Sunbird Portfolios™
QUALITY LISTED PORTFOLIOS

Market Update – May 2023

Asset class total return to 31/05/2023	1M (%)	3M (%)	6M (%)	1Y (%)	3Y (% p.a.)	5Y (% p.a.)	Current Yield (%)
Cash	0.3	0.9	1.7	2.9	1.0	1.1	3.9
Fixed Term Deposits	0.4	0.9	1.8	3.3	1.2	1.4	4.2
Australian Bonds	-1.2	2.1	1.4	1.7	-2.8	1.0	2.9
Australian Bank Hybrids	-1.4	-1.4	0.4	2.3	3.2	3.4	4.7
Australian Property	-1.8	-3.8	0.1	-3.6	8.1	4.4	4.5
Australian Shares	-2.5	-0.9	-0.6	2.9	11.4	7.5	4.4
Global Shares (unhedged)	1.2	8.4	7.9	13.4	11.9	11.3	1.4
Global Infrastructure (hedged)	-4.7	-0.6	-4.7	-9.3	4.6	4.8	3.1

Source: Refinitiv, RBA cash rate, 12M Term deposit, Australian Composite Bonds, Hybrids cash yield to call, Property ASX 300 AREIT, Australian Shares S&P/ASX 200, Global Shares MSCI World ex-Aust unhedged, Global Infrastructure FTSE Developed Core 50/50, hedged

Financial Indicator movement	31/05/23	1M	3M	6M	1Y
AUD/USD (cents)	0.65	-0.01	-0.02	-0.03	-0.07
Aust. 10-year bond yield (%)	3.60	0.21	-0.28	0.05	0.24
Gold US$/ounce	1,967	-4.0%	7.7%	11.2%	7.1%
Brent oil US$/bbl	72	-3.8%	-14.6%	-16.2%	-41.7%
Iron ore US$/t	101	-2.5%	-20.2%	-8.7%	-22.0%
Copper US$/pound	3.64	-5.8%	-11.2%	-2.4%	-15.3%

Note: Past performance is not a reliable indicator of future performance.

Global

Despite worries over the US debt ceiling and the US Federal Reserve (the Fed) continuing to lift interest rates to dampen inflation, the S&P 500 continued its remarkable rally throughout May. The large US technology stocks have led the rally, with Artificial Intelligence (AI) applications contributing to the latest optimism. However, the lack of breadth in the US rally has been highlighted as a concern over its sustainability.

In early June, Republicans and Democrats came to an agreement to suspend the US$31.4 trillion debt ceiling until early 2025, in return for a range of spending cuts. This will allow the US government to continue to run a US$1-2 trillion budget deficit and issue new government bonds. It won't really resolve the US budget deficit and public debt issues but will delay the day of reckoning until 2025, post the next US Presidential election in November 2024.

Meanwhile, the Fed increased the US cash rate to 5.00-5.25% in May, its 10th straight rate increase but is widely expected to be nearing peak rates and to be 'data dependent' moving forward. US futures are expecting the Fed to remain on hold in June.

The other major trend was China's post-COVID recovery continuing to fade into May. Structural issues in the property market remain and construction has been weakening, which has seen commodity prices retreat. China is expected to offer more stimulus in June, but it doesn't seem construction can sustainably recover until issues around oversupply, bad loans and property developer solvency are dealt with.

The oil price has also been drifting lower as global growth slows and Russian oil continues to be sold to India and China at discounted rates. OPEC has been trying to support the oil price by announcing regular production cuts, but so far, any rally has not been sustainable and a downtrend soon resumes. However, a weakening oil price is a positive for the inflation outlook.

Australia

The May Federal Budget update revealed a surprise budget surplus of $4bn, due to an improvement in tax revenue related to commodities and full employment. However, the budget is forecast to move to a $37bn deficit by FY25, due to increased spending, while gross public debt hits $1 trillion. Even though Australia's debt/GDP metrics (37%) remain lower than most developed economies, it was still disappointing that not enough is being done to arrest government spending. Further, it was hard to see how the budget helps contain inflationary pressures.

The Reserve Bank of Australia (RBA) resumed rate hikes in May, with another 25bps increase, taking the cash rate to 3.85% (the RBA has since followed up with another 25bps rate hike in June, leading to a 4.10% cash rate). This was a bit of a surprise to financial markets who had expected a longer holding period. The RBA seems to be concerned over rising services and wage inflation but also rising rents and house prices. Headline inflation remains around 6.8% and is not retreating as fast as the RBA had expected.

Many households have now rolled over from a fixed rate to a variable home loan rate and will be fully exposed to higher interest rates and living expenses in the next six months. It is likely that the economy will slow considerably over FY24, but of course that is what the RBA is trying to achieve to lower inflation. There will be a fine line between whether the economy can continue to grow or moves into recession.

Outlook

Interest rates continue to move higher and potentially for longer than markets expected. We continue to remain cautious as we haven't yet seen the full impact of higher interest rates and tighter credit conditions on the economy. We expect FY24 to be a challenging year. The bond market remains bearish, as long-term interest rates are lower than short-term interest rates. But equity markets remain relatively optimistic, judging by their resilience.

We continue to lean towards a bearish view - the global economy will continue to slow and that company earnings are yet to fully reflect a slowdown. We remain invested but positioned defensively. We will become more bullish once market valuations have adjusted lower and we are closer to Central Banks easing interest rates.

The next key events on the calendar include:

- Fed meeting – 13/14 June 2023
- May Aust. CPI – 28 June 2023
- RBA meeting – 04 July 2023

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Bill Keenan is the founder of Sunbird Portfolios. Sunbird provides independent advice to leading financial advisers across Australia.

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Warnings, Disclosures and Disclaimer

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