Pressure mounts on consumers - The September 2023 NFP Quarterly Market Update

By Perpetual Wealth Management

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In the September 2023 Perpetual Private Quarterly Market Update we take a look at how the market is adjusting as monetary policy begins to take hold. You can download our full report – or read our concise review below.

Please note: except where otherwise noted or quoted, the views in this article are those of Perpetual Private's investment team.

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September Quarter 2023: What happened?

- Having enjoyed an environment of increasing optimism, Australian shares had a challenging quarter. Although momentum carried markets higher in July, they softened through August and September, returning -0.7% over the three months.
- International shares followed an almost identical path to that of their Australian equivalents in the three months to September. An upbeat July, followed by a complete

retracement over the following two months, saw international equities lose 0.4% over the quarter.

- As enthusiasm for large tech companies began to wane, the NASDAQ dropped -3.9%. The less technology-focused S&P 500 proved to be mildly more resilient (-3.4%).
- The domestic bond market returned -0.72% during the September 2023 quarter, while international fixed income returned -0.46%. Credit outperformed the general market, especially high yield debt, which returned 3.3% for the period.

(Indices referenced: MSCI AC World, S&P/ASX 300, Bloomberg Global Aggregate index, Bloomberg AusBond Composite (0+Y) index. All performance numbers to end September 2023 quarter unless otherwise stated).

"Spring is the time of year when it is summer in the sun and winter in the shade" Charles Dickens

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It has been an eventful eighteen months. After the negativity of 2022, the September 2023 quarter was typified by further swings in sentiment and valuations, as markets and economies continue to adjust to the new monetary landscape. The period started with positive momentum as investors marvelled at the power and potential of artificial intelligence. However, as economies and, more importantly inflation, continue to be resilient, appreciation that interest rates would truly be 'higher for longer', lead to a lurch downwards across asset markets.

Perpetual Private Investment Director, Andrew Garrett, says the current volatility is not unusual.

"We expect this to continue for some time, as markets come to terms with the new economic reality. However, we do expect as we enter the new year to progressively get greater clarity of the true path ahead for investment markets," he says.

We suggested in our June quarter market update that the supply side of the inflation shock may be behind us, but the escalating circumstances in the Middle East may lead to a much larger regional conflict that affects energy prices and pushes inflation higher for longer.

Inflation calming, pressure on consumers increasing

The September quarter marks the first extended pause in interest rate increases since the RBA began tightening in May 2022. The central bank's current expectations for inflation returning to the 2-3% target range sit in the closing months of 2025.

Both local labour markets and consumer behaviour continue to defy this challenging environment, with low unemployment, high inflation, increasing interest rates, the stubborn resilience of consumer spending and continued economic growth.

Spending levels are higher than expected, even though they are declining. Confidence is at very low levels, household saving continues to drop, and disposable income is contracting at the fastest pace it's been at in 30 years.

While labour markets remain at historically low levels, it may be argued the consumer can persist through the current climate of economic volatility. Realistically this seems unsustainable. Given the tight monetary environment, layoffs – as has already been happening in the US, particularly in tech – will occur.

What the influence will be of global forces such as conflict, the US election, and the collapse in the Chinese real estate industry, is unclear. We cannot rule out the possibility of recession – or of a soft landing. Oil prices[1] gained 22.3% between June and October, and buoyant consumer behaviour has tightened the market for energy prices. If the current price spike holds, central banks will focus on bringing inflation down and will have less ability to reduce interest rates anytime soon.

We believe there are still risks surrounding the outlook for certain sectors of the market. The pressure on corporate earnings from higher interest rates and a slowing economy has yet to play out. Quality industry-leading companies with the pricing power to pass on these higher costs, and strong balance sheets without elevated debt levels, should be relatively well positioned.

[1] Measured by Brent Crude (continuous)

Proof that governance matters

Over the next year the forces driving markets are likely to multiply: interest rates will continue to be crucial, but so will geopolitics, technological change, decarbonisation, and consumer sentiment. What do the recent Qantas and Newscorp scandals tell us, as portfolio managers, about managing the risk inherent in change?

The 'G' of ESG, governance, is one of the most important components to investment. While succession planning is important, one could argue that instances like Qantas had more to do

with a potential lack of governance. Both environmental and social components feed into and closely interrelate with governance.

“From our point of view, we consider ESG factors as important components of the risk measures that we use when we're looking at any company, or indeed any strategy,” says Garrett.

Perpetual Private’s Quarterly Investment Update for September 2023 covers the changing nature of investment dynamics and looks at the outlook for shares, fixed income, real estate, currency and alternatives.

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