap underpinned the upward revision to the headline figure.

Please refer to the end of this report for the footnotes

In China, Shanghai eased several of their stringent COVID restrictions. This included the removal of requirements that negative PCR test results be provided before people can access public transport and many shared spaces. Specific details vary by locality. This follows COVID-19 restrictions being eased across many other large cities over recent days and weeks, including Beijing.

China's trade balance narrowed to US$69.8 billion in November as slowing global growth weighs on export demand. This was the narrowest trade deficit in seven months. The result was underpinned by an 8.7% decline in exports and a 10.6% decline in imports. Both figures were the weakest monthly outcomes since May 2020 and considerably weaker than expected by consensus. The import side of the trade position shows the extent to which COVID restrictions are weighing on domestic demand.

Sentiment is weighing heavily on the Chinese economy. The Caixin services purchasing managers' index (PMI) fell to 47 in December from 46.7 in November, the lowest reading in seven months. December's services PMI fell to 39.4 from 45.1 in November, the lowest reading since February 2020.

As COVID-19 case numbers surged in November, prompting harsh movement restrictions which weighed heavily on services activity over the month, president Xi ditched the long-held COVID-zero policy in December as China's economy was stumbling due to these jarring limitations. Ironically, this led economic activity to slow greatly in December as many people chose, on their own accord, to stay home to avoid catching the virus as infections continued to surge.

The Korean KOSPI ended November in red territory, down a staggering -9.55% (-24.89% 1-yr rolling) and the Japanese Nikkei 225 down -6.55% (-7.34% 1-yr rolling). The Chinese Shanghai Composite and Hong Kong's Hang Seng closed the month at -1.97% and 6.37% respectively. Both are still under a large amount of strain for the year, with their 1-yr rolling returns at -15.13% and -15.46% respectively.

Europe

September quarter GDP for the eurozone area was revised up as final figures were released. The economy grew at 0.3% in the quarter, up from a preliminary reading of 0.2%. Despite the upward revision, this was still the softest quarterly increase since the March quarter of 2021 as a combination of surging inflation, rising interest rates, energy instability, and the war in Ukraine weigh on activity. In annual terms, activity expanded 2.3%, down from 4.2% in the June quarter.

Germany's ZEW Indicator of Economic Sentiment increased to -23.3 in December from -36.7 in November. The outcome was better than the -26.4 points the market was expecting. It is the highest reading since February.

Germany's CPI declined by 0.5% over the month of November, confirming the preliminary read. While the monthly decline was positive, CPI remained 10% higher than a year ago. The outcome was in line with what markets were expecting.

German factory orders rose by more than expected in October, following from falls over the prior two months. Factory orders were 0.8% higher over the month. This was above consensus expectations of a 0.1% gain and followed a revised fall of 2.9% in the prior month. Factory orders were 3.2% lower in annual terms, and capital goods orders were 3.2% higher. Orders for consumer (-6.3%) and intermediate goods (-1.4%) were both lower.

The UK labour market is showing resilience, while the unemployment rate increased and the number of job vacancies declined, growth in pay and employment remain elevated.

Growth in average total pay (including bonuses) and regular pay (excluding bonuses) both increased by 6.1% in annual terms to the end of October. For regular pay, this is the strongest growth rate seen outside of the coronavirus pandemic period.

House prices in the UK fell 2.1% in December. This added to a 1.1% fall in prices in November and trims annual growth to 5.6%, from 7.2% previously.

The STOXX Europe 600 Total Return Index fell -3.44%, dragging the rolling 1-yr return down to -12.9%. The French CAC 40 lost 3.93%, the German DAX 3.29%, and the UK FTSE100 followed with a 1.60% drop. December's results exacerbated 1-yr rolling figures, with their returns now at -9.5%, -12.35%, and 1.6% respectively.

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.

For more information

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