

# Quarterly economic and market update

April 2023

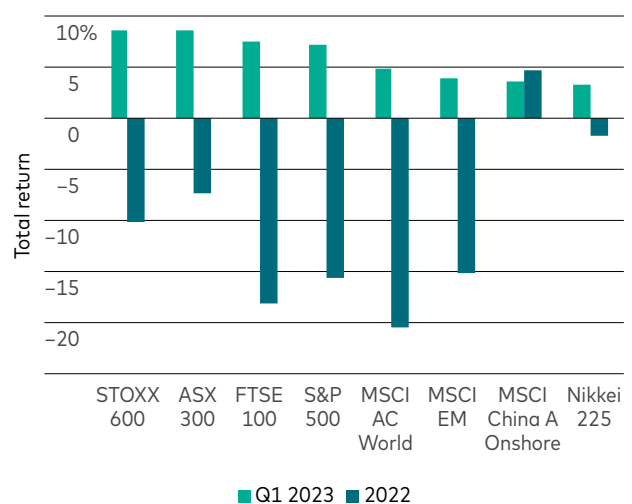
## Quarter in review

Global markets advanced through the first quarter of 2023 with generally positive returns in both equity and bond markets. Inflation and the tightening of central bank policy remained in the spotlight for the markets, punctuated by a spike of volatility triggered by the failing of two large U.S. banks in March, and UBS's takeover of the failing Credit Suisse in Europe.

The global equity market experienced a strong start in January as markets looked towards signs of fading inflation as a signal that central banks may soon pause the interest rate hiking cycle, providing relief to borrowers. However, markets reversed course over February as stronger-than-expected inflation data prompted central banks to continue hiking. In March, the collapse of SVB contributed to a spike in volatility, but the tension was eased as central banks and regulators intervened, soothing market concerns over the banking sector.

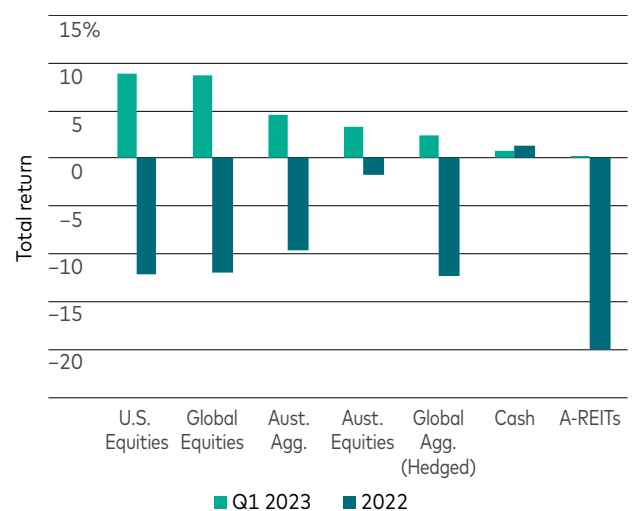
Overall, global equity markets closed the quarter 7.2% higher in local currency terms (**Figure 1**) as equity indexes held on to their January gains. The S&P/ASX 300 Index returned 3.3% over the quarter as all sectors except energy and financials advanced. Similar sector weakness in global equities were offset by a resurgence in technology companies. Emerging markets stocks returned 3.8% over the quarter, weaker than their developed peers, as the U.S. dollar strengthened in February, which can be a headwind for emerging markets equities. Bonds also advanced as investors sought safe-haven assets and expectations for interest rate rises eased (**Figure 2**).

**Figure 1.** Global equities gained



**Note:** Returns are cumulative total returns in local currency.  
**Sources:** FactSet, as of 31 March 2023.

**Figure 2.** AUD indexes broadly advanced



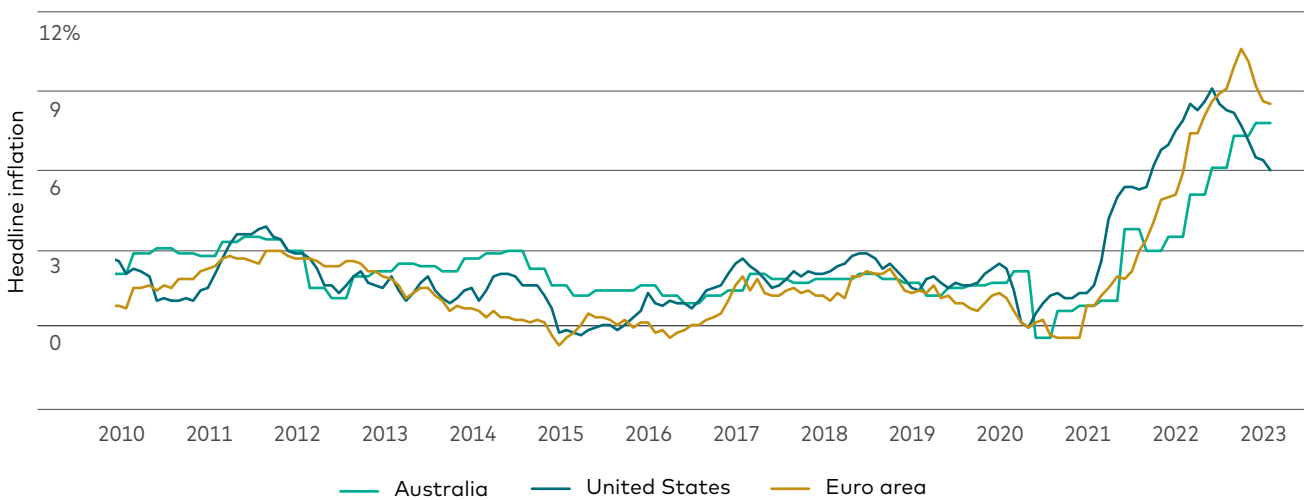
**Note:** Returns are cumulative total returns denominated in AUD.  
**Source:** FactSet, Refinitiv, as of 31 March 2023.

## Economic and market outlook

Since the pandemic, the global economy has recovered strongly, with the demand for goods and services generally outstripping supply. This has helped push inflation to its highest level since the early 1990s and compelled central banks to raise interest rates rapidly in an effort to cool the economy and re-anchor inflation. In Australia, the Reserve Bank of Australia (RBA) has raised interest rates from 0.1% to 3.6% since May 2022, but inflation unfortunately remains well above the RBA's 2–3% inflation target.

Recent data suggest that inflation has likely peaked, with headline inflation falling from a high of 9.1% to 6.4% in the United States and from 10.6% to 8.6% in the euro area (see **Figure 3**). Australia's quarterly inflation data, widely seen as the most reliable gauge for inflation, has also likely peaked. More timely Australian inflation-related measures suggest that inflation is now on a downward path.

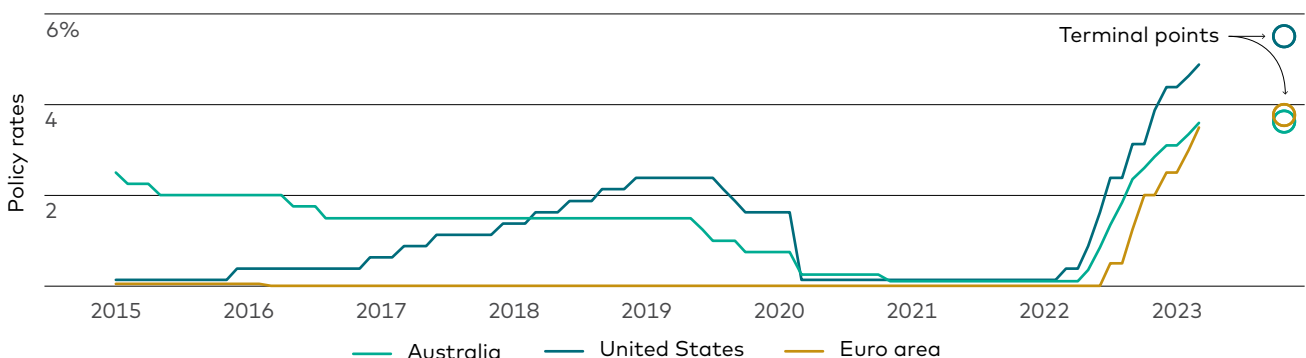
**Figure 3.** Inflation has peaked in most developed markets



**Sources:** Bloomberg, as of 5 April 2023.

With inflation pressures easing, we expect central banks, including the RBA, the U.S. Federal Reserve and the European Central Bank, to soon pause the interest rate hiking cycle (see **Figure 4**). A pause allows central banks time to assess the impact of higher interest rates, which typically take one to two years to fully pass through to economic growth and inflation. However, the key risk is that inflation remains stubbornly high and central banks are forced to resume the hiking cycle.

**Figure 4.** Interest rates are close to their terminal point



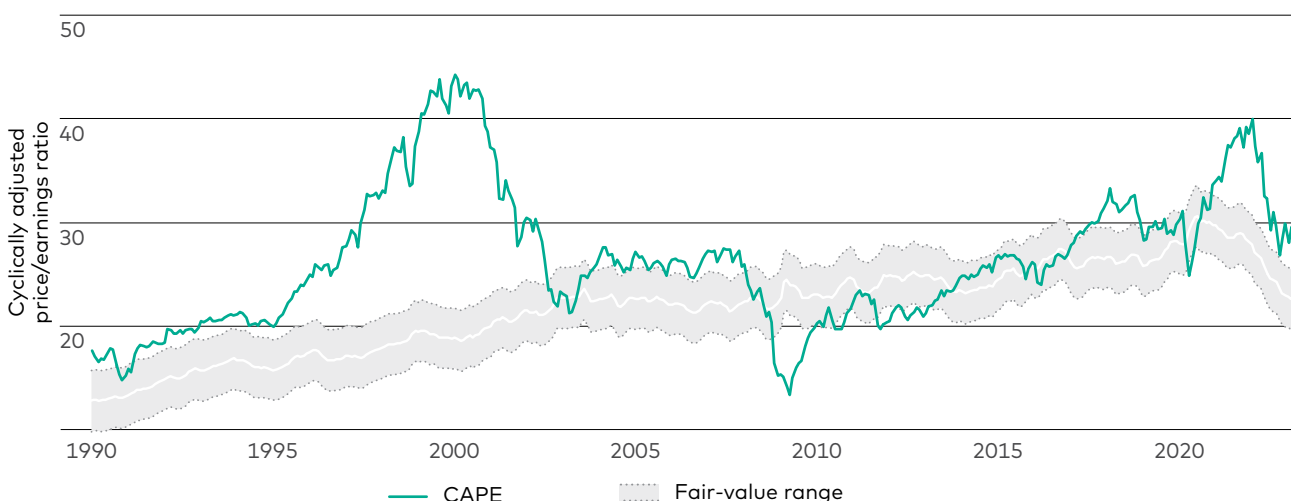
**Source:** Bloomberg historical data and Vanguard forecasts, as of 5 April 2023.

Markets have remained focused on inflation and central bank policy year to date, driving volatility in equity and bond markets alike. Clear signs have now emerged that inflation has peaked, and as such markets are now pricing in a slowing pace of interest rate hikes. This has resulted in falling yields that have benefited bond prices quarter-to-date but are expected to moderately reduce forward-looking returns. Despite recent declines, yields and fixed income valuations continue to be more attractive than they were a year ago when interest rates sat close to historic lows.

Meanwhile, equity valuations have remained relatively robust year-to-date despite a guarded view on corporate earnings. **Figure 5** shows a long-term measure of U.S. equity valuations, the cyclically adjusted price-earnings (CAPE) ratio, against Vanguard's estimates of fair value. Although cheaper markets are more fairly priced than a year ago, valuations are still sitting above their fair value when adjusting for current levels of interest rates and inflation. This presents potential downside risks for equities particularly if inflation remains stickier or if earnings expectations disappoint.

As volatility persists it's as important as ever for investors to remember their investment plans. For most investors, ensuring their plans continue to align with their investment goals, staying diversified, and maintaining discipline, are all well worth a reminder.

**Figure 5.** U.S. equity valuations are still above our estimates of fair value



**Notes:** "Fair-value CAPE" is based on a statistical model that corrects CAPE measures for the level of inflation and interest rates. The statistical model specification is a three-variable vector error correction, including equity-earnings yields, 10-year trailing inflation, and 10-year U.S. Treasury yields estimated over the period January 1940 to March 2023.

**Source:** Vanguard calculations, based on data from Refinitiv, 31 March 2023.

## Connect with Vanguard™

[vanguard.com.au](https://vanguard.com.au)

1300 655 101

The Vanguard logo is displayed in a bold, red, serif font. The word "Vanguard" is written in all lowercase letters, with a registered trademark symbol (®) at the end.

Vanguard Investments Australia Ltd (ABN 72 072 881 086 / AFS Licence 227263) is the product issuer and the Operator of Vanguard Personal Investor. We have not taken your objectives, financial situation or needs into account when preparing the information so it may not be applicable to the particular situation you are considering. You should consider your objectives, financial situation or needs, and the disclosure documents for Vanguard's financial products before making any investment decision. Before you make any financial decision, you should seek professional advice from a suitably qualified adviser. A copy of the Target Market Determinations (TMD) for Vanguard's financial products can be obtained at [vanguard.com.au](https://vanguard.com.au) free of charge and include a description of who the financial product is appropriate for. You should refer to the TMD for Vanguard's financial products before making any investment decisions. You can access our IDPS Guide, PDSs Prospectus and TMD at [vanguard.com.au](https://vanguard.com.au) or by calling 1300 655 101. Past performance information is given for illustrative purposes only and should not be relied upon as, and is not, an indication of future performance. This publication was prepared in good faith and we accept no liability for any errors or omissions. The funds or securities referred to herein are not sponsored, endorsed, or promoted by MSCI, and MSCI bears no liability with respect to any such funds or securities. The prospectus or the Statement of Additional Information contains a more detailed description of the limited relationship MSCI has with Vanguard and any related funds. © 2023 Vanguard Investments Australia Ltd. All rights reserved.

QEMUBC\_042023