

31 August 2023

Market review

Australian equity markets declined in August, with the S&P ASX 200 Net Total Return Index returning -0.73% (in Australian dollars, AUD), while the MSCI World (hedged to AUD) Index returned -1.83%. With foreign currency markets rallying against the Australian dollar, the MSCI World (unhedged) Index returned +1.46% in AUD terms.

Australian shares fell in August, with technology, utilities and consumer staples stocks leading the losses, although there was a late month rebound as the latest batch of US economic data bolstered speculations of a potential pause in Federal Reserve (Fed) interest rate hikes. Gains in the consumer discretionary sector partially offset the losses in Australian equities. The domestic annual consumer price index showed a 4.9% increase in July, albeit slower than June's 5.4%. In retail data, Australian monthly sales grew by 0.5% in July, reversing from a 0.8% fall in June. However, July's unemployment rate reached 3.7%. In August, the Westpac-Melbourne Institute Consumer Sentiment declined 0.4% to 81.0 as the central bank's rate decision failed to alleviate borrowing cost concerns. Furthermore, according to the latest purchasing managers' index (PMI), the domestic service sector shrank. Similarly, contraction in manufacturing activity continued as the Judo Bank Australia Manufacturing PMI fell to 49.4.

In Australian fixed income, the 10-year government bond yield ended August below 4.1%, retreating significantly from nine-year highs. Meanwhile, the Reserve Bank of Australia (RBA) maintained its cash rate at 4.1% for a second consecutive month in August, while markets were expecting an increase of 25 basis points. However, the RBA is likely to keep its restrictive monetary stance in the months ahead.

US stocks fell in August but outperformed the world average. Major domestic indices dropped, breaking a five-month streak of gains, with the technology-heavy NASDAQ Composite Index performing worse than the S&P 500 Index. Japan also outperformed

the global average, with stocks finishing the month roughly flat, although the yen continued to weaken over the period. European and UK stocks fell, and emerging markets (EMs) struggled. China was particularly hard hit as the country's trade data was weak, and several large property developers recently reported being in financial distress. Indian and, more notably, Latin American indices also declined.

In other global fixed income, sovereign bonds fell in the UK and US but were more resilient in Europe. Meanwhile, global corporate bonds also weakened. As the only major central bank to meet in August, the Bank of England raised rates by 25 basis points. UK Gilt yields rose slightly over the month. Elsewhere, European sovereign bond yields fell slightly although US yields rose.

Finally, August was a weak month for the Australian dollar, which started the month slightly above the 0.66 level versus the US dollar but fell below 0.64 mid-month. Yet, the AUD appreciated slightly in the second half of July, ending the month above 0.64. Lastly, the Australian dollar was down -3.47% vs the US dollar, -2.24% vs the British pound (GBP), -2.10% vs the euro and -1.25% vs Japanese Yen (JPY).

Performance

In August, the Fund returned -0.61% in gross terms and -0.68% net of fees.

Risk assets including equities and the Australian dollar were the largest detractors over the month. China exposure, which had been reduced, sold off as concerns around the property sector grew with Chinese equities ending the month down -8%. Developed market equities were the most sizeable detractor as Australian equities sold off by -0.73% and global equities hedged to AUD sold off by -1.83%. Fixed income exposures across government bonds, syndicated loans and floating rate notes were typically up over the month but could not compensate for the Fund's negative return.

Activity

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).

In August, with yields rising we decided to add further to our Australian government bond position while liquidating our global high yield exposure given the turn in the US credit cycle with the number of downgrades increasing. We also reduced our exposure to China given continued headwinds and rotated into India on the back of strong Indian macro and earnings growth momentum. Additionally, we took some profit on the NASDAQ Composite Index exposure, reducing the position but adding to MSCI World Index to maintain the Fund's overall equity exposure.

Outlook & strategy

While headline inflation is coming down in the US, "core-core" inflation remains above levels consistent with central bank targets. Ultimately, we believe that this process of rate hikes and stickier inflation will end in a recession. However, we continue to think that this is a price central banks are willing to pay to maintain credibility on inflation targets in the future. Yet a softer landing is now starting to gain more traction than we had previously thought likely, economic data has surprised to the upside. While a downturn does not appear to be imminent, we continue to expect a US recession to occur around early 2024.

Activity data elsewhere has generally been weaker. The Eurozone's "winter recession" has been revised away, but surveys suggest the economy has entered the second half of the year with very little momentum. And it is difficult to see how the UK economy could potentially avoid a recession.

Weak second quarter gross domestic product data confirmed that China's reopening tailwinds have faded. It should still be possible to achieve the growth target of around 5% set by the authorities even if revisions to the back data have contributed to our latest forecast dropping to just 5.1%. The removal of 'houses are for living, not for speculation' from official Chinese rhetoric may lead to targeted policy action in this sector. Meanwhile, the RBA has probably reached the peak in the cash rate, but most other central banks will continue rate hikes in the rest of 2023 reaching terminal rates by year end.

Specific share class 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.

Contact us
Telephone:
1800 636 888 or +61 3 9612 4646 if
calling from outside Australia
Email: clientservice@sghiscock.com.au

abrdn.com.au

Important information

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