MarketSay"

The early trend in August saw a continuation of the equity market strength seen in July, however the Jackson Hole Symposium reversed that trend with the Fed Chair failing to deliver the dovish message markets had hoped for. Inflation data in the US has been a little more encouraging, while in Europe the huge increase in energy prices continues to drive historically high numbers. Central banks continued to hike interest rates as they all search for a 'soft landing', a path that continues to narrow. The manufacturing sector in China continues to cause issues for global supply chains as rolling covid lockdowns maintain a drag on the economy.

Policy Watch: The US Federal Reserve's Jackson Hole Symposium provided a key catalyst for asset prices in August. Fed Chair Powell directly addressed market assumptions and pricing for future rate moves and largely dismissed them. Rhetoric out of the Fed continued to be hawkish suggesting further rate increases lie ahead. The RBA increased the cash rate by 50bps as did the Reserve Bank of NZ by 50bps and the Bank of England.

Inflation Watch: Inflationary pressures in Europe persist on the back of record high energy prices, while US price measures are starting to slow.

Risk Budget: Volatility for equities rose late in August as markets sold off into the end of the month. Bond market volatility remains elevated as bond yields moved sharply higher, pricing in more aggression from central banks.

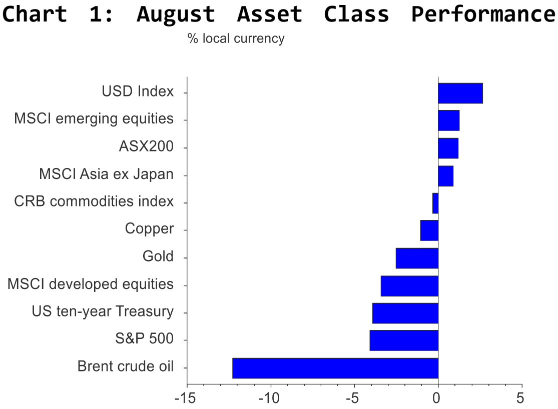
Call to Action: We suspect that long bonds and equities will again underperform in the short run as central banks maintain their hawkish stance. Currencies and credit spreads continue to represent opportunities for active investors. We believe that in the equity market, safe haven sectors are likely to attract investment flows and find price support. Managing risk through the cycle is particularly important, and ineffective tiny tactical tilts will not preserve capital in major risk off environments. We continue to favour more active and bold positioning – preferring to primarily focus on capital preservation at this important time.

Date of Publication: 7 September 2022
Sayers Wealth Pty Ltd | ABN 61 642 217 007 | AFSL No. 525093

August Review

Global equities lost ground late in August, as hawkish commentary from the Federal Reserve Chairman Powell at the annual Jackson Hole symposium dented investor sentiment. The MSCI Developed Markets Index fell (-3.4%), and the S&P 500 lost ground, dropping (-4.1%) in local currency terms. The S&P/ASX 200 outperformed and lifted (+1.2%) over August, driven by a resilient reporting season where results broadly came in better than feared.

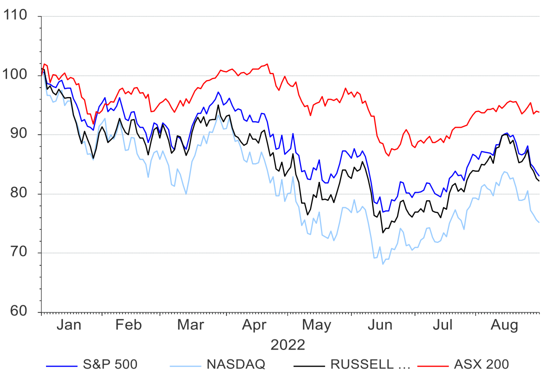
Chart 1: August Asset Class Performance



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Bond markets continued to price in more aggression from central banks, the Australian 10-year yield sold-off by 54bps to 3.60% following the RBA's 50bps hike to 1.85%. US yields also sold-off 52bps to 3.13%.

Chart 2: US and Australian Equity Markets YTD Relative Performance (100 = 1 Jan 2022)

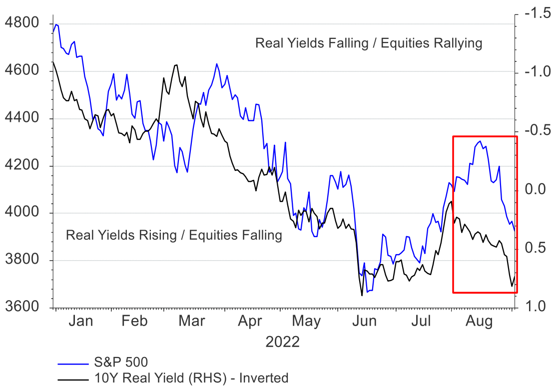


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Commodity prices fell in August. Brent Oil prices declined US$14 to US$96/bbl on both demand concerns and supply issues being resolved. Iron Ore prices also dropped US$19 to US$99/Mt as COVID impacts linger and supply lifts. Gold prices continue to trend lower, moving down US$38 to US$1,716, amid US dollar strength and higher real bond yields.

In Australia, corporate reporting season was better than many in the market had feared. Despite downbeat headlines and volatile markets, Australian companies delivered results that suggested higher costs are being passed on and consumers are by-and-large still spending, with the median company beating consensus at the half-yearly NPAT line by +0.7%. This has allowed beats to outnumber misses by a ratio of 3:2, which is roughly the same split recorded in February. This is a solid performance given the headwinds buffeting corporates at present. However, these results are backward looking. Where outlook commentary was weak, uncertain or withdrawn, stocks were sold off despite solid results.

Chart 3: S&P500 & US Real 10Yr Yield

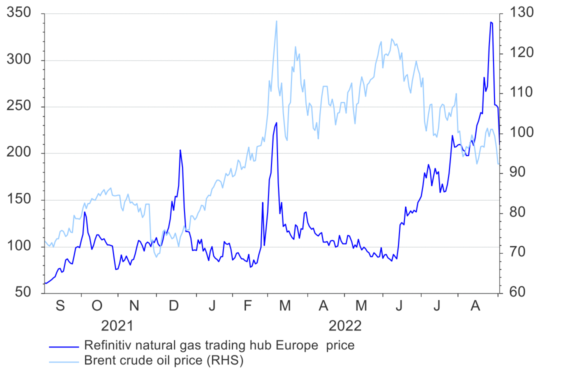


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

US Equities had rallied nearly 15 per cent since the Fed raised interest rates on 16 June 2022 before the Chairmans Powell's address at Jackson Hole towards the end of the month. Much of the rally was based on the belief that the US central bank might pause its hiking to assess what impact it has so far, that inflation had peaked and was easing, that weakening growth might force the Fed's hand, and that the bank would cut rates in 2023. In a relatively brief speech, Fed Chairman Jerome Powell effectively dismissed these beliefs. He clearly outlined that the FOMC's job is far from done in their view and that the fight against higher prices would require restrictive policy for some time and that a softening economy may be required to reduce inflation.

This was a pivotal moment for equity markets, with weakness persisting since and real yields moving higher – placing pressure on equity valuations. The most recent move however has been on light volumes with many market participants on holidays for the northern hemisphere summer.

Chart 4: Energy prices rising again in Europe



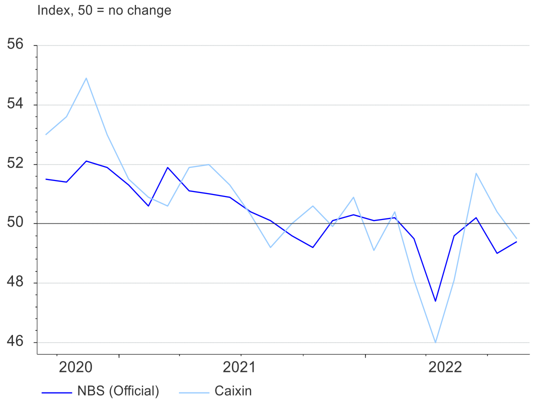
Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

European gas prices have fallen from their peak but prices remain extremely elevated and supply is far from guaranteed ahead of what could be a very cold winter. Energy price pressures in Europe continue to stoke large inflation numbers and are placing considerable pressure on consumers, businesses, and indeed central banks. The Euro Area CPI for August headline reading printed at 9.1%, one tenth higher than expected by consensus, a new record high. While in the UK market participants are forecasting that inflation may hit over 22% early in 2023 if gas prices don't moderate.

Heading into the end of August the Nord Stream gas pipeline that links Russia to continental Europe was operating at just 20% capacity with ongoing maintenance issues cited by Gazprom for the reduced flow. There is scepticism on the validity of these issues and raises the prospect of Russia using gas supplies as a tool to push back against Western sanctions. Prices are likely to remain volatile.

Extreme heat, power disruptions and rolling Covid lockdowns in major cities continue to hamper Chinese manufacturing. During August the official numbers of manufacturing output recovered slightly, but the sectors output is still shrinking. While the Caixin (unofficial) data fell back into contractionary territory pointing to subdued demand conditions. Geopolitical tensions are also weighing on investor sentiment in the region, with US House of Representatives Speaker Nancy Pelosi visiting early in the month increasing tensions between Taiwan, China and the US.

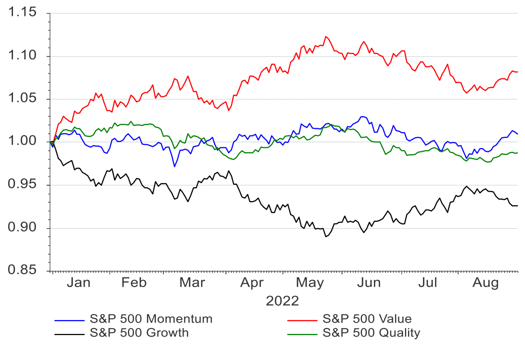
Chart 5: China Manufacturing PMIs



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Value, Momentum and Quality all rose over August at the expense of Growth as real (after inflation) interest rates rose.

Chart 6: S&P500 Equity Factor Relative Performance (YTD)

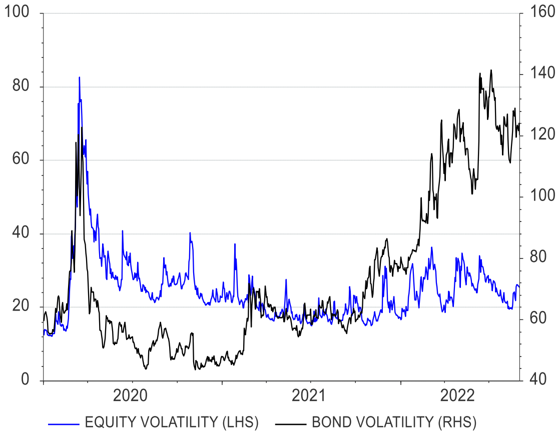


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Risk

Equity market volatility rose towards the end of August as markets fell sharply. Bond volatility continues to remain incredibly high by historical measures.

Chart 7: US Equity & Bond Inflation



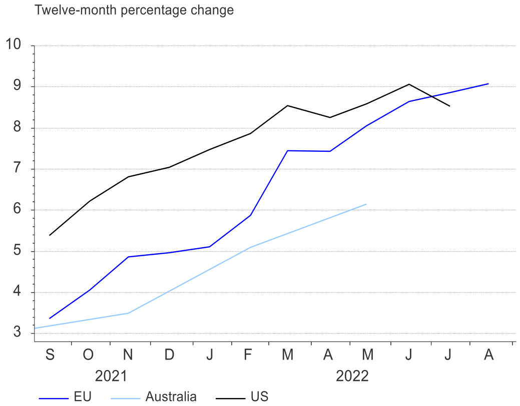
Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Outlook

The battle between liquidity and market optimism, and central banks resilience to stay the course and fight inflation despite the costs to growth, will continue to play out through the remainder of 2022. Who will blink first and capitulate is the fundamental question to be answered to get markets right.

Investors have been conditioned, over many years and painful cycles, that inflation has been tamed and any weakness in growth will be supported by central banks cutting rates. In 2021, as supply chain shocks caused rapidly rising inflation, investors backed the central bank's view of inflation being temporary and equity prices rallied on both a better earnings outlook and expanded multiples. With central banks reversing course – they have been fighting to break the conventional playbook in markets. Central banks are far more worried about inflation becoming entrenched and continue to talk tough. The idea of a pivot to rate cuts next year has been put to bed and central banks across the globe are united in their pursuit of lower inflation at the cost of lower growth. But markets are so far resisting and trying to buy the pull back.

Chart 8: Inflation Continues to rise

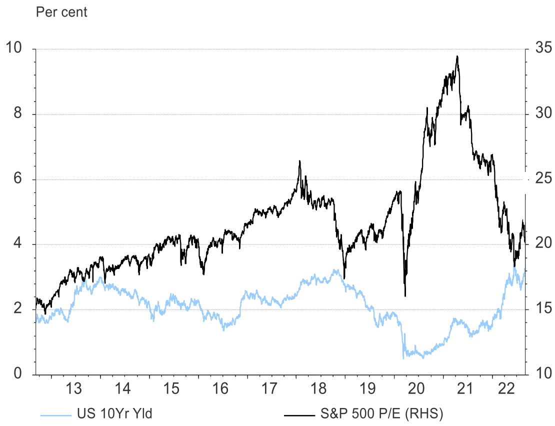


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

While equity multiples have fallen this year, they remain elevated by historical standards and corporate earnings forecasts for 2023 remain at excessive levels, despite the obvious pressure on margins from higher energy, wages and supply chain disruptions. Consumers are being squeezed by a higher cost of living, particularly rising mortgage rates, and aggregate demand is likely to fall further from current levels.

Markets in our view are underestimating the resolve of central banks to lower inflation and their willingness to accept materially lower demand – particularly from a point where most economies remain at or close to full employment. We remain defensively positioned and believe risk assets are yet to capitulate – where we would look to acquire quality investments at discounted prices.

Chart 9: S&P500 P/E v 10yr Bond Yield



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Global geopolitical risk remain a concern, and while markets appear to be largely ignoring them from a pricing perspective, they remain on the horizon as a potential concern that could further undermine confidence in risk assets. China continues to pursue a Covid zero policy and a relaxation of their approach, potentially combined with an economic stimulus package, remains a clear risk to our more cautious stance. While a China boom offset much of the GFC effects particularly in Australia, their capacity to engineer a recovery on a similar scale is severely diminished due to their level of Government indebtedness and highly leveraged property sector.

While we suspect that long bonds and equities will again underperform in the short run as central banks get their way, we remain active to opportunities that will benefit from such an environment. Currencies are trending and credit spreads have reset which continue to represent opportunities for active investors. Factor rotation within equity markets will continue to rotate, as the safe haven sectors attract investment flows and find price support.

Managing risk through the cycle is particularly important, and ineffective tiny tactical tilts will not preserve capital in major risk off environments. We continue to favour more active and bold positioning – preferring to primarily focus on capital preservation at this important time.

James Wright and Luke Hansen
Sayers Capital Solutions Group

7 September 2022

MarketSay"

sayers

Important Notice

This document has been prepared without consideration of any persons' investment objectives, financial situation or needs. The document is for wholesale investors only and is general advice only. Before acting on any advice or information contained in this document, Sayers Wealth Pty Ltd | AFS Licence No: 525093 (Sayers Wealth) recommends that you obtain professional advice based on your personal circumstances. Whilst this document is based on the information from sources which are considered reliable, Sayers Wealth, its directors, and employees, do not represent, warrant, or guarantee, expressly or impliedly, that the information is complete or accurate as at the date of publication. This document is not authorised for publication outside of Australia.

This document has been prepared by Sayers Wealth in good faith, but no independent verification has been made, nor is its accuracy or completeness guaranteed. Before making an investment decision, you need to consider whether this information is appropriate to your objectives, financial situation or needs. Past performance is not a reliable indicator of future performance.

Sayers recommends that you consider the relevant Product Disclosure Statement or other disclosure document, where relevant, before making investment decisions in relation to any particular product mentioned in this report.

Sayers's advisers may provide oral or written market commentary or trading strategies to clients that reflect opinions that are contrary to the opinions expressed in this report, and they may make investment recommendations that are inconsistent with the recommendations or views expressed in this report.

Ownership and Conflicts of Interest

Members of Sayers's Capital Solutions Group (CSG) may from time to time hold financial products that are the subject of a Sayers research report or other material.

The Sayers Conflicts of Interest Policy sets out how Sayers manages these conflicts. Where a holding is deemed to be material this will be disclosed in the client facing report.

The Sayers Group and associates, may have provided, provides or seeks to provide advisory, capital markets and / or other services, to the issuers and their associates mentioned in this report.

The Sayers Group Conflicts of Interest Policy outlines how these conflicts are identified and managed.

Our process

Further information about the methodology applied by Sayers in preparing research reports is available on the Sayers website.

General Disclosures

This report is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. The information contained in this report is subject to change without notice. The price and value of the investments referred to in this report and the income from them may fluctuate.

So far as laws and regulatory requirements permit, Sayers, its related companies, associated entities and any officer, employee, agent, adviser or contractor thereof (Sayers Group) does not warrant or represent that the information, recommendations, opinions or conclusions contained in this report (Information) is accurate, reliable, complete or current and it should not be relied on as such. The Information is indicative and prepared for information purposes only and does not purport to contain all matters relevant to any particular investment or financial instrument. Subject to any terms implied by law and which cannot be excluded, the Sayers Group shall not be liable for any errors, omissions, defects or misrepresentations in this report (including by reasons of negligence, negligent misstatement or otherwise) or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the Information. If any law prohibits the exclusion of such liability, the Sayers Group limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable.

Research Disclaimer

The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of Sayers. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed in this report.

Other

This report has been prepared for distribution only to clients of Sayers (and potentially to clients of other financial advisers). It may not be reproduced or distributed without the consent of Sayers. Please refer to the full details of the important disclosures, available in the Disclosures section of the Sayers Group website

Date of Publication: 7 September 2022
Sayers Wealth Pty Ltd | ABN 61 642 217 007 | AFSL No. 525093