

31 August 2022

Market review

Most equity markets fell in August as macroeconomic concerns spooked investors once again. There were falls in European, US and Japanese shares in Australian dollar terms; however, Australian equities and Emerging Market (EM) indices rose. The MSCI World Index returned -2.47% in August (total return in Australian dollars). Meanwhile, bond yields rose in August, as central bankers' comments prompted a wave of selling. The Reserve Bank of Australia (RBA) and the Bank of England (BoE) raised rates while US Federal Reserve (Fed) officials signalled more hikes to come.

Equities initially rose in August as positive sentiment from July carried through, but stocks dropped back in the second half of the month during a continued volatile period for markets. Selling was again motivated by high inflation figures and fears over central banks' intentions. In Australia, equities managed to hold on for a positive finish to August but hawkish comments from Jerome Powell, the Fed's chair, led to declines towards the end of the month in global equity markets, including Australia. Corporate earnings releases in Australia have, so far, been solid across the board, although many companies are indicating a deteriorating outlook for the current financial year. US stocks rose in the first few weeks, with investors taking optimism from lower-than-expected inflation figures, suggesting that central bank action had had the desired effect. However, this positivity was short-lived. Markets fell as central bankers at the annual Jackson Hole summit reiterated their hawkish intentions. The S&P 500 Index finished the month below 4,000. European stocks underperformed the global average, given growing fears about a potential recession, and the UK market also dropped. However, Japanese companies bucked the trend, with the Topix Index closing the month higher. Meanwhile, Asian equities eased slightly in August but outperformed western developed markets. Emerging market shares rose in general, with strength in India and Brazil, although Chinese onshore-listed A-shares fell. In commodities, prices dropped back over the period. Precious and industrial

metals weakened slightly, while agricultural commodities rose. However, energy prices showed some of the biggest moves. Oil fell sharply, with West Texas Intermediate dropping more than 10% to close the month below US\$90 per barrel.

In fixed income, bond yields soared throughout August, pushing prices lower. The RBA raised interest rates again, taking them to 1.85%. It guided that further hikes were likely, depending on future economic data and the inflation outlook. The BoE also raised rates, by 50 basis points (bps) - the largest rate hike in 27 years, bringing the base rate to 1.75%. Bond investors' fears intensified as Jay Powell spoke in Jackson Hole. July's US consumer price index was slightly below estimates, with annual inflation of 8.5%. However, the Fed chair was markedly hawkish, committing to control inflation even if the labour market weakens, while acknowledging that rate hikes could bring pain for households and businesses. The US employment picture has been mixed, with weekly initial jobless claims rising then falling during the month. In Europe, sovereign bond yields moved sharply higher in anticipation of rate hikes - perhaps as much as 75bps - from the European Central Bank in September. Central banks in Indonesia and South Korea also raised interest rates. However, the Bank of Japan repeated its commitment to a loose monetary policy and low interest rates. While corporate bonds and EM sovereign bonds also fell over the period, riskier bonds generally outperformed.

Portfolio review

In August, the fund returned 0.31% in gross terms, and 0.24% net of fees. The fund has a reduced exposure to both equities and fixed income in favor of cash. Across equities the current exposure reflects a tilt towards Australian equities, which was one of the few positive equity markets over the month and contributed positively to the overall performance. International equities sold off through the month and detracted. However, exposure to the abrdn Asian Opportunity Fund, which posted a positive return, contributed positively. Fixed income markets continued to sell off over

Investment strategy

The Fund will apply dynamic asset allocation to a diversified portfolio of traditional and alternative assets, without reference to a benchmark. The Fund may shift its investments quickly and significantly, based on valuations and expected returns, and may completely divest from a particular asset class. Fund volatility will be controlled through the use of dynamic asset allocation and effective diversification of assets.

Investment objective

To achieve a real return equivalent to 5% per annum above inflation (before fees) over a full market cycle (generally 3 to 5 years).

the month but the Betham Syndicated Loan Fund and the EM Corporate Bond Fund both posted positive returns. Domestic bond exposure led to an overall performance drag. Year to date, the fund is down by -9.47% (gross of fees).

During August, our view towards developed market equity turned less negative, as we saw signs of peaking US inflation, a more data-dependent Fed and further supportive market signals. We added US and Australian equities marginally. The observation of inflation peaking and economic growth slowing improved our outlook for developed market government bonds, so we also added to Australian government bonds.

Outlook

We think the three major risks faced by global financial markets remain in place: hawkish central banks, multi-decade high inflation and growth slowdown amid tightening financial condition. The latest data flow sends mixed signals as the US entered a technical recession after two quarters of negative GDP growth, yet the labor market remains tight. Meanwhile, headline inflation pressure eased and the US consumer price index print continuing to fall in August, but core inflation reaccelerated. In response, markets have now pushed the Fed terminal rate sharply higher to 4.25% and signaled that Fed will pause in May 2023.

Compared with the first half, our macroeconomic base case shifted to significant growth slowdown by 2023. The downside risk to our scenario is if stagflation-like environment lasts, investors will ask for higher risk premia across all asset classes. The upside risk to our base-case is if the Fed manages to engineer a soft landing to the US economy, which will point to lower interest rates and higher equity price-earnings ratios.

Our portfolio maintains an underweight position in equities due to changes in the base-case view. We think global equity valuations have priced in monetary tightening, but earnings expectations have further room to fall. Long-end interest rates have not yet priced in a recession. Our cycle playbook points to gradually building up duration as growth slows. However, before adding back equity more meaningfully, we are still waiting for a clearer signal on the inflation peak and the Fed's pivot from the aggressive hiking path.

Fund performance is available on the relevant factsheet.

The opinions expressed are those of abrdn as of the date of publication and are subject to change at any time due to changes in market or economic conditions.

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