2023 calendar year in review

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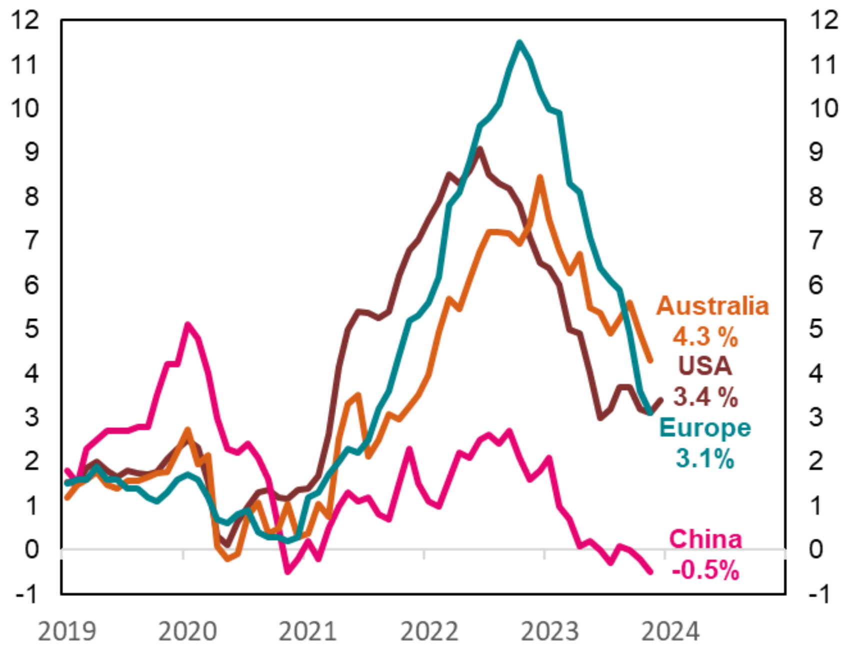
January 2024

"A favourable year for investment returns even with inflation, interest rates and political risks."

Global inflation is finally falling but the 'cost of living' is still a worry for consumers

After the astonishing highs set in 2022, global inflation pressures are finally cooling. Lower global oil & gas prices with improved production and transport supply chains have finally allowed consumer inflation to decline. For Europe and the United States, annual inflation is now recording closer to 3% compared to the circa 9% to 11% inflation rate highs set last year. China is the notable exception with falling consumer prices at -0.5%. Australia has also seen inflation improvement with annual inflation at 4.3% in November compared to the peak of 8.4% in December 2022. Yet there is still a "painful squeeze" for consumers who are struggling to keep food on the table and a roof over their heads. Australian bread & cereal prices have risen by circa 8%, electricity by 10%, gas closer to 13%, insurance by 9% and rents by 7% in the year to November.

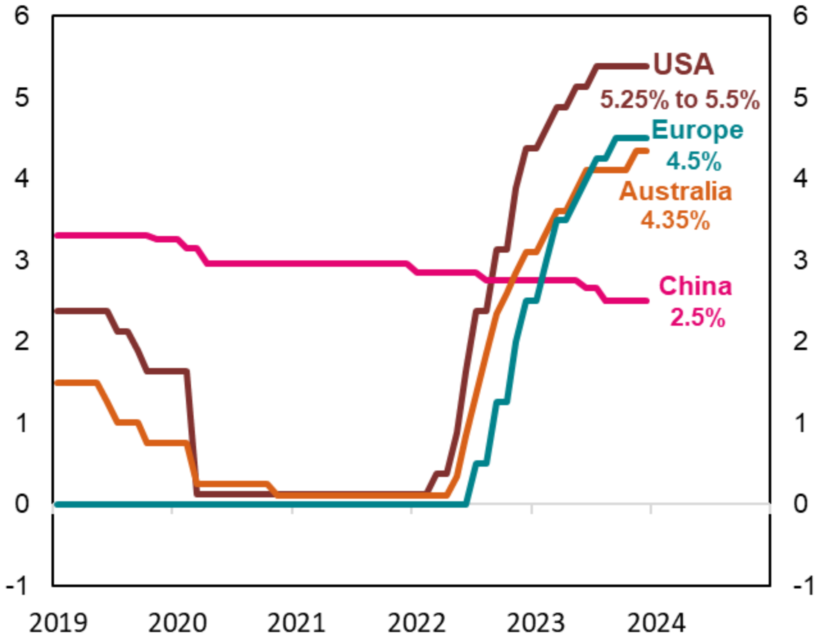
Chart 1: Global consumer inflation



Sources: Australian Bureau of Statistics, Eurostat, National Bureau of Statistics of China and US Bureau of Labor Statistics. Data as at 31 December 2023.

This painful squeeze has been very intense for loan borrowers. Central banks have rapidly raised cash interest rates to curb inflation. For the United States, cash interest rates have risen by a further 1% to currently stand near 5.5%. The European Central Bank raised cash interest rates by 2% to 4.5%. Australia's central bank; the Reserve Bank (RBA) followed this script by raising the cash interest rates from 3.1% last year to 4.35%.

Chart 2: Central banks rapidly raised cash interest rates to curb inflation



Sources: Reserve Bank of Australia statistical table International Official Interest Rates - F13. Data at 31 December 2023.

There appears to be relief on the horizon for borrowers. Given recent lower inflation results, both the American and European central banks have paused on raising interest rates since August. Indeed, financial markets have become optimistic that interest rates are set to fall in 2024. The Reserve Bank of Australia (RBA) is more cautious with their last interest rate rise being only in November as inflation concerns are still dominating.

The past year has also provided financial and political shocks. The global banking system had a major tremor in March 2023 with the collapse of three US regional banks and the takeover of Switzerland's second largest bank in Credit Suisse. This has seen both European and North American banks applying harsher credit conditions to businesses and consumers, thereby casting a shadow over the global economy. The 7 October Hamas attack on Israel has generated considerable tragedy and turmoil in the Middle East in the closing months of 2023. Russia's devastating invasion of Ukraine is a continuing shockwave that has proved influential across commodity prices and economic activity as well as global politics. Fortunately, Ukraine's brave defence has stalled the Russian army and led to political turmoil in Russia in June 2023.

The global economy has provided both positive and negative surprises

Global economic activity is a strange mix of strengths and weaknesses. The US economy has been the key positive by proving more resilient. Many commentators were forecasting a US recession given higher interest rates and banking stresses. Yet American business and consumers have remained optimistic. Strong jobs growth has allowed the US unemployment rate to end the year at a very low 3.7%. Wages growth has held at solid 5% annual pace given worker shortages. Even the US housing market has held up well with house prices making mild gains and construction activity stabilising. Essentially, the squeeze from high inflation and interest rates proved less troublesome than expected.

Europe disappointed with weak economic activity. Germany which is renowned as Europe's 'industrial powerhouse' has stagnated with the loss of cheap energy supply from Russia and weaker export demand from China. The United Kingdom also struggled as consumers have trimmed their spending given rising energy and food costs as well as higher interest rates.

China's economic slowdown and the financial woes of their property developers captured headlines throughout the year. There was optimism that China's economy would post a strong recovery in 2023 after the ending of the national government's "Zero-COVID" strategy of lockdowns in late 2022. However, China's growth has been constrained by the national government's intense scrutiny of property and technology companies and the reluctance to provide significant budget and interest rate stimulus.

Australia's economy is struggling

Australia's economy also underperformed in the past year. The impact of higher goods and services prices, rising mortgage interest rates and rents generated a very 'painful squeeze' for Australian consumers. Consumer sentiment is particularly negative with household budgets being stretched. As a result, consumers have been cautious in their retail spending as well as committing to new housing construction. Notably the Australian economy is in a 'per capita' recession where population growth at circa 2.5% exceeds annual real economic growth at 2.1% for the September quarter.

However there have been positive surprises. Australia's labour market has recorded solid job gains and the unemployment rate remains low at 3.9%. Business investment and government infrastructure spending have made strong contributions to job gains as well as broader economic activity.

The RBA raised the cash interest rate five times in 2023. The most recent interest rate rise by 0.25% to 4.35% in November was motivated by the RBA's view that inflation is "still too high and is proving more persistent than expected." However, there were hopeful signs at the end of 2023 that inflation pressures were starting to fade and that interest rates may have peaked. The most recent November consumer annual inflation result came in a 4.3% which is the lowest in two years.

A favourable year for investment returns even with inflation, interest rates and political risks

Global shares experienced considerable turbulence in 2023 but still managed to climb the 'wall of worries'. Inflation concerns, rising interest rates, as well as the tragic Russian – Ukraine and Hamas – Israel conflict have provided significant headwinds to global share prices. Encouragingly, global share returns have been very strong for the past year. Optimism over the promise of 'Artificial Intelligence' (AI), lower inflation outcomes and the encouraging resilience in the American economy have been the key drivers.

Global shares (unhedged) recorded an extraordinarily strong 21.4% return in 2023. This gain was also assisted by a weaker Australian dollar. By comparison, global shares (hedged) did not benefit from the falling Australian dollar but still managed to deliver a very strong 19.9% annual return

Table 1: Asset class returns in Australian dollars – periods to 31 December 2023

Asset class	Returns			
	1 yr	3 yrs (pa)	5 yrs (pa)	10 yrs (pa)
Cash	3.9%	1.7%	1.4%	1.8%
Australian bonds	5.1%	-2.7%	0.6%	2.6%
Global bonds (hedged)	5.3%	-3.1%	0.5%	2.6%
Global high yield bonds (hedged)	10.4%	0.5%	4.0%	4.4%
Global listed infrastructure (hedged)	-0.8%	3.5%	4.9%	6.8%
Global property securities (hedged)	7.9%	1.7%	1.9%	4.5%
Australian shares	12.4%	9.2%	10.3%	7.9%
Global shares (unhedged)	21.4%	10.2%	12.4%	10.9%
Global shares (hedged)	19.9%	5.9%	10.6%	8.7%
Emerging markets (unhedged)	9.2%	-1.1%	4.3%	5.5%

Past performance is not a reliable indicator of future performance.

Sources: FactSet, MLC Asset Management Services Limited. Benchmark data: Bloomberg AusBond Bank Bill Index (cash), Bloomberg AusBond Composite 0+ Yr Index (Aust bonds), Bloomberg Barclays Global Aggregate Index Hedged to $A (global bonds), Barclays US High Yield Ba/B Cash Pay x Financials ($A Hedged) (global high yield bonds) FTSE Global Core Infrastructure 50/50 Index Hedged to $A, FTSE EPRA/NAREIT Developed Index (net) hedged to $A (global property securities), S&P/ASX200 Total Return Index (Aust shares), MSCI All Country World Indices hedged to $A and unhedged (net) (global shares), and MSCI Emerging Markets Index (net) unhedged to $A (emerging markets).

Australian shares as measured by the ASX 200 made a strong 12.4% return for the year. The sharpest annual gains were in the Information Technology sector (31.3%) which accords with the global mania for technology. Consumer discretionary stocks (22.3% return) and financial sector shares (11.2% return) delivered surprisingly strong gains despite the challenge of higher inflation and interest rates squeezing consumers. The Resources sector also made strong gains of 12.8% given the benefit of strong commodity prices and a lower Australian Dollar boosting profits.

Australian fixed interest managed a solid 5.1% annual return while global bonds (hedged) delivered a 5.3% annual return. Milder inflation and signs of a slowing global economy encouraged investors that lower interest rates were on the horizon. Global high yield bonds (hedged) made a very strong 10.4% annual gain as investors found the elevated yield of corporate bonds more attractive.

Global property securities made an encouraging 7.9% return after a tough run of negative years during the pandemic. The hope for lower interest rates in coming years has mitigated concerns about "working from home" negatively impacting office occupancy.

Global prospects

Global share prices favourably surprised investors in the past year by making strong gains. The mania for Artificial Intelligence "AI" and technology has been the key driver. There is also confidence that the inflation threat has faded which could lead interest rates to fall in the next year.

However, these exuberant expectations may not be fulfilled if inflation proves more persistent and central bankers are more stubborn in lowering interest rates. The continued tragic Russian-Ukraine War and Hamas-Israel conflict are key threats to global economic stability and investor sentiment. Investors will also need to contend in 2024 with national elections in the United Kingdom, India, Indonesia, Mexico and the United States which could transform the global political landscape.

Accordingly, there are significant inflation, interest rate and political risks that investors should be cautious of. Assessing these complex risks is particularly challenging. Given there are multiple positive and negative outcomes possible over the next year, investors should maintain a disciplined and diversified strategy.

Important information