



MARKET COMMENTARY – Jan. 2024

Quarter-End Commentary

Overview

- 2023 was a strong year for most asset classes.
- Equities and bonds performed well in Q4 2023, with a large rally for global markets in the final two months of the year.
- Market expectations are for interest rate cuts early in 2024 despite central banks pushing back on the timing of eventual cuts.
- Bonds saw strong performance in the last quarter, due to falling interest rate expectations, with corporate bonds performing especially well.
- Commodities and commercial real estate underperformed compared to other asset classes.

Asset class recap of December quarter 2023

Global shares

The MSCI World Ex-Australia NR Index returned 9.9% over the quarter in local currency terms, with the 12-month return coming in at 23.32%. In Australian dollar terms, quarterly and annual returns were +5.31% and +23.23%, respectively, as the AUD fell against major currencies across 2023 but made much of the falls back rallying strongly in the quarter.

The quarter showcased a robust performance across various sectors in local currency terms:

- Information Technology led the way with a +17.0% return.
- Industrials, Financials, and Communication Services followed suit, each producing double-digit returns of +11.4%, +11.2%, and +10.0%, respectively.
- Positive returns were also observed in Consumer Discretionary (+9.6%), Materials (+9.5%), Utilities (+8.8%), Health Care (+4.2%), and Consumer Staples (+3.2%).
- Energy, however, faced challenges with negative returns of -5.5% throughout the quarter.

Australian shares

Australian shares finished the year strongly, with the S&P/ASX200 accumulation index returning 8.4%.

Some notable sector returns included Health Care (+13.3%), Materials (+13.2%) and Financials (+8.2%), particularly Materials & Financials, given the weight they hold within the index.

Information Technology (+6.4%), Consumer Discretionary (+6.0%) and Industrials (+5.8%), also had positive returns for the quarter. Telecommunication Services (+2.5%) and Consumer Staples (+0.1%) were relatively flat, while Energy (-9.0%), and Utilities (-2.1%) produced negative returns to round out the year.



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Bonds

US 10-year bond yields fell over the quarter from 4.6% to 3.9% causing a massive rally in prices of over 10% as inflation fears subsided. However late in October it is interesting to note that yields did rise to 5.004% a 16 year high before falling. This decrease in yields saw gains in the global benchmark indices.

Key 10-year treasury yields in local currency terms (December 31, 2023): Australia: 4.0%, Global: 3.9%.

Global property & infrastructure

Domestic listed property & global listed property and global infrastructure had strong positive results in the quarter alongside global equities.

Key quarterly results (in AUD hedged terms, December 30, 2023): Australian listed property (+16.5%), Global listed property (-17.6%) and Global listed infrastructure: (+7.8%).

Currencies

The U.S. dollar depreciated against some major currencies, with the Australian dollar finishing the quarter at 68 US cents – up from 64 US cents at the start of quarter.

Important Perspective

As we wrap up 2023, investors are likely to look back with satisfaction, aided by the robust performance in the final quarter. The strength was largely driven by the expectation the Federal Reserve will cut interest rates as many as six times in 2024 (implied market expectations) as the worst of the inflation spike is now considered behind us. The RBA and other central banks in the developed world are expected to cut interest rates throughout the year.

Several equity markets now sit at or near all-time highs—including Japan, France, Brazil, India, Mexico, and many others in local currency terms. Notably, small companies outperformed large companies by a large margin in the last quarter, reversing a long-term trend. At a sector level, 10 of the 11 major sectors delivered positive returns for the quarter, with energy the only sector to record a modestly negative number.

The Morningstar Global Market index, a barometer of global large-cap equities, posted an impressive gain of 11.2% for the quarter and 22.1% for the year, defying earlier predictions of a difficult year due to an economic downturn. To that end, the global economy has been resilient despite earlier expectations, especially in the U.S. where unemployment has stayed low and recession probabilities are falling.

At a country level, U.S. stocks did particularly well with large gains through 2023 in the so-called “Magnificent Seven” driving the broad market higher, finishing just below all-time highs. Gains were also recorded in Europe, including the U.K., although not quite as strong. Japan continued its stellar run through 2023 and had a great quarter in Japanese yen terms, as did several emerging markets including Brazil and India. At the other end, China saw losses, with poor investor sentiment and slower-than-expected economic activity. The overall strength



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in equities painted a positive picture of global investor health. The surge in small-cap stocks could also be indicative of the market's renewed appetite for risk, often a harbinger of economic optimism.

On the fixed-income front, bonds also delivered a strong performance in the final quarter of 2023, benefiting from the anticipated interest rate cuts by the Federal Reserve. The correlation between falling interest rates and increasing bond prices played out, with longer-dated bonds doing especially well. That said, it was corporate bonds that stood tall among their peers. These bonds, which are typically more sensitive to economic conditions, outperformed government bonds. Contrastingly, inflation-linked bonds, which are designed to help protect investors from inflation, failed to keep up with their counterparts. Given the falling inflation prints around the developed world, these securities were unable to attract the same level of demand, leading to underperformance for the period.

Commodities and commercial real estate underperformed compared to other asset classes. Meanwhile, the U.S. dollar fell against major peers.

Looking Ahead

As we enter 2024, it's essential we remind investors that the presence of uncertainty does not imply a scarcity of opportunities. Our approach to the year will be a blend of caution and optimism.

To that end, we see positives in this environment, with opportunities to add value in fixed income and select equity markets, among other ideas. A short list of our convictions include:

- Defensive equities, like healthcare
- U.S. banks
- Chinese technology stocks
- Emerging-markets debt
- Government bonds and inflation-protected securities

Of course, the path of interest rates and inflation will continue to act as key talking points among investors. Let's not forget that investors went into 2023 worried about inflation and expecting a recession by the second half of the year. This never transpired. Now in 2024, investors are expecting low inflation, no recession, and significant interest rate cuts. This is a Goldilocks-like scenario if it plays out, but it's worth bearing in mind that it is far from guaranteed.

Most investors have long-term goals, such as retirement, and should therefore focus on long-term value creation. Similarly, it is worth noting that risk management is a critical pillar of successful investing. An effective risk management strategy balances investment opportunities with future uncertainty, equipping investors to navigate through market volatility.