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2023 August Market Wrap — Friday 1 August 2023

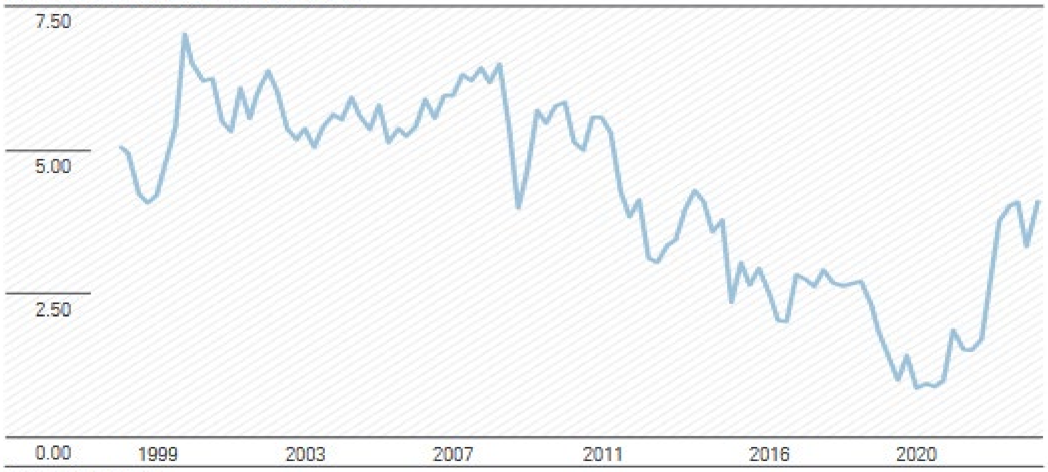
The Jackson Hole annual Economic Policy Symposium is over for another year. The aftermath of this year's event much less violent than the last. After a spike in volatility shortly after the keynote speech of Federal Reserve (the Fed) chairman Jerome Powell, US equity markets closed moderately higher, and the yield curve flattened.

Last year's short, sharp, and direct message caught financial markets on the hop. This year, a longer, more considered address, after raising the federal funds rate by 550-basis points (5.50%) since 16 March 2022, had a much lesser impact. However, Powell's message was unchanged – "It is the Fed's job to bring inflation down to our 2 percent goal, and we will do so."

While Powell clearly indicated the Fed will hike further, if necessary, increasingly the market believes the tightening cycle is over. He indicated, real interest rates are now positive and well above mainstream estimates of the neutral policy rate. The current rate setting is restrictive, but "we cannot identify with certainty the neutral rate of interest, and thus there is always uncertainty about the precise level of monetary policy restraint."

Given the uncertainty, higher-for-longer looks a reasonable bet, but clearly much will depend on the outlook for GDP growth in 2024. Should the lag effects of the 550-basis point tightening finally take hold and squeeze demand and drive unemployment meaningfully higher, then US economic growth will falter. It is unlikely conditions will remain as they are and so the clock is ticking.

Exhibit 1: Australia 10 Year Bond



Source: CNBC.com

So, do investors start looking to buy duration? That is, buying the long end of the yield curve. Timing is always important, and it could be premature. Remember, when buying bonds, the holder wants to see the yield fall. Bond prices fall as yields rise and vice versa. While the current Australian10-year bond yield is near a decade high, it is still well below

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the level between 1998 and 2013, but I don't think it is going back to 6%+ (Exhibit 1). In the US, the 10-year Treasury yield around 4.20% is at a 16 year high. There are differences between the US and Australian economies at present and it is unlikely the Fed and the Reserve Bank (RBA) will not move in unison when rates are cut. Australia is likely to go first, as pressures continue build on household consumption, the lag effect of interest rate increases, and headwinds from China strengthen.

While it is tempting to wait for the central bank pivot, those investors with appetite for liquid duration assets like 10-year bonds could begin accumulating a position or adding to existing positions with a careful eye on prudential portfolio weighting.

Australia's inflation rate continues to edge lower
The headline Monthly CPI Indicator for July rose 4.9% year-on-year (y/y) from 5.4% y/y in June, beating consensus of 5.2%. Excluding volatile items including automotive fuel, fruit and vegetables and holiday travel (thank you Qantas), the underlying print was 5.8% down from 6.1% in June. Still a long way to go to get back to the RBA 2 to 3% inflation band.

If you have any questions do not hesitate to contact me.

Summary of Major share indices

Index	1 Month	52 Weeks	YTD
DJIA	-1.40%	+9.68%	+4.75%
Nasdaq	+0.54%	+19.09%	+34.09%
S&P 500	+0.13%	+13.63%	+17.40%
Russel 2000	-3.15%	+4.22%	+7.86%
Europe 600 Index	+0.06%	+12.40%	+7.84%
UK FTSE 100 Index	-1.20%	+4.07%	-0.17%
Hong Kong Hang Seng	-5.92%	-5.50%	-7.07%
Japan Nikkei 225	+1.95%	+18.69%	+25.77%
China Shanghai Composite	-4.53%	-1.46%	+1.61%
India S&P BSE Sensex	-0.63%	+10.32%	+6.56%
ASX 200 (Australia)	-0.73%	+11.67%	+6.61%

Australian Dollar

	Close	52-week Range
AUD	0.6717%	0.6170-0.7364%

Government Bonds

	Close	52-week Range
US 3 Month Bill	5.454%	1.623-7.959%
US 10 Years Note	4.108%	3.181-4.366%
US 30 Years Bond	4.218%	3.259 – 4.479%
Australia 10 years	3.983%	3.160-4.328%

Source: Wall Street Journal.