

QUARTERLY
MARKET
REPORT
MARCH 31, 2023



Everything Everywhere All At Once.

The March quarter has been dominated by the collapse of Silicon Valley Bank and the ensuing banking crisis, set against a background of cooling inflation, continuing rate hikes, and the prospect of global recession in 2023.

But the markets started the quarter with optimism. Economic data continually reinforced the narrative that inflation had indeed peaked – around December 2022 – and that central banks would reach the “terminal rate” much earlier than previously predicted. The ASX 200 gained 6.2% in January, the best January ever for the benchmark index. In the US the S&P 500 also rose 6.2%, its best start to a year since 2019.

Everything, everywhere came crashing down all at once a few days after Federal Reserve Chairman Powell said the Feds are likely to take rates higher than previously anticipated and could move at a faster pace if needed. The bond market immediately repriced the peak interest rate to be significantly higher and yields jumped up – and bond prices plummeted.

Silicon Valley Bank – which had half its assets in bonds – became insolvent. Its collapse, the collapse of several other smaller US regional banks, and the turmoil surrounding Credit Suisse Group spurred a frantic rush for safety, evoking memories of the GFC. Volatility gripped global markets and yields on bonds fell dramatically as the likelihood of global recession increased.

Throughout the quarter the prevailing market mood has switched from “hard landing ahead” in the economy to “soft landing” to “no landing” and then back to hard landing again. High tech stocks have had their best month since June 2020 while the battered bond market has had its best gains since 2008. The fall in the banking sector is proof that when interest rates rise as rapidly and as high as they have then it’s not surprising that something must break.

Bond traders and equity investors are now scrambling to make sense of the most challenging macro setup in a generation as the global banking crisis potentially signals an impending recession while the ongoing battle against runaway inflation muddies the picture over the future of interest rates. The combined effects of higher rates and tighter credit conditions will certainly slow growth throughout the rest of 2023

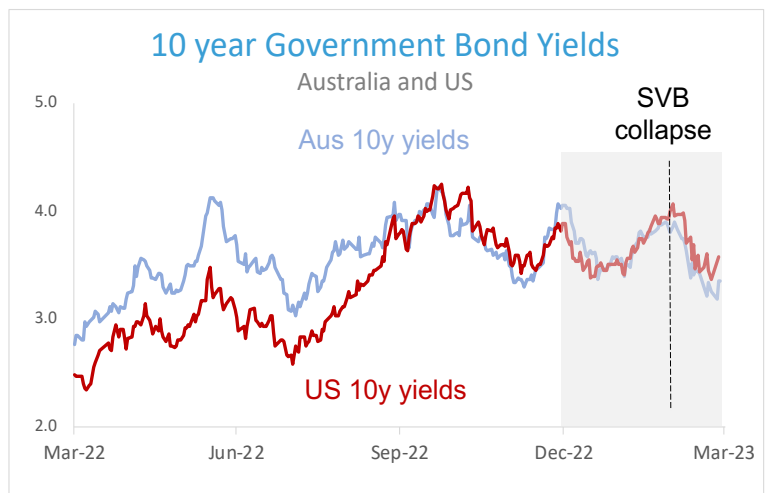
BEARISH PIVOT IN THE MIDDLE OF THE QUARTER

After a record January the Australian market pivoted as the RBA came out on February 7th with another 25 bps increase and made it clear that further increases were to come. The S&P/ASX 200 Index was rattled and lost 2.9% over the month, only then to be hit by a further 25 bps increase on March 7th followed by the banking turmoil that started on March 12th when Silicon Valley Bank collapsed.



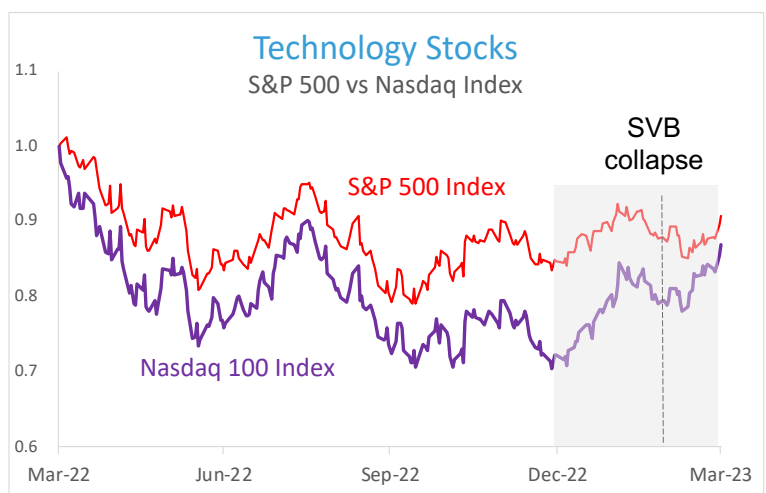
THE BOND MARKET VERSUS THE CENTRAL BANKS

After the collapse of SVB bond yields had their steepest fall since October 2008, as traders axed bets on any further interest rate increases this year and ramped up expectations for rate cuts. Uncertainty about the direction of interest rates is as high as it's been, and the volatile bond market reflects the balance between the flight to safety as recession seems imminent and the view that rates will stay higher for longer.



TECH STOCKS BOUNCE BACK

High-growth tech names are more sensitive to rising interest rates and underperformed the broader market in 2022. As the market now expects the "terminal rate" to be lower than first thought these companies have rallied. The collapse of SVB saw yields plummet, indicating that the market believes that rates may start falling before the end of the year, which is seen as favourable to these growth companies.



Market Overview

Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Cash	0.8%	2.0%	0.7%	1.1%	1.7%
Australian Bonds	4.6%	0.3%	-2.4%	1.3%	2.8%
Global Bonds	2.4%	-5.5%	-2.8%	0.3%	2.4%
Australian Equity	3.5%	0.1%	16.5%	8.7%	8.2%
Developed Markets	9.2%	4.3%	12.9%	11.0%	14.0%
Developed Markets (hedged)	7.1%	-7.6%	15.1%	7.6%	10.1%
Emerging Markets	5.3%	0.1%	4.6%	1.8%	6.6%
Australian REITS	0.5%	-13.9%	13.6%	4.8%	7.7%
Global REITS	2.6%	-10.6%	5.6%	5.2%	7.9%

- In the quarter Australian and Global Bonds have significantly outperformed cash, as yields have had steep declines since the banking crisis in mid-March.
- Despite market volatility and large swings in sentiment, returns of the Australian equity market have been relatively flat both over the quarter and the year.
- The Developed Markets are the best performing asset class in the quarter, mainly due to the rebound in tech stocks despite the global banking crisis.
- The strong USD resulted in depreciation of the AUD, so that a hedged exposure to global shares underperformed an unhedged exposure by 2.1% in the quarter.
- The recovery in China from the pandemic lockdowns has helped the broader Emerging Markets, although a strong US dollar is a tailwind to returns.
- Australian and Global REIT's have been hit particularly hard by rising interest rates and have been one of the worst performing asset classes over the last year.

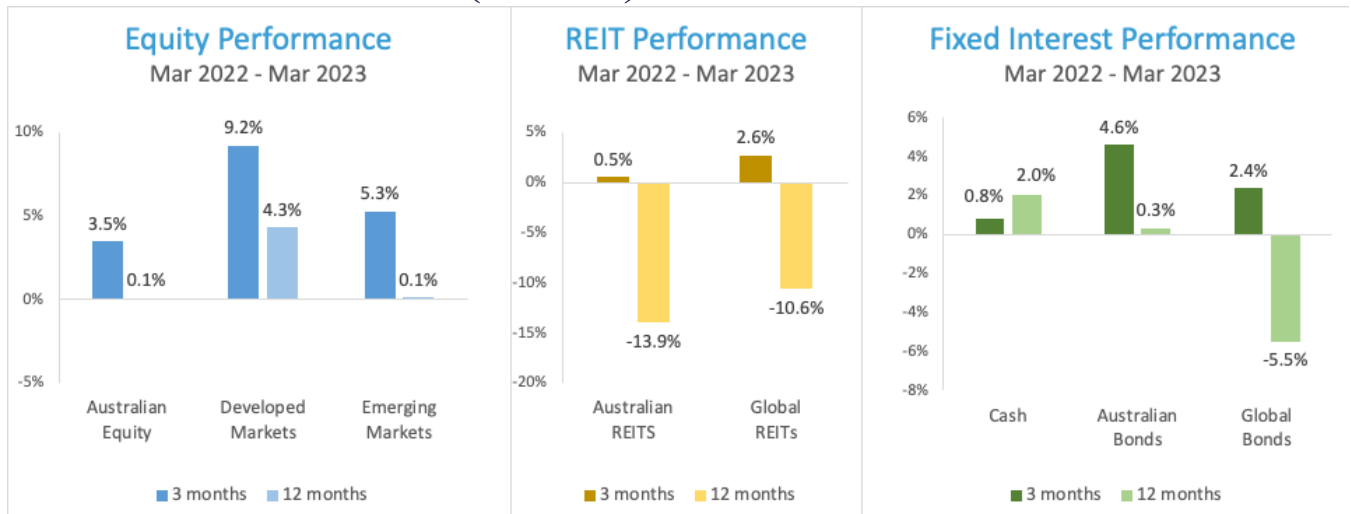
BANK CRISIS CAUSES A DISLOCATION IN MARKETS

In the wake of the first US bank failures since the GFC in 2008, March has seen financial stocks having their worst month since the outbreak of the pandemic. Because of the concentration of the banking sector in the Australian market, this had a much bigger impact on the ASX than on international markets. Furthermore IT stocks have bounced back, which only make a small part of the ASX.



Index data sources: Bloomberg AusBond Bank Bill Index, Bloomberg AusBond Composite 0+ Yr Index, Bloomberg Barclays Global Aggregate Bond Index (hedged to AUD), S&P/ASX 200 Index (Total Return), MSCI World ex Australia Index (net div., AUD), MSCI Emerging Markets Index (net div., AUD), S&P/ASX 200 A-REIT Index (Total Return), S&P Global REIT Index (net div., AUD)

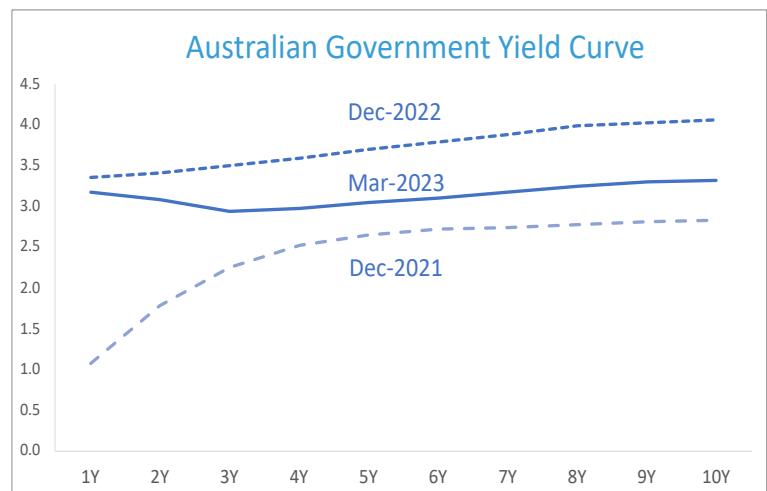
Market Overview (Chart)



Yield Curves

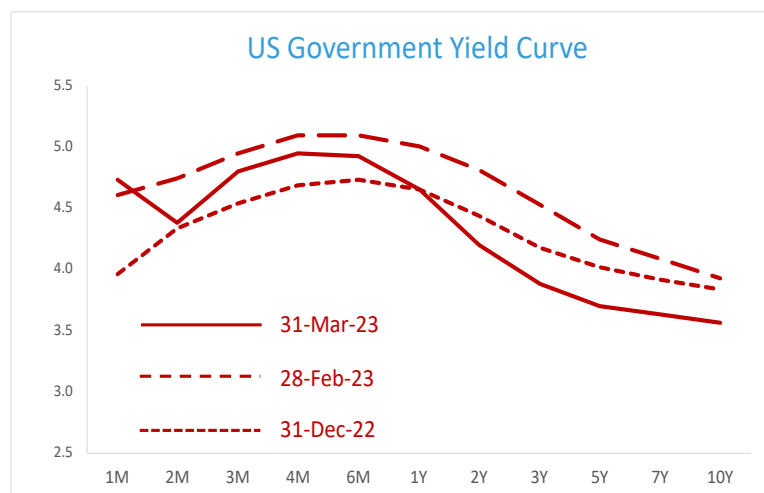
AUSTRALIA

The yield on the Australian 10-year government bond has dropped below 3.25% as the bond market priced in a possible pause in tightening while assessing the health of the global financial system and the broader economy. Borrowing costs are now at their highest in ten years, and this has been the fastest tightening cycle since 1989.



UNITED STATES

Bond markets are predicting that a US recession is around the corner amid a growing dissonance between how markets and the Federal Reserve see the outlook for the economy. The historic drop in bond yields in March reflects the fact that cash rate futures now indicate no more rate increases. However, the Fed has signalled its not done yet.



Source for yield curves: www.investing.com

Sector Performance

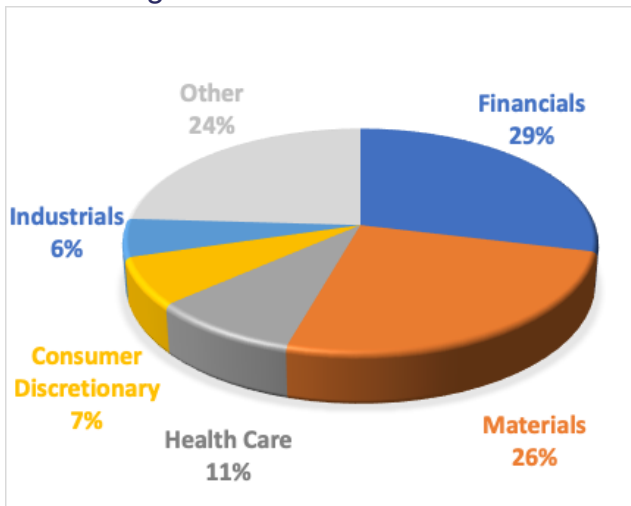
AUSTRALIA

In the wake of the global impact of the failure of SVB and the crisis at Credit Suisse the Financial sector was down by 2.7% this quarter. As this Sector makes up nearly 30% of the ASX it is one of the main drivers of market returns.

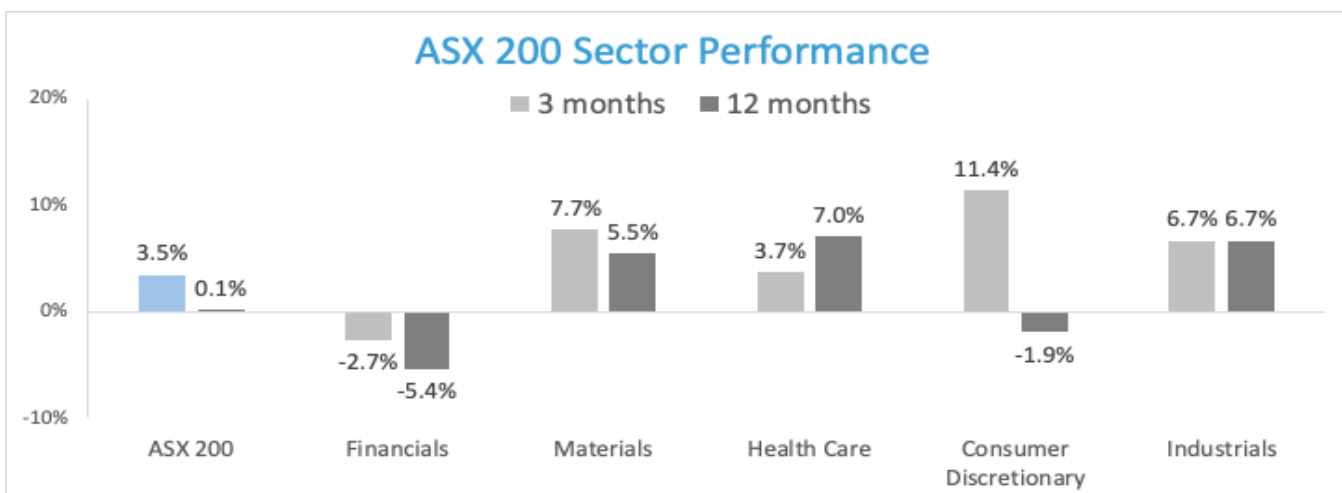
Energy stocks were down, pressured by persistently weak demand. Sectors that outperformed the overall market were Consumer Discretionary, Information Technology and Communications.

Sector	3 months	12 months
ASX 200	3.5%	0.1%
Communication Services	9.4%	3.6%
Consumer Discretionary	11.4%	-1.9%
Consumer Staple	7.6%	2.7%
Energy	-1.0%	14.7%
Financials	-2.7%	-5.4%
Health Care	3.7%	7.0%
Industrials	6.7%	6.7%
Information Technology	8.1%	-16.9%
Materials	7.7%	5.5%
Real Estate	0.1%	-14.8%
Utilities	1.8%	16.0%

Five sectors make up approximately 75% of the Australian market, with the two largest constituting 53%. The chart below shows the 12-month performance of the major sectors



Sector	Weight
Financials	28.8%
Materials	25.7%
Health Care	9.1%
Consumer Disc	6.9%
Real Estate	6.7%
Industrials	5.5%
Consumer Staples	4.8%
Communication Services	3.9%
Information Technology	3.6%
Energy	3.8%
Utilities	1.3%



Source: S&P Global, FE Analytics

Sector Performance

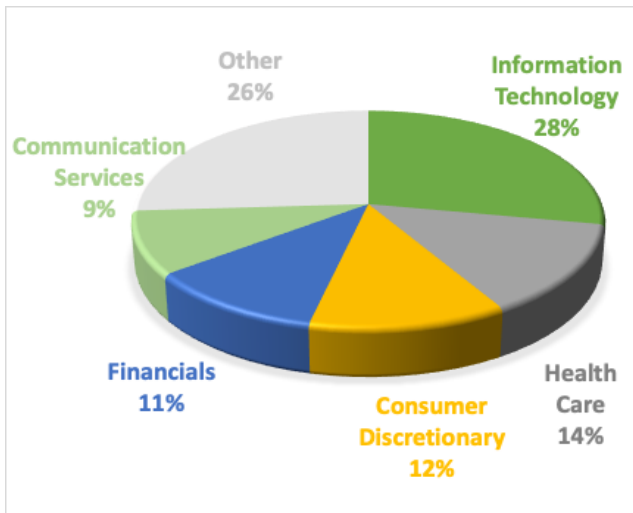
UNITED STATES

Sector performance in the S&P 500 was similar to Australia, with Financials and Energy the biggest losers, and IT / Communications and Consumer Discretionary the biggest winners.

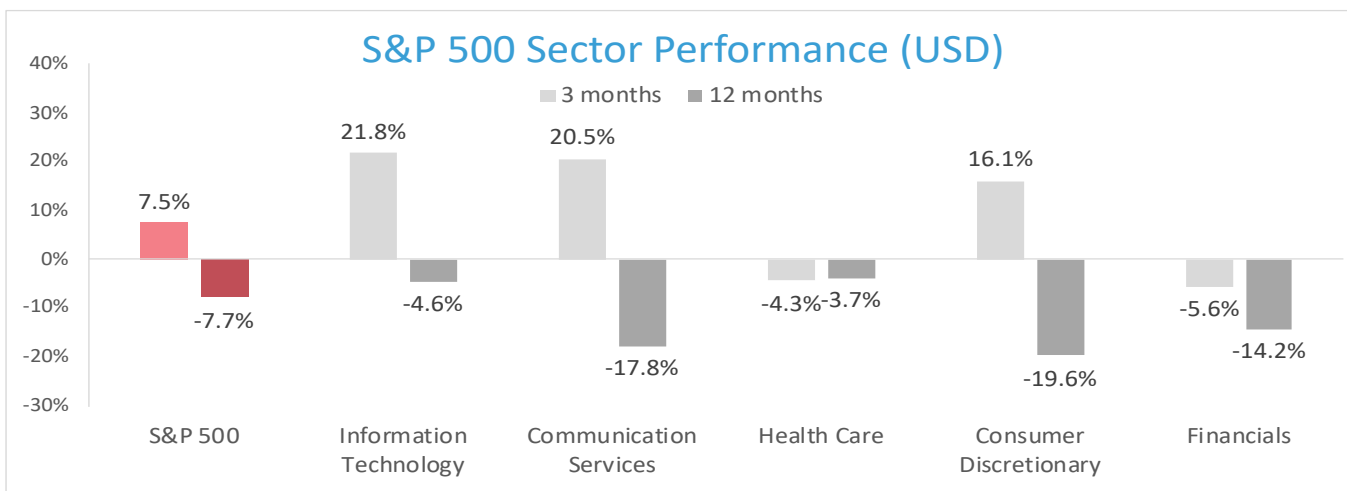
However, the S&P 500 has different sector weights than the ASX 200. For example, Communication Services and IT make up over 40% of the index, while Financials make up just under 12%.

Sector	3 months	12 months
S&P 500	7.5%	-7.7%
Communication Services	20.5%	-17.8%
Consumer Discretionary	16.1%	-19.6%
Consumer Staple	0.8%	1.2%
Energy	-4.7%	13.6%
Financials	-5.6%	-14.2%
Health Care	-4.3%	-3.7%
Industrials	3.5%	0.2%
Information Technology	21.8%	-4.6%
Materials	4.3%	-6.3%
Real Estate	2.0%	-19.7%
Utilities	-3.2%	-6.2%

Five sectors make up approximately 75% of the US market, with Tech companies constituting around 40%. The chart below shows the 12-month performance of the major sectors.



Sector	Weight
Information Technology	28.0%
Health Care	13.6%
Consumer Discretionary	12.0%
Financials	11.1%
Communication Services	9.4%
Industrials	7.9%
Consumer Staples	6.1%
Real Estate	2.8%
Energy	3.9%
Materials	2.6%
Utilities	2.7%



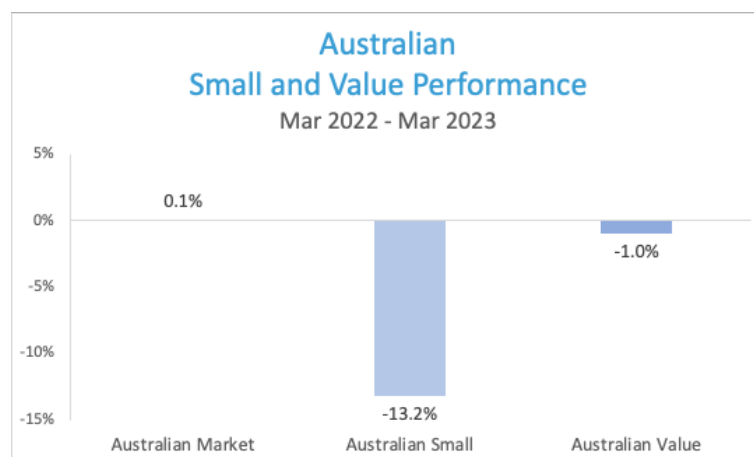
Source: S&P Global, FE Analytics

Equity Factors - Small and Value Premium

Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Australian Market	9.4%	-1.1%	5.5%	7.1%	8.7%
Australian Small	7.5%	-18.4%	1.4%	2.9%	5.1%
Australian Value	10.0%	3.2%	6.5%	7.1%	9.4%
Australian Growth	6.3%	-8.8%	5.4%	7.9%	8.1%
Global Market	3.9%	-12.5%	6.2%	9.3%	13.7%
Global Small	4.9%	-12.9%	4.1%	6.4%	13.1%
Global Value	8.7%	0.0%	5.2%	7.1%	12.0%
Global Growth	-0.9%	-24.4%	6.1%	10.6%	15.1%

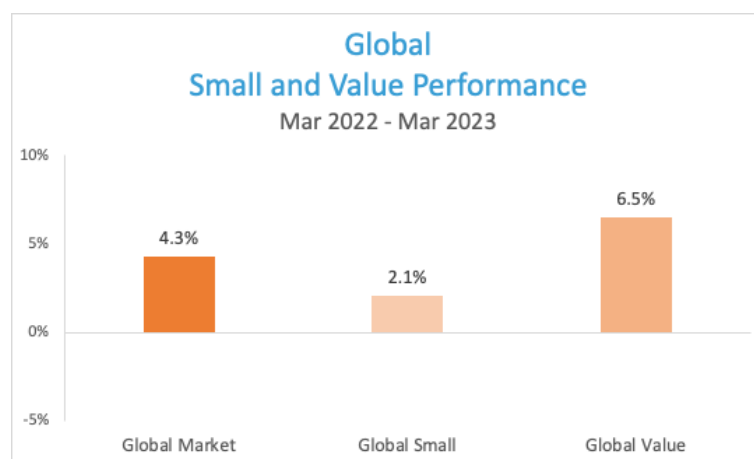
Australian Factors

Factors are very volatile over short time periods. Looking over the course of the last 12 months, value stocks out-performed growth stocks by 1.7%, as lower relative price companies on average did better than higher relative price companies. However smaller companies have under-performed the broader market by 13.3%.



Global Factors

The story is much the same in developed markets, where despite the bounce back this quarter in the IT sector there is a value premium (value – growth) of 5.4% over the last 12 months. Global small companies have underperformed global large caps, although not to the same degree as in Australia.



Value premium = Value Index – Growth Index; Small premium = Small Index – Market Index

S&P/ASX 200 Index (Total Return)

S&P/ASX Small Ordinaries Index (Total Return)

S&P Australia BMI Value Index (gross div., AUD)

S&P Australia BMI Growth Index (gross div., AUD)

MSCI World ex Australia Index (net div., AUD)

MSCI World ex Australia Small Cap Index (net div., AUD)

MSCI World ex Australia Value Index (net div., AUD)

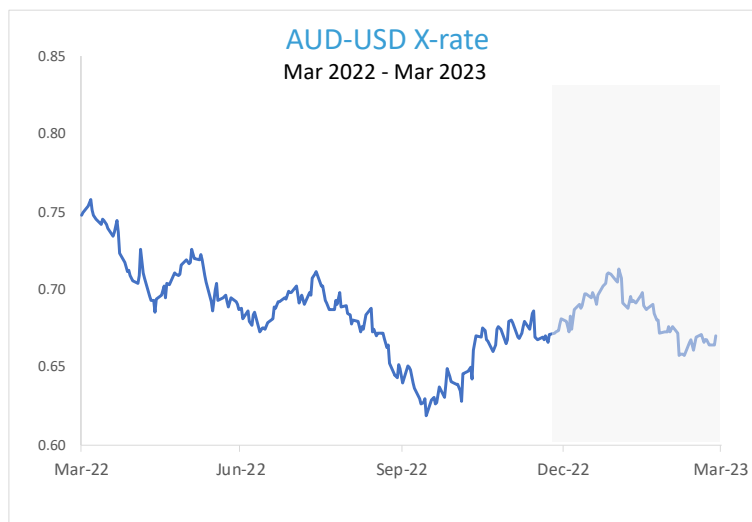
MSCI World ex Australia Growth Index (net div., AUD)

Currency and Commodities

EXCHANGE RATE

The Australian dollar was down 1.9% for the quarter and closed at 0.67 US dollars in a period marked by constantly shifting outlooks for interest rates and the banking sector globally.

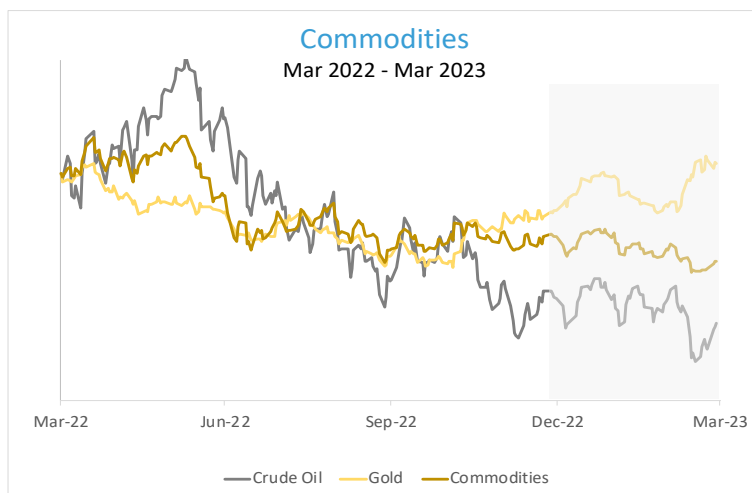
After the rate increase in February the RBA Minutes stated that they would consider a pause at a future meeting, in contrast to the US Fed's who reiterated that more work needs to be done to bring inflation down.



COMMODITIES

Gold rose 8.9% in the March quarter mainly driven by fears of wider banking contagion in the wake of the SVB collapse and the increased likelihood of a recession.

Crude Oil is down by 3.3% for the quarter on weaker energy demand and recession fears. However, there is optimism that China's recovery may off-set slower global growth.



Source: www.investing.com

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Principia Investment Consultants
April 2023

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