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Market wrap

February 2024

ECONOMICS OVERVIEW

Investors maintained a healthy appetite for risk in February,encouraged by a generally favourable set of financial results from listed companies in the US and Europe.

Economic and market overview

- Combined with a broadly supportive economic outlook, this enabled share markets to continue their recent rally and hit fresh all-time highs. The MSCI World Index added 5.9% in AUD.
- The 'risk on' mood extended to global credit and other risk assets, including cryptocurrencies. Bitcoin surged nearly 45% over the month, for example, topping the US$60,000 level for the first time since 2021.
- Returns from fixed income were less strong, as the timing of anticipated interest rate cuts continued to be pushed back.
- Major fixed income indices in Australia and elsewhere closed the month lower, owing to increases in government bond yields.

US

- The Federal Reserve's favoured measure of inflation – the core personal consumption expenditures price index – which excludes food and energy costs, increased 0.4% in January.
- This was the biggest monthly increase in the past 12 months and meant the annual inflation rate only declined to 2.8%; still meaningfully above the official target.
- Against this background, central bank policymakers continued to talk down the probability of interest rate cuts in the near term.
- Understandably, officials are hesitant to ease policy settings while inflationary forces remain so strong.
- The US central bank does not appear unduly concerned about a potential re-acceleration in inflation for now, but it could take a little longer than previously anticipated for inflation to fall back towards the 2% target.
- Employment data was also strong. The number of new jobs created in January was nearly double the consensus forecast and wage growth accelerated. Again, these indicators suggest caution might be required as central bank officials consider lowering interest rates.
- Selected other data releases painted a slightly less favourable picture of the economy. Factory production fell for the first time in three months in January, for example, and retail sales fell by the most in nearly a year.

Australia

- Headline inflation remained at an annual rate of 3.4% in January, still above the central bank's target range.
- The Reserve Bank of Australia left the official cash rate unchanged at its meeting in early February, but indi-

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cated that further increases in borrowing costs cannot be ruled out if inflation proves sticker than expected.
- The market does not believe policy settings will be tightened any further and is still anticipating two rate cuts this year.
- Labour market trends are less encouraging than in the US. New employment numbers were well short of expectations for a second consecutive month in January and the official unemployment rate rose to 4.1%, from 3.9% in December.
- Wages in Australia are still rising by more than 4% year-on-year, but pay growth could start to moderate if overall employment trends continue to worsen.
- These indicators are important, as policymakers believe there is a clear link between wages and inflation. As a result, they could wait for a sustained reduction in wage growth before lowering interest rates.

New Zealand

- Inflation expectations fell to their lowest level in two and a half years, strengthening suggestions that no further rate hikes will be required.
- A survey of businesses suggested inflation will have settled at around 2.5% in two years' time; comfortably within the Reserve Bank of New Zealand's 1% to 3% target range.
- Interest rates were left on hold at 5.5% at the end of February, as anticipated, but investors are still expecting two rate cuts later this year.
- House prices are still falling on a year-on-year basis, reflecting higher mortgage repayment costs and an uncertain economic outlook. Nonetheless, consumer confidence levels improved slightly in the latest survey.

Europe

- The Eurozone economy has averted recession for now, although growth remains subdued in most member countries. The European Commission has downgraded growthforecasts for this year and next. This partly reflects ongoing weakness in Germany, the largest economy in the bloc.
- Industrial production in Germany is running around 3% below levels from a year ago and there are no imminent signs of a turnaround, especially given the uncertain outlook for growth in China and the resulting impact on demand for German exports.
- The UK economy shrunk 0.3% in the fourth quarter of 2023. This was the second consecutive quarter of negative growth and means the country is now in recession.
- At the same time, the unemployment rate in the UK fell and wage growth slowed less than expected in the final quarter of last year. Wage growth excluding bonuses rose more than 6% in 2023, which could be concerning for Bank of England policymakers given the correlation between wages and inflation.
- Retail sales data were consistent with stronger earnings too, with the latest figures for the month of January coming in significantly above consensus forecasts.
- Against this background, it appears unlikely that interest rates in the UK will be lowered within the next six months.

Asia/AEM

- Japan's economy also slipped into recession in the second half of 2023, following a negative GDP growth reading for the December quarter.
- Despite the subdued growth readings, comments from a Bank of Japan board member raised expectations that the central bank is still considering raising official borrowing costs. The Bank moved interest rates from 0.1% to -0.1% eight years ago and they have been below zero ever since.
- Activity levels remain subdued in China too and the latest data showed consumer prices falling for a fourth consecutive month.
- The -0.8% reading for the year ending 31 January was the steepest drop in 15 years and suggests demand levels in the world's second-largest economy remain subdued.
- Officials in Beijing enhanced their efforts to revive the property sector, reducing a key mortgage reference rate. Five-year prime loan rates were lowered by 0.25%; the

first cut since June and the biggest reduction in the past five years.

- Policymakers are focusing on measures to ease a property crisis in the country, which is acting as an increasing drag on the economy and could prevent stated growth targets from being achieved.

Australian Dollar

- The AUD continued to weaken against the US dollar, closing the month 1.1% lower at 65.0 US cents.
- Stronger-than-expected labour market data and evolving forecasts for interest rates in the US provided support to the US dollar and saw the greenback appreciate against most major currencies.
- The AUD weakened slightly against other major currencies too, depreciating by 0.5% against a trade-weighted basket of international currencies.
- Positively, the AUD appreciated by 1.0% against the Japanese yen, rising towards the 100 yen level that was last seen in 2014.

Australian Equities

- Most ASX-listed companies reported their financial results for the six months ending 31 December. Investors remained particularly cautious on company outlooks and demonstrated a low tolerance for earnings 'misses' relative to market expectations, amplifying clear winners and punishing the losers.
- Overall, the S&P/ASX 200 Index ended February up 0.2%. IT stocks generally fared well, with constituents such as WiseTech Global illustrating the power of strong market leadership and pricing power in their results.
- Origin Energy was also among the standout performers, buoyed by the announcement of a revised takeover bid from the Brookfield Asset Management and MidOcean consortium. This allayed investors' concerns that the proposed government price cap on energy would terminate the acquisition.
- The Materials sector struggled, as labour shortages and rising costs continued to weigh on earnings results for major miners including BHP Group and Rio Tinto.
- In the Financials sector, investors recalibrated their expectations for banks' net interest margins as outlook commentaries indicated that further margin uplift is likely to be subdued. Insurers typically outperformed the four major banks, with rising premiums supporting their results.
- Small caps rose too, although like in the large cap space Materials stocks acted as a drag and prevented the S&P/ASX Small Ordinaries Index from making more meaningful progress.

Global Equities

- Many listed companies in the US and Europe released their results for the fourth quarter and for the 2023 year. There were both positive and negative surprises, but overall the results came in broadly in line with consensus forecasts.
- Investors' confidence in the outlook for technology stocks helped the NASDAQ to rise in value by 6.1% over the month, to a new record high.
- The rest of the US share market rallied too, with the broa er S&P 500 Index adding 5.3% and hitting fresh all-time highs.
- Nvidia was among US-listed stocks that performed particularly well. The shares soared nearly 30% after management talked up the earnings outlook for the Artificial Intelligence firm. Nvidia is now among the world's five most valuable companies.
- In Asia, the Nikkei in Japan finally recovered all of its lost ground since the late 1980s, achieving new record highs. The 7.9% return over the month was a little surprising given the economy slipped into recession in the second half of 2023.
- Shares in China and Hong Kong also rebounded sharply higher following January's falls. Reports suggested that Chinese state-backed funds have been pouring money into onshore share markets to help arrest the recent weakness.
- European markets generally fared well too. Despite the subdued outlook for growth, the German DAX set a new record high, for example, closing the month 4.6% higher.
- Even stronger gains in other selected markets in the region enabled the Euro Stoxx 50 to return 4.9%; again extending all-time highs for the Index.

Property Securities

- REITs in the Asia Pacific region were typically the best performers in February. The Australian property sector benefitted from a stronger than expected reporting season, while valuations in Hong Kong improved as investors priced in a likely removal of double stamp duty rates.
- Property stocks in the US were also among the best performers in the FTSE EPRA/NAREIT Developed Index.
- At the other end of the spectrum, laggards included Germany, Sweden, and Spain.
- Declines in asset values in Europe were larger than expected in most cases during the month, and financial expenses also surprised to the upside. These factors affected the performance of listed property securities in the region.officials was enough to push yields higher.

Global & Australian Fixed Income

- Government bond yields rose in key regions as investors dialled back expectations for interest rate cuts in the near term. This 'higher for longer' narrative acted as a headwind for fixed income and resulted in the Barclays Global Aggregate Index closing February 0.8% lower in AUD terms.
- At the beginning of the month, markets were priced for six rate cuts in the US this year – by the end of February, just three cuts were anticipated.
- Labour markets remain resilient, at least in the US. American firms appear sufficiently confident in the outlook to keep hiring new workers and tightness in the labour market continued to exert upward pressure on wages. This is prompting investors to question whether the Federal Reserve will be willing to ease policy settings.
- In the US, 10-year Treasury yields rose 0.34% as some of the previously anticipated rate cuts were removed from forecasts. It was a similar story in Europe, with 10-year gilt and bund yields closing the month 0.33% and 0.25% higher in the UK and Germany, respectively. Again, the anticipated timing of the first rate cuts is being pushed out as policymakers continue to discuss persistently high inflation.
- Locally, yields on 10-year Australian Commonwealth Government Bond yields rose 0.12%. This translated into a small negative return from the Bloomberg AusBond Composite 0+ Year Index and many domestically-focused bond funds.

Global Credit

Generally favourable financial results released by liste companies in the US and Europe helped ensure investors maintained a healthy risk appetite.

- Credit spreads ground tighter against this background in both the investment grade and high yield sub-sectors, which resulted in favourable returns from corporate bonds.
- Asian credit fared well too, as investors looked to increase-allocations to higher-yielding investment types.
- Potential delays to interest rate reductions could be seen as unwelcome for credit markets. On the other hand, it is-encouraging that corporate earnings appear to have been largely unaffected by higher borrowing costs.
- After peaking just below the long-term trend in 2023, a meaningful pickup in default rates among corporate issuers is not currently anticipated. This augurs well for future returns from the asset class – as long as companies can service their debt repayment obligations and do not default, the regular income stream provided by their coupon payments will provide steady positive returns from global credit portfolios.

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