JANUARY 2023

Monthly Market Update

Labour markets still tight and inflation sticky

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 16 FEBRUARY 2023

In January, financial markets increased sharply on optimism that central banks are nearing the end of the interest rate tightening cycle and may even engineer a soft economic landing. If a soft landing eventuates, profits will slow but not dramatically and then as the easing cycle commences, higher profits will be in the offering which may be needed to justify what looks to be an expensively valued share market in the US and to a lesser degree in Australia.

In the US non-farm payrolls increased by a very strong 517 000 which was well above consensus estimates for a rise of 187 000. The unemployment rate fell to 3.4% versus the estimate for 3.6% which was the lowest jobless level since May 1969. A broader measure of unemployment that includes discouraged workers and those holding part-time jobs for economic reasons also edged higher to 6.6%. The household survey, which the Labour Department uses to compute the unemployment rate, showed an even bigger increase of 894,000. The Labour market remains extremely tight, with job openings at a little less than two for every available worker. This situation still runs the risk that wage growth may run stronger in the future and suggests that interest rates will likely remain 'higher for longer' to ensure that inflation is sustainably reduced towards the Federal Reserve's target range. Market expectations for the peak Fed Funds rate rose back above 5% after the release of the non-farm payrolls data and have remained there. The US 10-year bond yield decreased over January however at the time or writing, and following an upward revision to the inflation reading for December, has backed back up to 3.76%, not far away from where it started the year.

The latest US CPI data shows the fight against inflation will be long and hard. The higher inflation reading was driven by the cost of shelter which increased by 7.9% versus 7.5% in December 2022. Energy costs increased 8.7% versus 7.3%, with petrol prices rising 1.5%, reversing from a 1.5% decline in December. Pleasingly, both fuel oil (27.7% vs 41.5%) and electricity prices slowed (11.9% vs 14.3%). Although inflation has shown signs of peaking at 9.1% in June last year, it remains more than three times above the Federal Reserve's 2% target and continues to point to a broad-based advance on the general price level, particularly services and housing.

> The Federal Reserve has gone to great pains to caution that interest rates would need to increase further and stay at high levels this year as the job market remains very tight.

In Australia a mixed set of data has created some doubt around the path for interest rates with analysts revising their forecasts for the terminal cash rate higher. Inflation printed higher than expected however retail sales for December

Emmanuel Calligeris
Chairman of the Investment Committee

were surprisingly weak. After a modest rally through the Christmas-New Year period, consumer confidence has fallen sharply to be back near the historic lows seen last November.

> Cost of living pressures and interest rate rises continue to weigh heavily on confidence.

Hopes of some easing in both have been dashed by the strong December quarter CPI and the RBA's recent tightening of monetary policy. The Reserve Bank's Statement on Monetary Policy (SoMP) provided a detailed picture around underlying inflation and wages. It highlighted a notable shift in that both indicators are now expected to track above 4% over the year in 2023 and wages growth to remain around 4% in 2024. It underscores the Governor's more hawkish tone. The path to achieving a soft landing in Australia remains narrow and the SoMP suggests this path is becoming even narrower with domestic inflation pressures looking both stronger and more persistent, especially with respect to the labour market.

In China, inflation recorded a rise of 2.1% as prices climbed following the end of covid restrictions. This is the same picture seen in other countries, however the more subdued pace of the reading, leaves the road open to a potential rate cut as the Chinese Government attempts to kick start the economy. China announced that state owned banks had issued a record CNY4.9tn of loans as authorities attempt to rekindle the property market. Chinese property prices remain depressed and are expected to have fallen further. Eurozone GDP grew marginally in the final quarter of 2022. The eurozone economy grew by 0.1% in the fourth quarter, a little better than market forecasts, although it was down from the previous quarter's 0.3% growth rate. On a year-on-year basis, GDP increased 1.9%. While the French and Spanish economies grew, those in Germany and Italy fell, with the latter two now in danger of a recession. Inflation data came in better than expected in Germany and the Netherlands. Annual German inflation touched 8.7% in January; although this was higher than December's 8.6%, the latter inflation figure had been repressed by a one-off government subsidy to all households to cover their energy bills. More broadly, Eurozone inflation dropped in January. The eurozone's headline inflation rate fell to 8.5% in January, down from 9.2% in December and its peak of 10.6% in October. The number was below forecast and the lowest since May of last year. Slowing energy price rises were a key factor behind the decline in headline inflation.

> However, core inflation (which excludes energy and food prices) remained unchanged at 5.2%, an indication that inflationary pressures have spread further across the economy.

Lastly, the National Institute of Economic and Social Research (NIESR) published a paper that predicted that the UK would avoid a recession this year. It forecasts that the UK economy will grow by 0.2% in 2023, before rising by 1.0% in 2024. These figures were revised down from previous estimates of 0.7% and 1.7% respectively. Falling inflation, especially lower gas prices, will come as a very welcome relief to consumers and businesses although living standards will still be hit. The estimates from the NIESR distinguishes it from other recent major institutions' forecasts, notably those from the Bank of England (BoE) and the IMF, which foresee the UK falling into recession this year.

The S&P/ASX 200 Total Return Index ended 6.23% higher in January and rallied even further in early February until central banks crashed the party. Consumer Discretionary (+9.8%) was the best performing sector, as strong consumer data and more dovish commentary out of the Federal Reserve encouraged a "soft landing" (WES +8.2%, ALL +11.3%). What's most stunning about this rally is what's driven it. Last year's losers have become this year's biggest winners. For example, building products group James Hardie, which was down 46% last year, is up more than 30% in 2023, whilst Kogan.com, which plunged 55% in 2022, is up 26% this year. Buy now, pay later firm Zip, down 83% per cent last year, is up 21%. This has also been reflected in the US where Meta Platforms has increased 50% since the start of the year.

> The recent rally in bond yields saw them in slightly overvalued territory but not greatly so, with yields reflecting the cooling in inflation.

We continue to expect that the US Federal Reserve and the Reserve Bank of Australia have not finished tightening policy this cycle, however, both are likely to be less aggressive as we head into 2023. There is no doubt that inflation is on a lower trajectory globally following the sharp spike in 2022. However, core inflation will be the measure to watch in 2023 as wage pressures continue due to low unemployment.

Returns

31st January 2023

ASSET CLASS RETURNS ARE BASED ON

Australian Cash
RBA Bank accepted Bills 90 Days

Australian Bonds
Bloomberg AusBond Composite 0+ Yr TR AUD

International Bonds Hedged
BarCap Global Aggregate TR Hdg AUD

Australian Listed Property
S&P/ASX 200 A-REIT TR

International Property Hedged
FTSE EPRA/NAREIT Dv REITS TR Hdg AUD

Australian Shares
S&P/ASX 200 TR

International Shares
MSCI World Ex Australia NR AUD

Emerging Market Shares
MSCI EM GR AUD

RETURNS TO THE 31ST JANUARY 2023

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Australian Cash	0.28	0.79	1.46	1.91	0.71	1.06	1.66
Australian Bonds	2.76	2.20	-0.85	-6.26	-2.74	1.14	2.63
International Bonds Hedged	2.10	3.15	-3.53	-8.94	-3.08	0.34	2.57
Australian Listed Property	8.12	9.69	0.47	-4.95	-0.91	5.62	8.52
International Property Hedged	8.47	9.09	-5.94	-11.88	-2.05	3.21	6.43
Australian Shares	6.23	9.59	10.32	12.21	5.96	8.51	8.79
International Shares	2.97	-0.72	0.94	-7.90	5.75	9.52	13.57
Emerging Market Shares	3.84	10.85	3.90	-12.13	-0.31	1.30	6.15

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