

April 2023 Quarterly Market Update for Trust investors: A shift from short to long

By Perpetual Private

20 April 2023

In the **April 2023 Perpetual Private Quarterly Market Update** we look at recent market moves and discuss the rationale behind a major shift in our fixed income strategy. You can download our full report – or read our concise review below.

[Download the report](#)

March 2023 quarter: What happened?

- 2023 got off to a good start with the Australian market rising on positive inflation news and the possibility rates could ease at year end. Later in the first quarter some nasty but quickly contained bank failures shut down the rally. However, Australian shares still generated a 3% quarterly return.
- Major global markets also had a strong start to 2023. In local currency terms, French and German markets were up well over 10% for the quarter. Globally, tech stocks rallied while energy companies fell. That reversed last year's trend.
- Bond markets emerged from their slump. Global bonds rose 2.4% for the quarter and local fixed income did even better, posting a return of 4.6%, partly in recognition of the strength of Australia's banking sector.

- The most recent data point in the great ‘investment style’ debate saw local Growth shares beat Value in the March quarter. However, Value now outpaces Growth over all other time periods out to five years.

Indices referenced: S&P/ASX 300 Index, German DAX Index, French CAC 40 Index, MSCI Australia Value Index, MSCI Australia Growth Index, Bloomberg Global Aggregate Index, Bloomberg AusBond Composite (0+Y) Index. All performance numbers for March 2023 quarter unless otherwise stated.

According to Perpetual Private Investment Director, Emily Barlow, the first three months of 2023 were “a quarter of two halves.” With some evidence that inflation was easing, share markets rose handily, reflecting the potential for rate cuts in late 2023 or early 2024. As we moved into March, the narrative changed, with bank failures in the US and Switzerland eroding confidence.

It’s easy to blame some rogue banks for the sudden reversal. Silicon Valley Bank (SVB) – the self-styled ‘financial partner of the innovation economy’ was under-hedged and over-exposed to start-ups and technology companies that were hammered by rising rates. Credit Suisse had struggled for years with risk controls and finding the right business model.

Central banks stepped in quickly to reduce the risk these local flare-ups would damage the global banking system. Stability has returned to the system and the Reserve Bank Governor recently wrote, “Australian banks are well regulated, well capitalised, profitable and highly liquid; they are in a strong position to continue lending to domestic households and businesses.”¹

Where to from here?

While commentators and investment markets are obsessively reading the tea leaves on future rates rises, the higher rates *already* in the system are reshaping the investment environment. They’re already having an effect on companies that relied on benign economic condition and cheap money. It’s why the long run of rate rises has claimed some of the world’s weaker banks. It’s why the price of barely profitable technology companies have tanked. And why we’re seeing businesses dependent on a free-spending consumer – like online food deliverers – hit the wall.

Back to basics

On a more positive note, a higher interest rate regime is rebalancing the profile of fixed income investing. And that could be good news for Trust investors who rely on income from their investments to fund their lifestyle.

Post GFC, efforts to engineer an economic recovery (via so-called quantitative easing (QE)) pushed rates on longer-term government bonds down to artificial levels.

The RBA’s website reveals² that the yield on 10-year Australian government bonds was close to 7% in the early 2000s, had fallen to 2% by 2018 and – with added impetus from pandemic-

focused policies – had plunged to 1.33% in February 2021³. Thanks to a string of rate rises it's now nearing 3.5%.

Emily Barlow says while that recent rate shift is painful for some – especially mortgage payers – it is bringing the 'shape' of fixed income markets back to normal.

"On a medium-term view, there's no doubt that QE distorted fixed income markets, driving long-term rates to zero and even lower in some countries. That's had a real effect on investors who had previously relied on government-backed bonds for reliable income. The speed with which rates have risen over the past year has been remarkable. But it has really only brought rates back to what is a more normal setting, where investors get rewarded for investing in bonds."

From corporate credit to government bonds

The reshaped economic environment, one where interest rates are higher for longer, is driving changes in the fixed income part of Perpetual Private portfolios.

We invest in both government bonds and corporate debt (debt issued by companies including banks and corporates like BHP).

Over the past few years Perpetual Private investors benefited from our overweight position in corporate debt (sometimes called credit). With government bond rates so low, our credit holdings helped generate better returns.

Credit securities also have a shorter time horizon and floating rates, which meant that as interest rates started to rise, they provided some downside protection. By contrast, when rates rise, government bonds typically fall in value because their **fixed** rates become less attractive. "In the environment we lived through over the past few years, credit investing was good for returns and helped reduce downside risk," say Emily Barlow.

Now the plates have shifted. Perpetual Private has been moving money from credit into bonds, a decision we think works on a number of levels.

- As interest rates stabilise at higher levels, longer-dated government bonds are more attractive sources of income.
- Because these bonds are backed by governments (and their unlimited taxing powers) they're more defensive than shorter-term credit securities issued by companies. That helps protect the portfolio if we fall into a recession.
- Corporate credit securities are affected by the same forces that affect company shares while government bonds are less correlated to equity markets. So investing in government bonds improves diversification and reduces risk.

A change in the composition



Now that more of the heavy lifting of income generation in Trust portfolios will be done by government bonds we're likely to see a different role for share income. "Over the past few years, investors have had to go up the risk curve, investing more in higher growth asset classes such as credit and equities to get a decent income," says Emily Barlow. "With bond yields back up, portfolios can be rebalanced. Bonds and income-focused alternative assets like infrastructure will generate a higher proportion of fund income and high quality equity investments take up their traditional role of generating the growth needed to beat inflation."

Perpetual Private's Quarterly Market Update for April 2023 covers how the past year's rate rises are reshaping markets and what that means for investors' portfolios. And details the outlook for equities, fixed income, real estate, currency and alternatives.

[Download the report](#)

Sources:

[1] RBA, *Financial Stability Review* April 2023.

[2] <https://www.rba.gov.au/chart-pack/interest-rates.html>

[3] <https://www.rba.gov.au/statistics/tables/xls/f02hist.xls?v=2023-04-14-10-03-23>

Perpetual Private advice and services are provided by Perpetual Trustee Company Limited (PTCo) ABN 42 000 001 007, AFSL 236643. This information was prepared and used by PTCo. It contains general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. The information is believed to be accurate at the time of compilation and is provided in good faith.

PTCo do not warrant the accuracy or completeness of any information contributed by a third party. This information, including any assumptions and conclusions is not intended to be a comprehensive statement of relevant practice or law that is often complex and can change. No company in the Perpetual Group (Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Past performance is not indicative of future performance.

