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Count
The confidence to look ahead

Market **Wrap**

January 2024

Economic and market overview

- A rally in the second half of the month helped global share markets generate solid gains in January, extending the rally from November and December.
- The latest indicators suggest economic conditions are holding up quite well in most regions, which augurs well for corporate earnings.
- With inflation still above central bank targets, investors pared back their expectations for interest rate cuts this year. At the beginning of January investors had been anticipating six rate cuts in the US this year, with the first expected in March. That timing now seems unlikely, with policy settings more likely to be eased a little later.
- It was a similar story elsewhere, with investors conceding that policy settings are unlikely to be loosened as much as previously thought in the near term.
- Bond yields rose against this background, which weighed on returns from fixed income markets.
- Geopolitical risk remained elevated, particularly in the Middle East. A series of attacks on commercial vessels in the Red Sea by Houthis – a Yemen-based group, backed by Iran – prompted some shipping companies to divert Asia-Europe traffic around the tip of Africa, instead of through the Suez Canal, increasing freight times and costs. In some cases, shipping costs have more than trebled over the past two months, which could feed through to consumer goods inflation and, in turn, make it less likely that central banks will lower interest rates.

- **US**: GDP growth in the December quarter was stronger than anticipated. The economy grew 2.5% in 2023 as a whole, supported by robust consumer spending.
- Retailers enjoyed strong pre-Christmas trading, according to the latest retail sales data. Discretionary spending appears to be holding up well despite higher borrowing costs, perhaps owing to the strong labour market and a good level of wage growth.
- The latest employment data suggested US firms remain quite optimistic about their future prospects. More than 200,000 new jobs were created in December, which was above forecasts.
- Most importantly of all, annualised inflation in December quickened from the prior month and was comfortably above consensus forecasts.
- Combined, these data led investors to question whether policymakers will be willing to lower interest rates in the near term. There had been speculation that the Federal Reserve would lower borrowing costs in March, but by month end traders were only pricing in a 35% likelihood of such a move.
- In other news, Donald Trump appears likely to be selected as the nominee for the Republican Party in November's election, following landslide victories against other candidates in two States.
- A Trump vs Biden contest would be a re-run of the 2020 election and promises to dominate the news agenda in the US for most of this year.

- **Australia**: All measures of inflation slowed sharply in the December quarter, which was consistent with previous guidance from Reserve Bank of Australia policymakers. At the headline level, consumer prices rose at an annual pace of 4.1%, down from 5.4% in the September quarter.
- Inflation remains significantly above the 2% to 3% target, but officials will nonetheless be happy with the direction of travel.
- The economy lost more than 65,000 jobs in December, which surprised economists and came after four months of gains.
- Combined with moderating inflation, any prolonged downturn in the labour market would likely increase the probability of interest rates being cut in the months ahead.
- The latest projections suggest official borrowing costs will be lowered in the second half of 2024 and by between 0.50% and 0.75% by the end of the year.

- **New Zealand**: Inflation slowed to 4.7% year-on-year, which was in line with consensus forecasts.
- Business confidence levels improved, which prompted some observers to suggest policymakers might be hesitant to lower official borrowing costs as quickly as previously thought.
- At the beginning of January, a rate cut in May had been fully priced into the market. During the course of the month, however, the probability fell to around 50%.

- **Europe:** Inflation in France and Germany continued to ease, consistent with forecasts from European Central Bank officials.
- Nonetheless, policymakers poured cold water on investors' expectations for interest rate cuts in the near term, indicating that official borrowing costs are unlikely to be lowered until the middle of the year at the earliest.
- This could disappoint manufacturers, which continue to struggle against a background of stalling demand. Industrial output in Germany shrank 2% in 2023, for example.
- Curiously, employment trends are holding up quite well despite the subdued economic backdrop. Unemployment has fallen to a record low of 6.4% in the Eurozone, which could feed through to wage demands and, in turn, further inflationary pressures. According to the European Central Bank, wages rose more than 5% in 2023.
- In the UK, inflation quickened in December for the first time in eleven months. Again, this prompted investors to pare back their expectations for interest rate cuts in the near term.

- **Asia/EM**: Q4 GDP growth data were released in China. Real GDP was reported at 5.2% for the full 2023 year, while nominal GDP came in at 4.2% owing to the deflation seen last year.
- Apart from Covid-affected 2020, this was the slowest annual growth rate in the world's second-largest economy since the mid-1970s.
- Home sales remain subdued and a downturn in import volumes suggests households and business are cutting back on discretionary expenditure.
- Authorities appear concerned about the outlook for the year ahead too and responded by lowering the *reserve requirement ratio*, which determines how much cash banks need to keep in reserve. The policy change is designed to make more cash available for lending, in turn boosting spending and supporting overall economic activity levels.
- In Japan, comments from central bank officials were closely scrutinised, as investors believed policymakers were preparing to raise interest rates for the first time since 2007.
- Inflation remains significantly above the long-term average, questioning the rationale for persevering with negative rates.

Australian dollar

- The AUD weakened by 3.6% against the US dollar in January. This primarily reflected broad-based strength in the USD, rather than any local influences affecting the 'Aussie'. The USD strengthened against most major currencies, following strong employment data and higher-than-expected inflation.
- That said the AUD weakened against other majors too, depreciating by 1.9% against a trade-weighted basket of international currencies.

Australian equities

- Australian equities closed January at an all-time high, surpassing levels not seen since August 2021. The market was buoyed by cooler-than-expected local inflation figures and growing expectations that the Reserve Bank of Australia would leave interest rates on hold at its February meeting.
- The S&P/ASX 200 Accumulation Index ended January 1.2% higher.
- The Energy sector outperformed, soaring 5.2% as escalating tensions in the Middle East bolstered oil prices. Uranium miners Boss Energy and Paladin Energy also generated stellar returns, between 30% and 40%, given tight global supply and demand fundamentals for the commodity. Sentiment towards these stocks also improved following news that one of the world's largest uranium producers had cut its production.
- The Financials sector (+5.0%) also fared well, supported by insurance stocks. AUB Group (+10.5%), QBE Insurance Group (+7.0%) and Insurance Australia Group (+6.7%) all made positive contributions.
- The lithium price came under pressure, adversely affecting miners such as Sayona Mining (-43.7%), Liontown Resources (-37.6%) and Arcadium Lithium (-20.6%). These stocks were among the worst performers in the Materials sector (-4.8%).
- Iron ore prices oscillated during the month, initially rising but then dropping back and closing the month little changed. The price movements were driven by changing expectations for steel demand in China, Australia's largest iron ore customer, alongside reports of further deterioration in the Chinese property market.
- The Utilities sector (-1.5%) was among the laggards, with APA Group (-0.6%) and AGL Energy (-8.5%) offsetting a positive contribution from Origin Energy (+0.6%).
- Small cap stocks underperformed their large cap peers, continuing the trend seen in 2023 where investors typically favoured larger, quality stocks. The S&P/ASX Small Ordinaries added 0.9% in January.
- Most ASX-listed companies will be announcing their semi-annual results during February. The resilience of earnings and the tone of outlook statements is likely to affect sentiment towards the local share market in the month ahead.

Global equities

- Share markets made a strong start to the new year, with the MSCI World Index rising to within a whisker of record highs. The Index added 4.5% in AUD terms during the month, extending the rally from November and December.
- Favourable moves in US-listed stocks set the tone. The S&P 500 Index hit fresh all-time highs, adding 1.7% over the month. Technology stocks continued to fare well too, which helped the NASDAQ rise 1.0%.
- Generally speaking, investors were anticipating another solid set of financial figures from listed companies for the fourth quarter and for the 2023 year as a whole. The outlook for earnings is encouraging too, given resilient economic activity and the probability of interest rate cuts in the months ahead.
- Interestingly, while the major US indices roared towards record highs, Chinese shares slumped to their lowest levels for more than three years. China's CSI 300 Index and the Hang Seng in Hong Kong closed January 6.3% and 9.2% lower, respectively, reflecting a broad-based economic downturn and under-whelming earnings prospects for the year ahead.
- Japanese shares performed much more strongly, leading the way among developed markets worldwide. The Nikkei added 8.4% over the month. After 35 years in the doldrums, Japanese shares are re-approaching record levels seen in the late 1980s.
- European markets were mixed, but made modest progress in aggregate. Swiss stocks were among the best performers in the region, while those in the UK and Spain underperformed.

Global and Australian fixed income

- The release of inflation data and evolving forecasts for official interest rates continued to affect bond yields and drive returns from fixed income.
- Government bond yields edged higher in all major markets, as the timing of anticipated rate cuts was pushed out. This was a headwind for fixed income and resulted in a return of -0.3% from the Bloomberg Global Aggregate Index in AUD terms.
- Despite higher-than-expected inflation readings in the US, benchmark 10-year Treasury yields were little changed over the month. The timing of the first interest rate cut could be delayed a little, but ultimately investors are still expecting policy settings to be eased significantly over the course of this year.
- More significant moves were seen in Europe. Yields on 10-year government bonds in the UK and Germany rose 0.26% and 0.14% respectively, as Bank of England and European Central Bank officials indicated rate cuts are unlikely in the near term.
- Yields on Japanese Government Bonds rose quite meaningfully too. No changes to monetary policy are anticipated at the next central bank meeting in March, but a subtle change in the tone of forward-looking commentary from officials was enough to push yields higher.
- Yields on 10-year Australian Commonwealth Government Bonds closed January slightly above their end-December levels. Yields had risen much more significantly in the first half of the month, but trended lower into month end – particularly following the release of lower-than-expected inflation data for the December quarter.

Global credit

- Global credit continued to fare well in January, following a period of very strong performance during November and December.
- Spreads on investment grade issues tightened, closing the month at their lowest levels for two years.
- European issuers performed particularly well, after GDP data showed the Eurozone economy avoided recession in the December quarter. Reasonably resilient activity levels and the prospect of rate cuts later in the year augur well for corporate earnings in the region and are helping support demand for high-quality credit.
- US names continued to perform well too, with a high level of new issuance not appearing to cause any indigestion in the market. Around US$240 billion of new corporate issues were priced during the month, which underlined the strong demand that exists currently for securities offering yields over and above those on offer from cash and comparable government bonds.
- In Asia, attention remained focused on the beleaguered property sector. Towards month end, a court in Hong Kong ordered the liquidation of developer China Evergrande Group. With more than US$300 billion of liabilities, Evergrande was the world's most indebted developer and had struggled to come up with a credible restructuring program over the past two years.
- The episode highlights the peril of over-leveraging for companies and provides a reminder of the importance of careful security selection in this asset class.

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