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The confidence to look ahead

Market **Wrap**

March 2024

Economic and market overview

- Investors scrutinised comments from central banks, trying to work out when interest rates might be lowered in key regions.
- The 'last mile' of the inflation journey is proving challenging and frustrating for central bank policymakers. While inflation has fallen sharply from Covid-related highs, pricing pressures persist and are preventing official inflation from falling back to target levels. In turn, it remains uncertain whether borrowing costs will be lowered this year and, if so, by how much.
- Equity markets shrugged these concerns aside, rising to fresh record highs in several regions.
- In Australia, the S&P/ASX 200 Index returned 3.3% and most other major markets enjoyed similarly strong gains.
- Fixed income registered positive returns too, particularly corporate bond markets where prospective yields over and above those available on comparable government bonds continued to appeal to investors.
- The 'risk on' rally extended to cryptocurrency markets. Bitcoin rose above the US$70,000 level for the first time, buoyed by record inflows.

- **US**: Headline inflation the US quickened in February, to an annual rate of 3.2% from 3.1% in January. Although the increase was only modest, it was unsettling to see any acceleration at all.
- Against this background, Federal Reserve Board members poured cold water on expectations for imminent interest rate cuts, suggesting that sticky inflation and the resilience of economic data means it is sensible to persevere with current policy settings for now.
- The latest manufacturing data also strengthened, again suggesting it could be imprudent to ease policy settings while economic activity levels are so buoyant.
- On the labour market front, a further 275,000 new jobs were created in February. This suggests US firms remain confident in the outlook for activity levels and profitability.
- Although the anticipated timing of the first rate cut has been pushed back, investors are still expecting the Federal Funds rate to be lowered three times in the remainder of this year.
- In other news, Donald Trump won the leadership contest of the Republican Party and will run against President Biden in November's repeat of the 2020 election. Persistently high inflation and elevated borrowing costs will undoubtedly be unwelcome for Biden as he seeks a second term in office.

- **Australia**: The Reserve Bank of Australia left interest rates on hold at 4.35%, but suggested borrowing costs are unlikely to rise any further in this cycle. References to possible additional rate hikes were removed from the statement that accompanied the formal interest rate announcement.
- Officials seem confident that inflation will fall back within the 2% to 3% target range in 2025, but are understandably hesitant to suggest borrowing costs could be lowered in the near term. At month end, investors were still expecting two rate cuts this year.
- The latest labour market indicators were surprisingly strong. More than 116,000 new jobs were created in February and the unemployment rate fell to 3.7%. The possibility of wage growth remaining elevated – feeding through to inflation – likely remains a key concern among Reserve Bank of Australia policymakers.

- **New Zealand**: The Reserve Bank of New Zealand did not meet in March and so other economic news dominated attention.
- The latest GDP data showed the economy slipped into recession in the second half of 2023. GDP fell 0.1% in the fourth quarter, following a 0.3% contraction in Q3.
- Higher borrowing costs appear to be hindering activity levels, underlining the desire for lower borrowing costs. Like elsewhere, however, officials remain concerned about persistently high inflation and the risk of cutting interest rates too soon.
- Policymakers have highlighted record immigration numbers and outlined the impact this could have on pricing pressures. As a result, the central bank has suggested interest rates are unlikely to be lowered this year. Time will tell whether the unexpectedly poor economic data will prompt a change in this guidance.
- Investors seem to think so, as three rate cuts are currently priced into forecasts before the end of this year.

- **Europe:** Interest rates were lowered by 0.25% in Switzerland – the first G10 country to ease borrowing costs in this cycle. The Swiss National Bank also lowered its inflation forecast.
- Inflationary forces appear stronger elsewhere in Europe. Headline inflation in the Eurozone was 2.6% year-on-year in February – above consensus forecasts – and the 'core' measure held above 3%.
- Economic indicators continue to worsen, particularly in Germany. Business sentiment fell further, consistent with data that showed a slowdown in overall growth. Manufacturing data also remains weak, suggesting Europe's largest economy might have remained in recession in the first quarter of 2024.
- An anticipated interest rate cut in the middle of the year will start to appear less likely unless pricing pressures moderate and inflation falls towards the European Central Bank's 2% target.
- Headline inflation in the UK fell to its lowest level in almost two and a half years, although Bank of England officials indicated it is still too early to lower official interest rates.
- Consensus forecasts still suggest borrowing costs in the UK will be cut three times later in the year.

- **Asia**: The economic outlook in China brightened, following news that export orders rose for the first time in a year. Moreover, Chinese exports topped all estimates in the first two months of 2024 in US dollar terms. Imports also exceeded expectations, suggesting authorities' efforts to stimulate domestic demand could be bearing fruit.
- Separately and according to the latest data, industrial production in China rose 7% in the first two months of the year; ahead of expectations.
- Chinese authorities reiterated their annual growth target of 5% for the world's second-largest economy.
- Elsewhere, the Bank of Japan finally abolished its negative interest rate policy, lifting official borrowing costs above zero for the first time in eight years.
- Previously announced GDP growth figures were revised upwards, although the Japanese economy remains fragile and policy settings appear likely to remain accommodative. Officials remain keen to keep interest rates low to encourage borrowing and, in turn, support activity levels.
- Expectations that rates will remain very low hindered the yen, which fell to its lowest level against the US dollar since 1990.

Australian dollar

- The AUD was little changed against a trade weighted basket of international currencies, appreciating by 0.4% against the US dollar for example.
- The AUD performed more strongly against the Japanese yen, closing the month up 1.2% to ¥98.59. This reflected broad-based weakness in the yen, rather than strength in the AUD.

Australian equities

- Australian shares fared particularly well in March on the back of rising commodity prices, lower bond yields, and hopes for interest rate cuts both domestically and offshore.
- The S&P/ASX 200 Index ended the month 2.6% higher, and was up 3.3% on a total return basis including dividends.
- Energy stocks tracked the stronger oil price, with news that OPEC+ members will extend voluntary production cuts.
- Gold prices rose above US$2,000/oz for the first time ever, which supported returns from selected miners and gold-related stocks in the Materials sector.
- Major banks Commonwealth Bank of Australia, ANZ Group and National Australia Bank performed strongly, contributing around 0.5% alone to the S&P/ASX 200 Index return. Less positively, Westpac shares declined over the month and the stock was a key detractor.
- Stocks in the Communication Services sector tended to struggle. Spark New Zealand, REA Group and Seek were among the worst performers, each closing the month between 4% and 8% lower.
- The Consumer Discretionary sector also underperformed the broader market, reflecting subdued performances from Collins Foods and Aristocrat Leisure. Negative contributions from these stocks more than offset stronger performance from Webjet, which added more than 25% following a positive investor day.
- Small caps performed even better than their larger cap peers, with the S&P/ASX Small Ordinaries Index adding 4.8%.
- Mesoblast was among the best performers, rallying 88.1% after the small biotech company received positive feedback from the US regulator regarding clinical data for its latest drug.

Global equities

- Several major share markets worldwide rose to fresh record highs in March, as investors maintained a healthy risk appetite.
- The MSCI World Index added more than 3% in AUD terms, led by further solid gains among US shares, in particular.
- The S&P 500 Index closed the month 3.2% higher, buoyed by generally favourable economic indicators and expectations that US listed firms will continue to generate solid earnings.
- That said, the latest funds flow data suggested investors might be starting to lock in recent gains from technology stocks, in particular. These outflows were insufficient to dampen the rally in tech names, however, and the NASDAQ closed the month 1.8% higher.
- Apple was a notable underperformer, with the shares down more than 5%. The company was hit with a €1.8 billion fine in Europe for anti-competitive behaviour and it was revealed that iPhone sales in China were down nearly 25% in the first six weeks of 2024. Thankfully other large tech stocks including artificial intelligence company Nvidia and Alphabet (owner of the Google search engine) picked up the slack and enabled the NASDAQ to maintain its recent strong run.
- European stocks added more than 4% overall. With a return of more than 10% Spanish stocks were the standout performers, although all major markets in the region enjoyed solid gains.
- In Asia, the latest funds flow data suggested outflows from Chinese equities might have paused, following a subdued start to the year for the CSI 300 Index. This helped share markets in China and Hong Kong to arrest recent weakness and register modest gains over the month.
- Elsewhere in the region, Japan's Nikkei and the Straits Times in Singapore both added around 3%. Notably, Japan's Nikkei topped the 40,000 level for the first time ever.
- Interestingly, a recent study found that dividend payments from listed companies globally grew 5% in 2023, to a record US$1.66 trillion. Around half of the uplift was attributable to higher dividends from banks.

Property Securities

- The equity market rally extended to global property securities, with the FTSE EPRA/NAREIT Developed Index adding 3.6% in Australian dollar terms.
- The best performing regions included Sweden (+16.9%) and Spain (+12.3%). European stocks typically performed well given suggestions that the European Central Bank could lower interest rates as early as June. Swedish stocks benefited from these expectations more than most, as Sweden is the most levered property market in the region.
- Asian markets performed less well. J-REITs rose, although Hong Kong saw a -7.0% return and Singaporean stocks were little changed overall.
- Locally, A-REITs fared very well in March, rallying 9.3% on the back of strong contributions from stocks including Goodman Group (+13.1%) and Charter Hall Group (+9.8%).
- Improving sentiment was driven by ongoing expectations of interest rate cuts, which is expected to benefit interest rate sensitive constituents in this part of the market.

Global and Australian fixed income

- Central bank officials continued to talk down the prospect of interest rate cuts in the near term, but investors remain confident that policy settings will be eased in key regions in the remainder of this year.
- Government bond yields moved lower against this background, resulting in positive returns from global fixed income. The Bloomberg Global Aggregate Index returned 0.8% in AUD terms.
- The UK market performed particularly well. Gilt yields fell 19 bps, following a sharp fall in inflation in February. In Germany, bund yields closed the month 11 bps lower.
- There was more limited movement in the US, reflecting the 'higher for longer' interest rate narrative. Yields on 10-year Treasuries closed the month just 5 bps lower, at 4.20%.
- Japanese Government Bond yields were little changed over the month, despite the abolition of the negative interest rate policy and as the Bank of Japan announced it was discontinuing *yield curve control* measures.
- Locally, yields on 10-year Australian Commonwealth Government Bonds closed the month 17 bps lower. This helped the Bloomberg AusBond Composite 0+ Year Index return 1.1%.

Global credit

- Credit spreads tightened further, resulting in another pleasing month of performance for corporate bonds globally. Prospective yields over and above those available on comparable government bonds continued to appeal to investors and enabled credit to perform well in all key regions.
- Looking ahead, issuance volumes are expected to moderate from record levels in Q1. Several companies 'front loaded' their funding requirements for 2024 early in the year, tapping into very strong investor appetite for yielding investments.
- New issues in March were greeted slightly less warmly by the market than in January and February, suggesting investors are becoming increasingly selective as valuations have risen.