FPW FINANCIAL ADVICE

Count The confidence to look ahead

Market Wrap

May 2024

Economic and market overview

- Most major share markets made solid progress in May, extending gains in the calendar year to date and, in many cases, rising to fresh all-time highs.
- Sentiment was buoyed by a moderation in inflation in the US and a fall in the oil price. Overall, investors remained hopeful that interest rates in the US and elsewhere could be lowered later this year.
- Bond yields also stabilised, following sharp increases in April. This resulted in improved returns from local and international fixed income indices.

- **US**: Employment and wage data for the month of April were less strong than in March, raising hopes that inflation could moderate further. In turn, this could enable the Federal Reserve to lower official interest rates. Consensus forecasts still suggest the policy easing cycle will have started before the end of this year.
- Annual inflation fell to 3.4%, from 3.5% in the prior month, but remains above the central bank's target.
- GDP data showed that the world's largest economy grew at a slower pace than initially reported in the March quarter. GDP rose at an annualised rate of 1.3% during the period; less than the 1.6% initial estimate. Lower personal consumption was blamed for the correction, with elevated borrowing costs keeping a lid on discretionary spending.
- In other news, former President Donald Trump was convicted of falsifying business records. He is due to be sentenced next month, although experts suggested fines are more likely than a prison sentence.
- Accordingly, political analysts suggested the convictions are unlikely to prevent Trump from running as a Presidential candidate in November's election, but that the 'guilty' charges reduce the likelihood of him being re-elected.

- **Australia**: The latest data showed that Australian inflation quickened in April, to an annual rate of 3.6%. Like in some other countries, inflationary forces are proving persistent and are preventing policymakers from bringing inflation back within target ranges.
- Despite the increase, officials are still forecasting that inflation will have fallen to 2.75% by mid-2025, potentially enabling the Reserve Bank of Australia to lower official cash rates around that time. Rate cuts before the end of 2024 now seem unlikely.
- The 2024-25 Federal Budget was released in Canberra in mid month and contained few surprises. Among the highlights was the announcement of lower personal income tax rates, including a reduction in the lowest tax rate to 16%, from 19% previously.
- All Australian households will also receive a $300 rebate on their electricity bill. Along with the income tax cuts, this is designed to ease cost-of-living pressures and, in turn, should help support discretionary expenditure.
- The government also suggested net overseas migration will more than halve, from over half a million in 2022-23 to 260,000 in 2024-25. This should help ease property demand and could be good news for Australian jobseekers.
- It was also reassuring to hear that Australia was in budget surplus in 2023/24, for a second consecutive year. That said, the budget is expected to move into deficit in the next two years, with government spending exceeding tax receipts.

- **New Zealand**: Reserve Bank of New Zealand officials debated a mixed set of economic indicators at their latest meeting. At an annual rate of 4.0%, inflation in the March quarter remained uncomfortably high, although an increase in unemployment suggested economic activity levels could be tailing off.
- Policymakers ultimately decided to leave cash rates unchanged at 5.50%, but consensus forecasts indicate borrowing costs will have been lowered by 0.25% before the end of this year. The Reserve Bank's own forecasts indicate cash rates could be lowered to 3.5% by the end of 2026.
- Retail sales improved in the first three months of the year, for the first time in the past nine quarters. This suggested New Zealanders are becoming more optimistic in the outlook, perhaps in anticipation of lower borrowing costs.

- **Europe:** Official interest rates were lowered in Sweden and Switzerland during May, raising hopes that the European Central Bank will follow suit and ease policy settings in the Eurozone. A 0.25% reduction in cash rates is anticipated after the Bank's next meeting, on 6 June.
- The latest PMI data – a good indicator of activity levels in the manufacturing and services sectors – improved to its highest level in a year, suggesting economic growth in the Eurozone might be gaining momentum. GDP growth data for the March quarter will be released in early June, providing further insight.
- In the UK, the ruling Conservative Party called a general election for early July. Opinion polls strongly suggest there will be a change in government, with Keir Starmer's Labour Party tipped for a landslide victory.
- The Bank of England is not expected to adjust interest rates during the election campaign, suggesting investors will have to wait until August at the earliest for an interest rate cut. With inflation in the UK now down to 2.3% – close to the 2% target – policymakers are expected to start lowering borrowing costs in the months ahead to help support a fragile economic recovery.
- The latest GDP data confirmed the recent recession in the UK is over. The economy grew 0.6% in the March quarter, following contraction in the second half of 2023.

- **Asia**: The US announced fresh tariffs on a range of imports from China including semiconductors, batteries, solar-related products, and various minerals. Most notably, tariffs on electric vehicles imported from China into the US appear set to rise further, to more than 100% of the price of the vehicle itself.
- The European Commission is also expected to increase duties on electric vehicles imported from China, to protect the interests of auto manufacturers in the region.
- The new tariffs could adversely affect overall export orders from China and could see authorities in Beijing introduce fresh tariffs of their own on goods imported from the US and Europe.
- In Japan, GDP data showed the economy shrank at an annualised rate of 2.0% in the first three months of 2024; a worse outcome than anticipated. Industrial output dipped lower, partly owing to a temporary halt in production at some of the country's largest auto makers following a safety scandal. Private consumption was also weaker than expected.
- Despite the subdued conditions the Bank of Japan is still expected to raise interest rates in June or July, with further hikes expected later in the year.

Australian dollar

- The likelihood of Australian interest rates remaining high for longer than was previously anticipated supported the AUD on foreign exchange markets. The 'Aussie' appreciated by 1.5% against a trade-weighted basket of international currencies.
- Most notably the AUD added 2.8% against the US dollar, closing May at 66.5 US cents.
- Similar gains were seen against the yen, with the AUD closing the month up 2.5% to ¥104.7.

Australian equities

- Australian shares recovered in May after April's dip, supported by generally positive commentary from listed companies at annual conference events and the release of encouraging trading updates.
- Optimism around artificial intelligence, coupled with positive company trading updates from Xero (+10.6%) and Technology One (+9.7%) supported a 5%+ return from the Information Technology sector. Xero delivered an impressive 75% increase in its full year earnings, owing to strong capital management and solid growth across all of its regional segments.
- The Utilities sector (+3.4%) also fared well, supported by gains in AGL Energy and Origin Energy. AGL shares rose more than 9%, following an upgrade to the company's FY24 earnings guidance. Management cited better consumer demand and operational performance, as well as higher wholesale electricity prices. Origin (+4.5%) also performed well after announcing the New South Wales government will underwrite some of the costs to keep its Eraring power plant open until 2027, underscoring the need for energy security and reliability.
- At the other end of the scale, the Communication Services sector closed down 2.6%. Spark New Zealand (-12.2%) was the worst performer in this area of the market, after flagging weaker demand at a trading update. This resulted in a downgrade to the company's full year earnings guidance.
- Consumer Staples stocks also tended to struggle, led lower by Endeavour Group, Metcash and Treasury Wine. Falls of between 6% and 8% from these stocks more than offset gains in a2 Milk Company and Bega Cheese.
- Collectively, small Companies underperformed their larger cap peers again in May. The S&P/ASX Small Ordinaries Index was little changed from its end-April level.
- Small cap stocks Mayne Pharma Group, Weebit Nano and Bapcor all lost around a quarter of their value. The latter flagged the impact of the cost-of-living crisis, suggesting consumers are pulling back on discretionary spending.

Global equities

- Share markets extended gains in the year to date, following further evidence that company earnings are holding up well despite elevated borrowing costs and moderating economic activity levels.
- The MSCI World Index rose 4.1% over the month, with positive contributions from major markets in all key regions.
- The S&P 500 Index in the US added 5.0%, buoyed by particularly strong returns from the 'Magnificent Seven': Alphabet (Google), Amazon, Apple, Meta (Facebook), Microsoft, Nvidia, and Tesla. These primarily tech-related names enabled the NASDAQ to climb 6.9%, to fresh record highs.
- Nvidia was the last of the group to announce its earnings for the March quarter. The results were well received by the market and the shares have now nearly trebled over the past year. The artificial intelligence giant is now the world's third most valuable company, behind technology giants Microsoft and Apple.
- Europe's major stock markets typically registered gains of between 1% and 4%, although Swiss shares performed even better following an interest rate cut in the country.
- Asian markets were mixed. The Hang Seng in Hong Kong and Singapore's Straits Times Index both closed the month around 2% higher, although Japanese stocks were little changed and China's CSI 300 Index weakened slightly.
- Returns from most other emerging markets were subdued too, suggesting investors might be favouring the relative security of larger, more established markets given prevailing economic and geopolitical uncertainties.
- Finally, towards month end it was announced that Saudi Aramco planned to raise nearly $20 billion in a new share sale. The company previously raised more than $40 billion in 2019, selling a minority stake in an initial public offering that valued the state-owned energy company of Saudi Arabia at around $2.5 trillion.

Property securities

- Global property securities appreciated in May, with the FTSE EPRA/NAREIT Developed Index adding 2.8% in AUD terms.
- European markets were the best performers, with Spain, Germany and France all adding between 5% and 8%. Suggestions that the European Central Bank could lower interest rates in June supported sentiment towards interest-rate sensitive property sectors in the region.
- Most major Asian markets lagged global peers and lost ground. J-REITs fared particularly poorly amid ongoing speculation that the Bank of Japan is preparing to raise interest rates.
- Locally, A-REITs added 1.9% over the month, which extended returns to nearly 10% in the calendar year to date.

Global and Australian fixed income

- Yield movements in government bond markets are often highly correlated, with developments in the US Treasury market typically setting the tone globally. This was not the case in May, with local drivers and interest rate expectations driving yields in different markets.
- Ten-year Treasury yields moved 0.18% lower on the back of a moderation in US inflation, although yields on Japanese Government Bonds moved higher – rising above the 1% level for the first time since 2012 – amid suggestions that the Bank of Japan was preparing to raise interest rates.
- Gilt yields in the UK were little changed, while yields on German bunds edged higher even as investors prepared for a rate cut.
- Combined, the moves resulted in positive returns from international fixed income. The Bloomberg Global Aggregate Index added 0.8% in AUD terms.
- Yields on Australian Commonwealth Government Bonds were almost unchanged in May, although this masked a fair degree of volatility during the month as investors digested the latest economic data and comments from central bank officials.
- Pleasingly the Bloomberg AusBond Composite 0+ Year Index added 0.4%, clawing back some of April's losses.

Global credit

- Corporate bonds continued to generate steady, positive returns for investors. Resilient profitability in most areas of the market has meant default rates have not increased above long-term averages. In turn, prospective yields over and above those available from comparable government bonds and cash instruments remain appealing to income-oriented investors.
- Credit securities have continued to generate modest capital growth too, with spreads continuing to tighten. Spreads fell to 0.95% in May, which boosted total returns from the asset class.
- There was little to choose between the performance of corporate bonds in the US and Europe, with both enjoying strong demand in both primary and secondary markets.