



Economic & Investment Update - April 2024

The first quarter of 2024 was marked by continued strength for risk assets, with a number of major equity indices extending record highs. While softening, stubborn inflation tempered market expectations of imminent interest rate cuts and geopolitical tensions kept oil prices elevated. Nonetheless, resilient economic data and earnings announcements buoyed investors.

US economic data was broadly positive, which saw predictions of a recession in the US fall. Annualised GDP growth for Q4 was revised up to 3.4% supported by sustained consumer spending. However, inflation was slightly higher than expected in both January and February, which prompted the US Federal Reserve to caution against cutting rates. As it stands, the market is currently pricing in three 25 basis points cuts in 2024, down from an expectation of six at the start of the year.

In Europe, signs of improving business activity emerged in Southern Europe, driven largely by a rebound in the services sector. However, with a further weakening in manufacturing, Germany continued to struggle. While inflation rates cooled, figures exceeded forecasts and the European Central Bank indicated that a cautious approach would be taken on future interest rate cuts.

In Japan, the Bank of Japan (BOJ) set a short-term interest rate at 0.0% to 0.1%, indicating a shift from the long-term negative interest rate policy. This demonstrated the BOJ's confidence in Japan's macroeconomic development. At the same time, the BOJ committed to maintaining its accommodative policy stance, providing some comfort to the currency market and leading to further weakening of the Japanese yen.

China's economy made a stronger than expected start to the year, even as the crisis in its property sector deepened and retail sales weakened. According to official data, annualised growth expanded by 5.3% in the March quarter, beating expectations. Premier Li Qiang announced an ambitious 2024 economic growth target of around 5%, promising steps to transform the country's development model towards high-tech manufacturing and away from substantial infrastructure and property spending.

In Australia, data releases confirmed economic growth had stalled, despite Australia's swelling population and strong employment market. Household consumption remained particularly weak amid strong domestic price pressures and higher interest rates. The RBA kept the cash rate at 4.35% throughout the March quarter with the bank's previous bias toward further rate hikes moderated to a more neutral stance as inflation fell.

MARKETS

In Australia, the S&P/ASX 200 Accumulation Index returned 5.3% over the March quarter. Information Technology stocks generated the best sector return, up 23.6% driven by the Artificial Intelligence-led rally in mega-cap US tech names. However, weakness in China and falling iron ore and lithium prices resulted in the Materials sectors shedding 6.3% for the quarter.

Smaller ASX-listed companies (top 100-300) returned 7.6% for the quarter, outperforming the return of the S&P/ASX 200 Accumulation index.

Global equity markets continued to rally in the March quarter with the MSCI World (ex-Australia) Net Return Index (AUD hedged) up 10.1%. With the Australian Dollar weaker, unhedged investment returns were enhanced, up 14.1% for the quarter.

Developed markets generated strong returns with the Japanese Nikkei the strongest performer, up 20.6% for the quarter, driven by strong earnings results, continued low interest rates and a weaker Yen. The broad-based US S&P 500 Index also performed well (+10.2%) as market momentum



S&P/ASX 200 Acc Index (Source: Google Finance)

boosted investor confidence and the US Federal Reserve reiterated their commitment to rate cuts in 2024.

However, Chinese markets struggled, particularly early in the quarter, as manufacturing activity shrank for a fourth straight month and the liquidation of property giant 'Evergrande' impacted investor sentiment. With Chinese authorities intervening to help stabilise the local equity market, Chinese shares (as measured by the Shanghai Shenzhen CSI 300 Index) ultimately finished up 3.1% for the quarter while the Hong Kong Hang Seng Index was down 3.0%.

The domestic property sector also generated strong returns for the quarter (+16.8%) buoyed by a fall in the Australian 10-year bond rate, slowing inflation and continued Merger and Acquisition activity. Global property securities finished down 0.1% for the quarter as falling property valuations led to lower returns in most regions outside the Asia-Pacific.

Bond markets moved cautiously over the March quarter as investors sought clarity on future monetary policy direction. Domestic bonds, as measured by the Bloomberg AusBond Composite Index) gained 1.0% while the Bloomberg Global Agg TR Index (AUD Hedged) finished down 0.3%.

The table below (sourced from Lonsec) summarises the returns from a number of market sectors.

Sector	Index	3 mths (%)	1 year (%)	5 years (% p.a.)
<u>Equities</u>				
Australia	S&P/ASX 200 TR (Accumulation) Index	5.3	14.5	9.2
	S&P/ASX Small Ordinaries TR (Accum) Index	7.6	13.8	5.4
International	MSCI World ex Aust NR Index (AUD)	14.1	28.7	14.1
	MSCI World ex Aust NR Index (AUD Hedged)	10.1	25.0	11.1
Emerging Mkts	MSCI Emerging Mkts NR Index (AUD)	7.1	11.0	4.0
<u>Listed Property</u>				
Australian	S&P/ASX 200 A-REIT TR (Accumulation) Index	16.8	36.6	6.5
International	FTSE EPRA/NAREIT Dev NR Property Index (AUD Hedged)	-0.1	7.7	-0.8
<u>Infrastructure</u>				
Global	S&P Global Infrastructure TR Index (AUD Hedged)	2.8	3.7	4.3
<u>Currencies</u>				
AUD v USD	Against US Dollar	-4.3	-2.5	-1.7
<u>Fixed Interest</u>				
Australian	Bloomberg Ausbond Composite All Maturities	1.0	1.5	0.2
	Bloomberg Ausbond Credit All Maturities	1.4	4.7	1.7
International	Bloomberg Global Agg TR Index (AUD Hedged)	-0.3	2.5	-0.1
<u>Commodities</u>				
Gold	Gold Spot Price – AUD	13.1	16.2	13.4
Oil	WTI Oil \$/b – USD	-6.4	-3.8	7.1

OUTLOOK

Despite significant central bank interest rate hikes, the global economy is expected to remain relatively resilient. According to the International Monetary Fund, the global economy is forecast to grow by 3.2% during both 2024 and 2025. However, several economies are delicately balanced and could experience a marked economic slowdown (i.e. a hard landing).

With core inflation falling more slowly than expected in many developed economies, investors are now adjusting to an environment where inflation and interest rates are likely to remain 'higher for longer'. This has already spilled over into investment markets in recent weeks with bond yields rising sharply, equity markets pulling back from record highs and precious metal prices ballooning.

Regionally, the outlook diverges significantly with US forecast to continue to grow reasonably strongly, seemingly shrugging off the past two years interest rate rises. While positive for the economy, recent data has not supported the idea that inflation is under control and on a sustainable path back to the 2% target. There are now mixed opinions as to whether there will indeed be any rate cuts this year in the US.

In Europe, following a marked economic slowdown in 2023, the eurozone appears to be slowly emerging from a recession with the Union's two economic powerhouses of France and Germany improving, albeit slowly. With inflation continuing to ease, the European Central Bank has strongly hinted that it is still likely to begin reducing interest rates from a record-high 4% in June. Beyond this, it has been careful to leave its options open.

In China, while growth has been reasonably strong (5.3% for the March quarter), various structural challenges remain which may hinder future economic growth. The world's second largest economy continues to struggle to mount a strong and sustainable post-COVID bounce, burdened by a protracted property downturn, mounting local government debts and weak private-sector spending.

Although the Bank of Japan has tightened its monetary policy, which would ordinarily restrain economic growth, Japan's economy is likely to strengthen particularly in the second half of this year. Monetary policy will remain relatively loose even if the central bank raises rates further while wages are poised to grow faster than inflation, which should reverse the decline in real consumer spending.

In Australia, while economic growth has largely stalled, there are some fears that interest rates could be hiked again as employment holds strong and inflation remains difficult to contain. Although inflation pressures have eased, the level of inflation (3.6% in the year to March) remains above the Reserve Bank's preferred target range of 2% to 3%, with core services inflation hovering around 4.0%.

Our views on the various asset classes are outlined below.

Australian Equities

Within Australian Equities, we recommend investors hold a neutral position in large cap stocks and smaller companies.

The outlook for Australian equities remains positive driven by strong commodity prices, population growth and a resilient consumer. Market valuations appears 'fair' with ongoing strength in iron ore prices and the potential for rate cuts during the 2024/25 financial year providing a positive backdrop for earnings growth over the year.

However, risks exist to the outlook for Australian equities and a delay in interest rate cuts may make equities particularly vulnerable as companies will be faced with higher funding costs and softening demand for their goods and services.

International Equities

With the outlook for equity markets remaining challenging, we recommend investors retain a neutral to underweight position to International developed markets and move to a neutral to underweight position to International emerging markets.

Global equity valuations appear stretched, particularly in the US, thanks to the stellar outperformance of the Magnificent 7 (Apple, Amazon, Alphabet / Google, Meta / Facebook, Microsoft, NVIDIA and Tesla) over the last 12 months, albeit with recent declines in the share prices of Apple, Meta/Facebook, NVIDIA and Tesla. Further bond yield increases have the potential to impact developed equity market valuations in the coming months.

Within emerging markets, while valuations look attractive on a relative basis, emerging markets currently look to be fairly priced, in line with their long-term average. However, with so much uncertainty around China and its growth outlook, emerging market risks are currently elevated.

Property

We recommend investors retain a neutral to underweight position to both Australian property and International property.

While domestic property share prices have recently softened in conjunction with rising bond yields, investors should be wary about buying into a market that has rallied strongly over the last 12 months. We maintain a negative view on office space (which remains structurally challenged) and the retail sector. We maintain a positive outlook for industrial property and are neutral on the healthcare sector.

Similar dynamics are at play in global property, hence we maintain our recommended neutral to underweight exposure to this sector.

Fixed Interest

Following recent rises in yields, Australian and International sovereign bonds are now trading close to fair value. Government bonds currently offer a reasonable coupon rate and historically have provided investors with a hedge against share market volatility. However, should bond yields rise, Australian and International sovereign bonds are at risk of further capital falls.

While not offering a similar hedge against share markets, higher rates continue to be available from term deposits.

Bank hybrids offer a strong return, albeit with some risk given their correlation to equity markets. Yields on corporate bonds look reasonable on face value but carry increased risk in the event of an economic downturn and credit contraction.

Alternatives

We retain a neutral setting for Infrastructure investments despite rising bond yields. Private Equity investments are expected to continue to be well supported, underpinned by strong returns, however given market uncertainty, we suggest that now is a good time to move towards a neutral position by realising investment gains.

In this climate of market uncertainty, we continue to support an allocation to gold or silver in diversified portfolios. Exposure to gold, either through gold producers or via an investment in physical gold, as well as physical silver, through ASX listed entities, acts as a risk-diversifier against a further deterioration in economic conditions or escalation in geopolitical tensions.

Sources: Lonsec, RBA, IMF. Please note that the information above is general in nature and does not take into account your personal circumstances, financial needs or objectives. Before acting on this information, you should consider its appropriateness having regard to your objectives, financial situation and needs. In particular, you should speak to Kevin Smith of The Professional Super Advisers on (02) 9955 5800 prior to acting upon this information.