GPS Wealth Monthly Market Update

Rising Rates to Lower Inflation

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 12 SEPTEMBER 2022

The reporting season and a hawkish US Federal Reserve underpinned financial market moves in August. **In Australia as was the case in the US, share markets reached a high in the middle of the month before focusing on the Jackson Hole symposium where cold water was poured over the rally in stocks and bonds.** The US Federal Reserve Chairman, Jerome Powel, delivered a hawkish speech with the message that the Central Bank's resolve to raise rates to fight inflation remains unshaken. Bond prices fell over the month, with the 2-year bond yield in the US reaching its highest level (3.4%) since 2007. In Australia, the Reserve Bank delivered another interest rate rise of 0.50% in early August bring the official cash rate to 2.35%. Share markets, which were taken by surprise with Powell's comments, continued their sharp sell-off in the second half of August, particularly technology stocks. The US share market as represented by the S&P 500 returned -3.34% over the month to be -15.5% lower over the year. In Australia the S&P ASX 200 increased 1.18% over the month, to be -3.63% lower over the year.

In the US core inflation projections remain unchanged. Headline CPI is expected to moderate to 6.7% by December due to falling energy prices however the core CPI forecast for December remains at 5.8% due to a tight labour market. The labour report was good, showing 315,000 new jobs (vs 300,000 expected) and modest 0.3% wage inflation, an almost "goldilocks" scenario of moderate numbers that did not add further to policy pressures. The services ISM survey was a stronger than expected reading on the US services sector fuelled expectations that the US Federal Reserve will keep raising interest rates to combat inflation. US government bond yields soared.

In Australia GDP increased by a solid 0.9% in the second quarter of the year bringing the annual rate to a very respectable 3.9%. Growth was spread across several components with household consumption (+2.2%), machinery and equipment investment (+4.0%), public capital formation (+5.9%) and net-exports (+1.0pp) driving the increase in activity. Weakness was concentrated in private dwellings (-2.9%) and non-dwelling construction (-5.0%) from previously flagged material and labour shortages and flood activity slowing construction activity on the east coast of Australia. The consumer remains resilient thanks to a strong labour market boosting household incomes. A substantial 153 000 jobs were added in the second quarter that saw the unemployment rate drop to 3.5%. This produced another solid 2.5% increase in total wages and salaries, while gross mixed income rose 4.7%. Combined with additional stimulus payments to households, gross household disposable income increased a strong 1% over the quarter. This is providing consumers with a buffer to higher inflation and

Emmanuel Calligeris
Chairman of the Investment Committee

increased mortgage rates. The savings rate only fell from 11.1% to 8.7% which is high compared to an average of 4.5% in the few years prior to the pandemic.

> The strong labour market buttressed consumption, which is growing above its long-term trend and has still allowed consumers to keep savings elevated.

The housing market is showing signs of weakness with housing finance contracting by more than 15% over the year and the weaker demand for mortgages is weighing on national house prices.

The outlook is bleak for Europe. The ECB announced a 0.75% rate rise, the largest increase since the start of monetary union. It's given up on inflation targeting and its main aim now seems to be restoring its inflation-fighting credibility given that inflation recorded an increase of 9.1% in the year ending August. The inflation rate broke a new record high, as energy cost remains elevated (38.3% vs 39.6%) and food prices continue to accelerate (10.6% vs 9.8%). Prices also rose faster for services (3.8% vs 3.7%) and non-energy industrial goods (5% vs 45.%). Excluding energy, inflation increased to 5.8% (vs 5.4% in July) and excluding energy, food, alcohol and tobacco, inflation also increased to 4.3% (vs 4%).

> It is hard to see how the ECB can bring down inflation that is mainly driven by supply side factors.

A recession that suppresses demand will bring down inflation but the cost will be a lot of economic pain. The ECB seems too optimistic about the economic outlook.

In China, the government's tough approach to new Covid outbreaks – continues to be a drag on the country's economy. In the last two weeks, eight major cities, home to 127 million people, have gone into full or partial lockdowns impacting manufacturing and transport. Real estate is of growing concern and there are real worries of a major crash. Confidence in the sector has plummeted as many developers enter bankruptcy. The government does not appear to be giving up on deleveraging reforms. Funds are being pooled by policy banks and the Peoples Bank of China. There is also some support from local governments where the uncompleted projects are located, however, these support measures are only being used to finish uncompleted projects so that mortgage borrowers will continue to repay the banks. It could take several quarters to see a positive effect from the announced measures and it could take years to finish all the uncompleted projects. The property market woes have hit the job market. The surveyed jobless rate in urban areas was 5.4% compared to the recent low of 4.9% in September and October 2021. Migrant workers have been hardest hit as they are predominantly employed across the construction industry's value chain, including raw material mining and processing.

> Export growth has slowed reflecting the impact of rising inflation and slowing growth in the rest of the world.

Chinese goods shipments to the rest of the world rose by 7.1% from a year ago to $314.9 billion, the weakest gain since April. Slowing exports also reflect disruptions in factory production due to temporary power shortages as a severe drought and heat wave swept through central China in August, Recent flare-ups of Covid-19 cases, however, threaten to disrupt manufacturing in more cities as authorities stepped up restrictions ahead of a Communist Party gathering in October, when Chinese leader Xi Jinping is expected to break with recent precedent and claim a third term.

The S&P/ASX 200 Accumulation Index returned 1.18% in August. The Australian market outperformed global equities (MSCI World -4.3%) as hawkish commentary from the Federal Reserve's annual Jackson Hole symposium softened investor sentiment. US bond yields ended the month higher after the Fed reiterated its focus on lowering inflation, noting it will be tightening policy 'purposefully' through rate rises and a step up in the pace of quantitative tightening. Commodity prices were generally softer with oil declining. Iron ore prices fell on renewed COVID concerns and Chinese steel output restrictions.

In August Energy (+7.8%) was the best performing sector driven by Whitehaven Coal Ltd (+28.2%) and Santos Ltd (+20.8%). On the other side of the ledger, the Real estate sector (-3.6%) was dragged down by Dexus (-8.3%) and GPT Group (-7.5%). At a stock level, the best performers included OZ Minerals (+36.2%), Pilbara Minerals (+31.8%) and Whitehaven Coal (+28.2%) whereas Domino Pizza Enterprise (-12.3%), Bendigo and Adelaide (-12.2%) and Reliance Worldwide (-11.4%) were amongst the biggest laggards.

> Several themes were clear in the reporting period including further signs of margin squeeze as a troika of costs (raw materials/freight, wages and interest expense) continue to weigh.

Notwithstanding the cost headwind, there was only a moderation in the net profit margin outlook due to strong revenues. The Australian share market looks fair value at current levels (6965 on the ASX 200) however analysts are likely to be downgrading earnings in the coming year as economic growth decelerates into 2023.

Returns

31st August 2022

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 AUGUST 2022

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Australian Cash	0.19	0.50	0.63	0.65	0.41	0.96	1.67
Australian Bonds	-2.54	-0.76	-6.74	-11.50	-3.14	0.97	2.55
International Bonds Hedged	-2.72	-1.93	-6.97	-10.53	-2.66	0.46	2.87
Australian Listed Property	-3.55	-3.19	-10.02	-11.10	-1.46	5.76	9.41
International Property Hedged	-5.66	-5.77	-9.29	-11.98	-0.63	3.37	7.31
Australian Shares	1.18	-2.39	0.75	-3.43	5.51	8.13	9.34
International Shares	-2.54	-1.11	-5.88	-9.62	8.21	11.12	14.20
Emerging Market Shares	2.21	-2.15	-8.23	-16.64	2.14	3.57	7.23

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