Economic & Investment Update - October 2024

Despite subdued global economic growth and rising geopolitical tensions, moderating inflation and lower interest rates boosted investor sentiment over the September quarter, leading to solid portfolio returns.

A shift in investor sentiment occurred as confidence increased that a majority of central banks globally had broken the back of the inflation upsurge that emerged following the Covid pandemic and the energy supply crunch sparked by Russia's invasion of Ukraine.

Following the release of lower inflation data, the Bank of Canada, European Central Bank and Bank of England all lowered interest rates early in the quarter. With August's inflation rate less than forecast (2.5% annualised), the US Federal Reserve eventually followed suit and cut interest rates by a larger than expected 0.5%, to 5.0% in September.

However, Japan bucked the trend and with annual inflation increasing to 3% in August and positive real wage growth, the Bank of Japan unexpectedly increased interest rates from 0.1% to 0.25% in August (the first interest rate rise in Japan in 17 years). This led to significant market volatility with the strengthening Japanese Yen impacting various trading strategies and resulting in the Japanese equity market posting its biggest one-day fall since 1987.

In China, as concerns of an economic slowdown increased, authorities announced new stimulus measures in September to help boost the economy, specifically the property sector and equity markets. The Chinese central bank cut key interest rates and continued to pledge further support and inject liquidity into the financial system.

Domestically, economic growth remained weak with growth over 2023-24 the weakest since 1991-92 (excluding the pandemic). Despite this, interest rates were again left unchanged at 4.35% with the RBA arguing that inflation was still too high and coming down too slowly.

MARKETS

In Australia, the S&P/ASX 200 Accumulation Index was up 7.8% over the September quarter. Information Technology stocks generated the best sector return, up 15.3% for the quarter, as ongoing AI enthusiasm supported the sector. The Materials sector was boosted by China's stimulus announcements which helped lift the sector's quarterly return (+10.8%). However, weaker oil demand resulted in the Energy sector producing the lowest quarterly return (-6.4%).

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

Smaller ASX-listed companies (top 100-300) returned +6.5% for the quarter, slightly underperforming the return of the S&P/ASX 200 Accumulation Index. However, investors rotated toward smaller caps in September due to their potential to benefit from lower interest rates.

Global equity markets continued to rally in the September quarter with the MSCI World (ex-Australia) Net Return Index (AUD hedged) up 4.4%. With the Australian Dollar strengthening, unhedged investment returns were reduced to 2.3% for the quarter.

In the US, the 0.5% interest rate cut and signs of resilience in the US economy lifted investor confidence with the Dow Jones Industrial Index up 8.2%, and the broader based S&P 500 Index, up 5.5%. However, the tech heavy Nasdaq index lagged and finished up only 2.8% with 5 of the "Magnificent 7" (Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia, and Tesla) finishing lower.

The Japanese market as measured by the Nikkei 225 PR index fluctuated wildly and finished down 4.2% for the September quarter.

Chinese markets performed strongly, buoyed by the stimulus measures announced in September, with the Shanghai Shenzhen CSI 300 PR index up 16.1% over the quarter.

The Australian property market, as measured by the S&P / ASX 200 A-REIT Accum Index accelerated strongly over the quarter, with the index up 14.5%. Domestic REITs reacted positively as the risk of further interest rate rises decreased. Global property securities and global infrastructure also performed well, finishing up 13.5% and 11.3% respectively, for the quarter.

Bond markets also rallied over the September quarter, both locally and internationally, as yields fell. Domestic bonds returned 3.0% for the September quarter whilst global bonds returned 4.0%, as interest rate cuts helped drive up bond prices.

Within the commodity sector, gold performed strongly returning +9.0% for the September quarter and +32.6 over the last 12 months with the strength in gold a result of continued and increasing geopolitical uncertainty, coupled with an easing in monetary conditions.

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.)
Equities				
Australia	S&P/ASX 200 TR (Accumulation) Index	7.8	21.8	8.4
	S&P/ASX Small Ordinaries TR (Accum) Index	6.5	18.8	4.4
International	MSCI World ex Aust NR Index (AUD)	2.3	23.2	12.5
	MSCI World ex Aust NR Index (AUD Hedged)	4.4	29.3	11.7
Emerging Mkts	MSCI Emerging Mkts NR Index (AUD)	4.7	17.3	5.2
Listed Property				
Australian	S&P/ASX 200 A-REIT TR (Accumulation) Index	14.5	47.0	7.0
International	FTSE EPRA/NAREIT Dev NR Property Index (AUD Hedged)	13.5	25.2	0.3
Infrastructure				
Global	S&P Global Infrastructure TR Index (AUD Hedged)	11.3	26.8	5.6
Currencies				
AUD v USD	Against US Dollar	3.6	7.4	0.5
Fixed Interest				
Australian	Bloomberg Ausbond Composite All Maturities	3.0	7.1	-0.4
	Bloomberg Ausbond Credit All Maturities	3.1	8.0	1.5
International	Bloomberg Global Agg TR Index (AUD Hedged)	4.0	9.1	-0.4
Commodities				
Gold	Gold Spot Price – AUD	9.0	32.6	11.7

OUTLOOK

While global economic growth is expected to remain subdued, moderating inflation and further interest rates cuts are likely to support the global economy during the remainder of 2024 and into 2025. According to the International Monetary Fund (IMF), global economic growth is expected to ease slightly to 3.2% in 2024 and remain at this level in 2025 while global inflation is expected to continue to fall. However, geopolitical risks continue to loom large and pose a downside risk to forecasts. Uncertainty is expected to increase in the lead up and potentially following the US Election in November alongside the continued impact of the conflicts in Ukraine and the Middle East.

In the US, economic growth is likely to slow but not stall and a "hard economic landing" (i.e. a recession) is now on balance, expected to be avoided. Given that the easing cycle commenced in September, further interest rate cuts are expected into 2025 with the pace and size of rate cuts dependent on future economic growth and inflation readings.

In Europe, growth is trending higher, but remains low by historical standards. France and Spain have seen improvements in their growth outlooks while Germany remains weak as a result of its persistent weakness in manufacturing. Consumer spending and investment should become the main drivers of growth as real incomes accelerate and interest rates fall.

Japanese growth is expected to slow sharply to just 0.3% this year, before accelerating to 1.1% next year, boosted by private consumption as real wage growth strengthens.

In China, despite the recent announced stimulus, growth is expected to continue to slow over 2024 and 2025. The property downturn remains a drag on economic activity depressing confidence and spending.

In Australia, while population growth and a resilient consumer continues to support the economy, inflation is likely to remain above the RBA's 2% to 3% target range. The RBA is expected to keep +in both inflation and the labour market.

Our views on the various asset classes are outlined below.

<u>Australian Equities</u>

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

After the recently concluded Australian corporate profit reporting season, consensus estimates for FY25 profit growth have continued to slide lower.

Following recent gains, Australian equity valuations look stretched and require a re-rating in bank and resource earnings which does not seem forthcoming. While expected profit growth in the Industrial sectors is attractive, this also looks to be largely priced in already. Risks still exist to the outlook for Australian equities and further delays in interest rate cuts may make equities particularly vulnerable as companies will continue to manage high funding costs and soft demand for their goods and services.

<u>International Equities</u>

With the outlook for equity markets improving, we recommend investors retain a neutral position in International developed and emerging markets.

The onset of the interest rate easing cycle should lower companies funding costs, help increase consumer spending and boost corporate investments.

Within developed markets, a meaningful valuation gap has emerged between the US large caps and other markets with Japan and Europe exhibiting more sensible prices for reasonable earnings growth. However, small to mid-cap US stocks continue to look attractive from a valuation perspective with falling interest rates providing additional support.

Within emerging markets, while valuations look attractive on a relative basis, risks continue to be elevated given the continued uncertainty around China.

Regarding currency, falls in global interest rates and a stable rate in Australia is supportive of a stronger Australian Dollar, albeit that global conflicts may help to support the US Dollar. As such, consideration should be given to hedge global currency exposure.

Property

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

Despite recent gains, valuations remain attractive. While the RBA seems to be a long way off from cutting the cash rate, markets are forward looking and are anticipating domestic interest rate cuts in 2025. At a sector level, 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 markets however, interest rate cuts have already commenced in many regions with more expected. Global property also provides greater breadth and depth of opportunities.

Fixed Interest

We recommend investors retain a neutral position to Fixed Interest.

Bond yields are offering good value (especially in Australia) and offer protection should equity markets experience a downturn. Furthermore, valuations receive support in a climate of falling official interest rates.

Yields on corporate bonds look reasonable but carry increased risk in the event of an economic downturn and credit contraction. As such, we favour Australian corporate debt over global debt. Floating rate corporate debt still looks attractive but as rates fall, fixed rate debt will come to the fore.

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.

Alternatives

We retain a neutral to overweight setting to Infrastructure especially given the current global easing interest rate environment. Private Equity investments are expected to continue to be well supported.

Despite recent record valuations, 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.