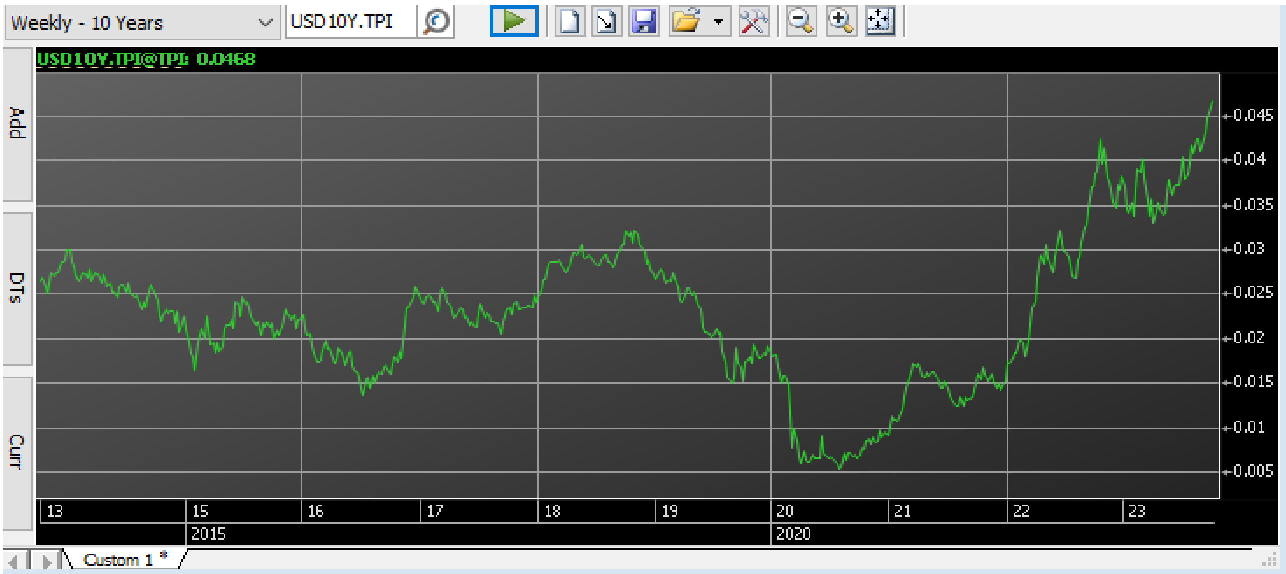
6th October 2023

ShawandPartners
Morrissey Group

Markets are jumpy.

This week the US 10-year treasury bond hit its highest yield (lowest price) since October 2007 which is why the markets are so nervous at present.



It's also squished the AUD down to US$0.63. The RBA held fire on Tuesday, but the commentary was all about the next CPI number in a few weeks which might force them to lift again. Inflation is sticking both here and abroad.

Below is a snippet from the RBA's recently marked up monetary policy statement.

Figure 1: RBA Monetary Policy Statement Comparison: latest vs prior

At its meeting today, the Board decided to leave the cash rate target unchanged at 4.10 per cent and the interest rate paid on Exchange Settlement balances unchanged at 4.00 per cent.

Interest rates have been increased by 4 percentage points since May last year. The higher interest rates are working to establish a more sustainable balance between supply and demand in the economy and will continue to do so. In light of this and the uncertainty surrounding the economic outlook, the Board again decided to hold interest rates steady this month. This will provide further time to assess the impact of the increase in interest rates to date and the economic outlook.

Inflation in Australia has passed its peak ~~and the monthly CPI indicator for July showed a further decline. But inflation~~ but is still too high and will remain so for some time yet. ~~While~~Timely indicators on inflation suggest that goods price inflation has eased~~,~~ further, but the prices of many services are ~~rising~~continuing to rise briskly~~.~~ and fuel prices have risen noticeably of late. Rent inflation ~~is~~ also remains elevated. The central forecast is for CPI inflation to continue to decline and to be back within the 2–3 per cent target range in late 2025.

~~The~~Growth in the Australian economy was a little stronger than expected over the first half of the year. But the economy is still experiencing a period of below-trend growth and this is expected to continue for a while. High inflation is weighing on people's real incomes and household consumption growth is weak, as is dwelling investment. Notwithstanding this, conditions in the labour market remain tight, although they have eased a little. Given that the economy and employment are forecast to grow below trend, the unemployment rate is expected to rise gradually to around 4½ per cent late next year. Wages growth has picked up over the past year but is still consistent with the inflation target, provided that productivity growth picks up.

It's not smooth sailing at present; income, growth, large, small, gold's been smashed, even energy has been on the nose, bitcoin is proving resilient; the nervousness is creating market weakness and of course ultimately, decent opportunities.

I figured the high yielding property trusts had stopped falling some months ago- that was before they fell a further 20%. We are in the midst of a classic 'baby out with the bathwater' period, and for those businesses who are seeking capital- good luck.

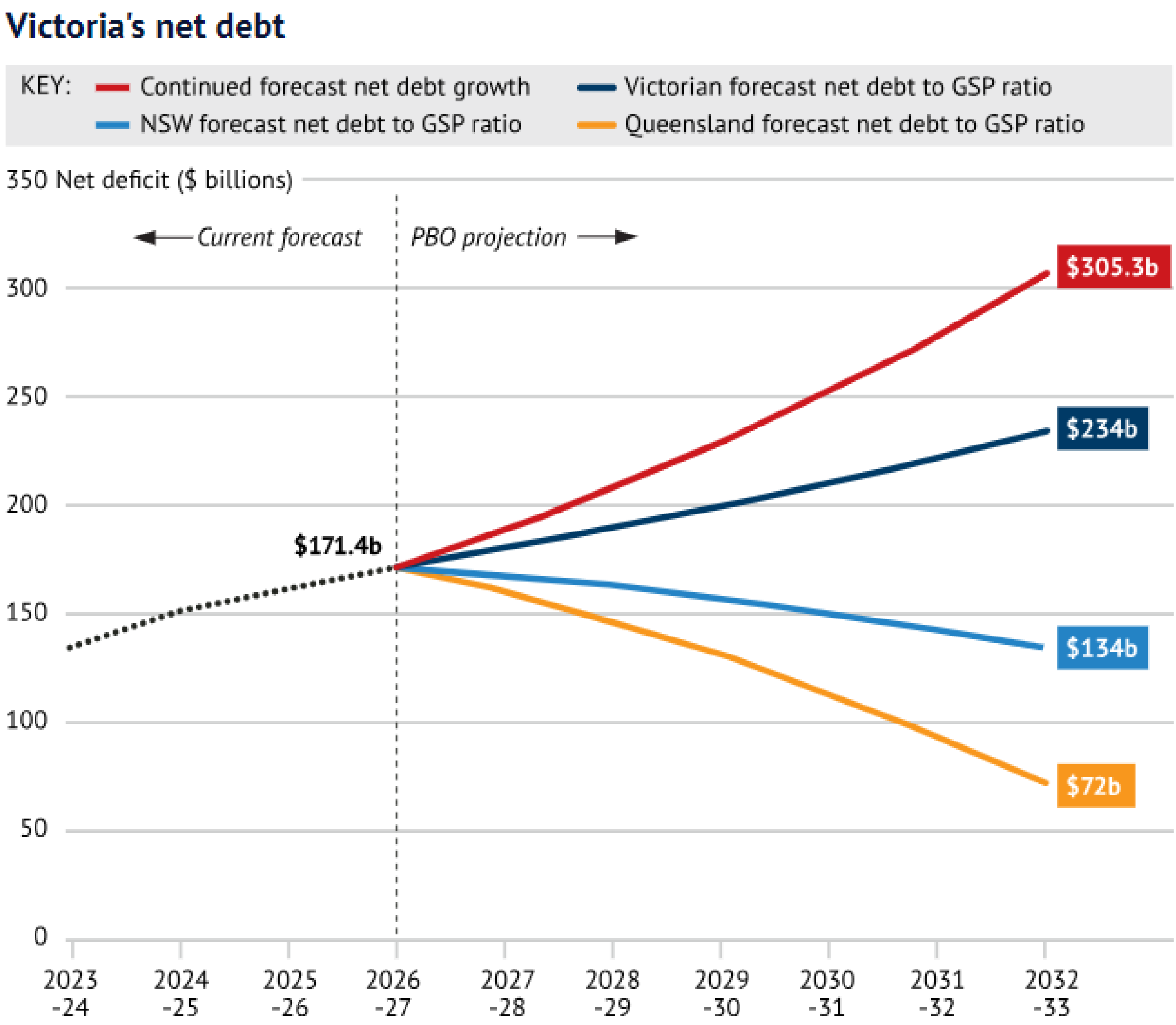
Market commentators are drawing the inevitable newspaper selling parallels with 2007, but from my anecdotal viewpoint the overall company strength at a balance sheet level across almost all sectors, looks considerably better. It looks to me that most of the risk has been shifted from the consumer and business across to Governments. Higher interest rates equal higher interest payments on debt.

The US keep kicking the can down the road rather than addressing their debt problem and keep lifting their borrowings- and in the process creating the same pointless debt ceiling standoff and threats to shut the government down as political jockeying and posturing own the headlines.

A debt pile of $33trillion, versus a GDP of $27 trillion is not a sound financial position, but because it is political suicide to cut government handouts and raise taxes, i.e. repair the balance sheet, whoever the current Government is, will never address the issue.

Let's break that debt down. At a guess, in the US the average servicing cost of the Government's US$33 trillion in debt would be around 4.2%, or $1.4 trillion per annum. That's the total of Australia's GDP, just to pay the interest. They've still got to pay the debt back.

And we're not faring a great deal better- particularly us lucky souls here in Victoria post the devastation of Hurricane Andrews.



On the plus side, the big 4 banks here in Oz have dramatically higher capital adequacy requirements imposed upon them and are in turn, stronger than ever before, as are the major banks in the US- post feasting on the carcasses of their now deceased competitors during the GFC.

The problem is of course with interest rates moving north so quickly, in combination with imbedded inflation, there are undeniably tough times ahead. With the cost of living eking higher and higher, the much-predicted interest rate CUTS could be off the table for quite some time- and the market is adjusting to this new reality.

I'm not going to insult your intelligence by suggesting that I know what's to come, rather, make the point that whatever is broadly expected, rarely ever occurs.

So maybe if we all channel continuing negative outcomes, we'll all be pleasantly surprised by some economic smooth sailing.

George Tharenou's view'

On Wednesday this week, we met with UBS Head of Economics, George Tharenou. His opinion is extremely well regarded so I thought I'd summarise the points from his presentation.

George's views on central banks and economic conditions differ from the mainstream or "street" views in several key ways:

1. **RBA's Monetary Policy**: George suggests that the Reserve Bank of Australia (RBA) has a mild tightening bias and may consider hiking interest rates if inflation surprises on the upside. This view contrasts with the street, which might not anticipate such a move, given the RBA's past statements about potential tightening.
2. **Inflation Expectations**: George's view on Q3 inflation differs from the RBA's prediction. He expects it to be higher than what the RBA predicts, indicating a potential discrepancy in their inflation outlook.
3. **US Federal Reserve**: While some Fed speakers have been hawkish, George believes that it's crucial to see Fed Chairman Jerome Powell adopt a hawkish stance before concluding that the Fed is moving toward tightening monetary policy. This perspective suggests that George is looking for stronger signals from the Fed compared to others.
4. **Labor Market and Consumer Spending**: George focuses on income growth and consumer spending rather than real interest rates or financial conditions when assessing the economy's health. This approach is unique and suggests that he views strong income growth as a driver of consumer spending.
5. **Superannuation Asset Accumulation**: George emphasizes the significant growth in superannuation assets and the income stream generated from this pool. This perspective differs from a focus on traditional economic indicators and highlights the role of financial assets in supporting the economy.
6. **Population Growth**: George believes that robust population growth, driven by migration, is a factor that can prevent a recession. This viewpoint contrasts with concerns about the impact of demographics on economic growth in some economies.
7. **Housing Market**: George notes that housing supply is not keeping up with demand, and this issue persists despite higher prices. This view differs from the expectation that rising prices would incentivize more housing construction.
8. **US 10-year Treasury Yields**: George highlights the significant rise in US 10-year Treasury yields and suggests that this reflects the market's expectation that interest rates will remain higher for longer. This perspective contrasts with earlier expectations of rate cuts.
9. **China's Economic Outlook**: George anticipates a "sideways" trajectory for China's economy, while some clients hope for a "hard landing" to mitigate global inflation. This view contradicts expectations of rapid economic growth in China.

10. **AUD and Trade Dynamics**: George's clients are trading on a negative China story and a belief that the RBA won't raise rates as quickly as other central banks. This perspective contrasts with the idea that a strong Australian dollar might reflect confidence in the country's economic prospects.
11. **Mortgage Cliff Impact**: George suggests that the impact of the mortgage cliff (when many homeowners must refinance their mortgages) might not be as severe as expected because some households can mitigate higher payments by getting another job or selling their homes. This perspective differs from the potential risks associated with a large number of mortgage resets.

Overall, George's views appear to be characterized by a focus on income, assets, and specific nuances in economic data, which may differ from the broader market's emphasis on more traditional economic indicators and expectations.

5th October 2023

Financial Planning Weekly

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Bonds

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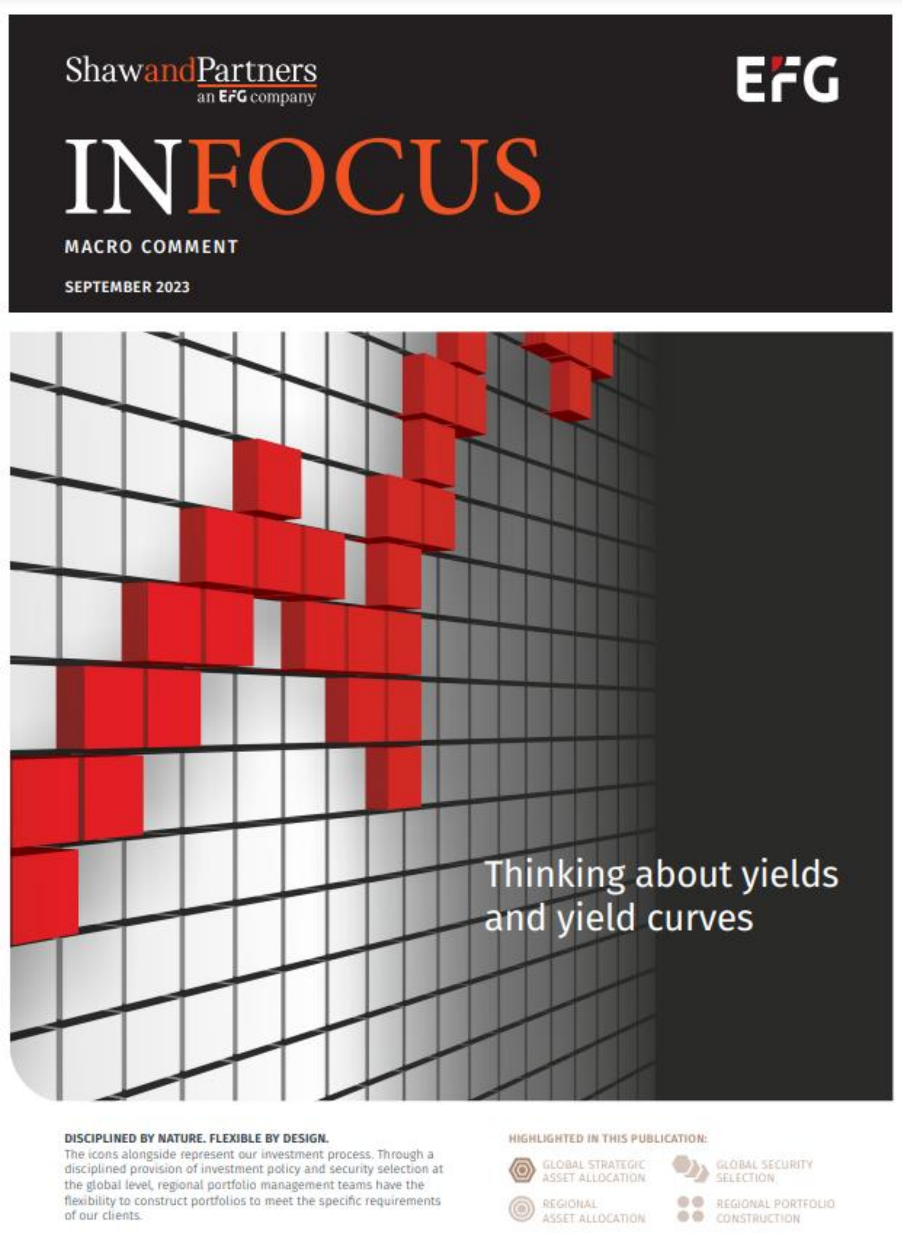
[Bonds]



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[EFG Infocus September]

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EFG Infocus October

Rebels Under 16's and 19's

On Saturday this week, the Shaw and Partners Melbourne Rebels Under 16's and Under 19's are heading into battle with the NSW Waratahs.

After a tough trip for both teams in WA against the Western Force, they'll be itching for redemption.

Come down and support the boys.

Time: Under 16's at 11.05am, Under 19's at 12.45pm
Day: Saturday 7th October
Location: Box Hill Rugby Club, corner Middleborough and Canterbury Road, Box Hill, Vic, 3128

Have a good weekend,

Ben and the team.

This report has been prepared by Ben Morrissey
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