

30 June 2023

Market review

Australian equity markets advanced modestly in June, with the S&P ASX 200 Net Total Return Index returning 1.76% (in Australian dollars, AUD), while the MSCI World (hedged to AUD) Index returned 6.09%. With the Australian dollar appreciating against the US dollar (USD) over the month, the MSCI World (unhedged) Index underperformed, returning 2.84% in AUD.

In June, Australian equities were supported by easing domestic inflation, which bolstered expectations that the Reserve Bank of Australia (RBA) could end its tightening cycle soon. The consumer staples, financials and materials sectors contributed to the positive performance. Despite encouraging domestic economic developments, investors remained cautious due to economic uncertainties in China, Australia's most important trading partner, and given the potential for further monetary tightening by other major central banks. Early in the month, the RBA surprised investors with an interest-rate hike of 25 basis points (bps), bringing the borrowing costs to an 11-year high of 4.1%. This move followed a similar hike in May, with the central bank remaining open to further tightening as inflation stayed high and wage growth improved. Australia's monthly Consumer Price Index of annual inflation rose by 5.6% in May, slower than the 6.8% increase in April. Recent data from the Australian Bureau of Statistics showed that retail turnover rose 0.7% in May, following a flat result in April.

In fixed income, the Australian 10-year government bond yield ended the month slightly over 4.00%, one of its highest levels this year, in part driven by an increasing likelihood of rising global bond yields. Investors are now keeping an eye on the RBA interest rate decision expected on 4 July. Finally, June was a volatile month for the Australian dollar, which started the month slightly above the 0.65 level and rallied to 0.69 before giving up some of the gains in the latter part of the month. Yet the Australian dollar ended the month above 0.66 and in positive territory for the month.

Elsewhere, global equities rose in June, while in the US, the S&P 500 Index recorded its best monthly performance since October 2022. Much of the returns were driven by outperformance from the technology sector. As a result, the NASDAQ Composite closed over 6.6%. Equities in Italy, Spain, France and Germany all advanced over the month. UK companies also rose but by less than the global average, while Japanese stock indices increased as well. Emerging market (EM) shares gained but returns were less than developed market peers. While India and Latin America (including Brazil) rose, China's onshore A-Share index underperformed.

In fixed income, US Treasury bonds, Gilts and German Bunds fell over the month. Yet US dollar corporate bonds outperformed, although European corporate bonds performed better. Riskier high yield and EM bonds outperformed investment grade issues. In the UK, the Bank of England (BoE) raised interest rates by 50 bps while the US Federal Reserve (Fed) skipped a raise in its June meeting. In Europe, the European Central Bank (ECB) raised rates by 25 bps.

Commodity prices rose in aggregate in June, partially recovering from May's losses. Energy prices, including Brent crude, the international benchmark, and natural gas, advanced, in part due to political turmoil in Russia that could potentially disrupt global commodity supplies. On the other hand, gold and silver prices retreated as the positive move in equities decreased investor appetite for precious metals.

Performance

In June, the Fund returned -0.15% in gross terms and -0.22% net of fees.

The main detractor in the Fund was the allocation to alternatives. Higher government bond yields during the month resulted in modest declines across infrastructure companies. However, we continue to see compelling long-term return opportunities with infrastructure, reflecting stable income across different economic scenarios and positive inflation

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).

linkage. Our rates exposure also detracted as yields on Australian government and global government bonds rose. Elsewhere, our equity and credit exposures also contributed.

Activity

Within our equity allocations, we took partial profit in the information technology sector and Chinese equities, while part of the proceeds was added to defensive equity. As for fixed income, we kept our duration profile unchanged in June. However, we switched the instrument to the long end of the curve given the yield levels are more attractive than previously.

Outlook & strategy

With the resolution of the US debt ceiling, market focus has shifted towards pricing growth and inflation dynamics, central bank policies, and market liquidity. The resilience of US economic activity reduces the risks of an imminent recession.

Against this backdrop, the Fed skipped a rate hike in its June meeting but kept the door open for one to two additional hikes in July and September 2023. Central bankers of the Fed, ECB and BoE all struck a hawkish tone at the ECB forum as of late June.

In Asia Pacific, we expect strong economic growth relative to the US and an improving corporate earnings outlook, driven by India, China reopening and a bottoming of the tech cycle. China's growth momentum moderated in the second quarter, but the outlook might still improve in the second half of 2023. In summary, we expect the US to potentially avoid a recession this year. Headline inflation in the developed world will moderate but core inflation remains persistent. Asia is projected to be the primary driver of global growth. Most central banks will likely continue rate hikes in the second half of 2023 but reach terminal rates by year-end.

Stress on US Treasuries due to debt ceiling default risks is expected to diminish, allowing Treasuries and duration to perform as US growth moderates. Tech is currently overbought, but we see supporting factors for tech to do well, post a pullback from overbought positions.

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Important information

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