Monthly View as at 30 November 2022

Overview

The same themes of high inflation and rising interest rates remain the key issues for the developed world. A positive change from the last few months has been that there are signs that inflation may have peaked in some countries. It might be a little too early to call, but some of the recent economic data are showing signs the interest rate increases are working and inflation pressures might be easing. After interest rates were kept artificially low during Covid, eventual normalisation of rates was inevitable.

With most countries experiencing high inflation, financial markets have been expecting interest rates to rise as central banks around the world attempt to discourage people from spending and encourage people to save, which in turn leads to slower growth. But how far do interest rates need to rise to slow growth but not cause the economy to move into a long and deep recession? This is the unknown markets are concerned about. After the significant growth we have seen post Covid, low growth or even a slight contraction would not be viewed as materially negative. The quicker this occurs, and inflation is back within the target levels of central banks, the better it will be for both the economy and markets in the long term. A long and deep recession is more likely to occur, or will even be required, the longer that high inflation exists, and policy responses are seen as tepid.

During November we have seen both some positive news and some signs that 2023 might have its challenges. In late November the Chairman of the US Federal Reserve, Jerome Powell, stated that it was time to slow the pace of interest rate rises, potentially from December, but also reiterated that monetary policy is likely to stay restrictive for some time. This is what investors had been looking for and the main US indices, the S&P500 and Dow Jones, experienced a strong rise.

Markets will look through the current news as to what the future may hold and despite talk of higher interest rates, slowing economies and potential recessions, we saw markets up strongly in November. However, the 2023 outlook has been tempered with some companies reporting lower earnings expectations than previously forecast. This is not saying earnings will decline but rather that the growth may be lower than first forecast. This will be the next piece of news markets will be watching closely.

During Covid, we saw bad news being good for markets as it meant governments would continue to stimulate economies through a difficult period, and this meant cheap money would be readily available. This year we have seen positive news in the form of low unemployment, robust consumer spending and a relatively positive company earnings season, however this has meant that inflation could remain elevated which would lead to persistently higher interest rates. While 2023 may be more ‘normal’, we do expect it to be volatile as various scenarios play out for economies.

New Zealand

In November the Reserve Bank increased interest rates by one of the largest single increases on record, 0.75%. Markets had expected this, so the share market response was muted but we did see interest rates move higher.

For the month the New Zealand share market increased by 1.9% as company results came in ahead of expectations. There were however a number of downgrades to the 2023 and 2024 earnings estimates which kept the market from moving higher. A better than expected earnings update from Fisher & Paykel and a positive announcement from A2 Milk were the stand out catalysts for the positive month.

Over the past 12 months, the New Zealand share market has fallen 8.4%. Outside of the high growth Nasdaq 100 index in the US, in NZD terms the NZX50 has been the worst performing index over the last 12 months. Some of this is due to the impact higher interest rates have had on a large part of the market (including high yielding companies such as the power companies).

Australia

The Australian share market rose strongly over the month, appreciating by 6.6%. Inflation pressures seem to be less pronounced in Australia than here in New Zealand, with one of the key Australian Consumer Price Index (CPI) indicators rising by a much less than expected, 0.2% for October. The market still expects the Reserve Bank of Australia (RBA) to increase the cash rate in December and again in February, but potentially the lower CPI data prints might allow the RBA to pause rate increases from there.

In the 12 months to 30 November, the Australian share market has increased 5.0% and in NZD terms is up 8.4%. After underperforming for a number of years prior to and during Covid, the Australian market has been one of the best performing markets globally; only the UK market in local currency terms has performed better over the last 12 months. Both markets have a heavy exposure to resources and financial services (banks and insurance) which have been relatively strong compared to the “tech heavy” indices like the Nasdaq and to a lesser degree the S&P500. Looking forward, valuation multiples in Australia remain favourable and these should support the market.

The recent announcements between China and Australia have also been relatively positive, which will be a significant benefit to the Australian market.

Global

At the start of November, central banks continue to raise interest rates as ongoing concerns about inflation persisted. Despite these headwinds, investor sentiment improved after the US inflation numbers showed that the uplift in prices was less than expected and lower than the previous month. Share markets rose sharply at the end of the month after Fed Chair Powell’s comments, with the US S&P500 index up 5.6%, and a similar return for the high growth Nasdaq index.

The US economic data continues to point towards a resilient US economy as retail sales were better than expected and the labour market continued to be strong. On a 12-month basis the S&P 500 is down 9.2% and the Nasdaq down 24.8%. The underperformance of the Nasdaq reflects the fact that the market darlings of previous years are now giving back a significant amount of that strong past performance.

A drag on the outlook for global growth has been China's perseverance with a zero Covid stance. A drive to vaccinate more elderly people has given some hope of a less restrictive policy going forward. Strong Chinese demand and better supply chains will be a benefit to global growth.

The challenges of the Eurozone around energy and the corresponding impact on inflation are well documented. November saw some good news as economies improved from depressed levels and the relatively mild temperatures in recent weeks reduced the risk of running out of gas this Allocation to long-term benchmarks winter. The UK FTSE 100 index was up 7.1% for November, and the German DAX returned +8.6%.

Summary

The last two months have allowed share markets to recover some of the losses that occurred in the first nine months of the year. Those clients who stay invested through these short-term volatile times continue to be rewarded with the opportunity to recoup the losses from earlier in the year.

There are signs of inflation falling as higher interest rates have the desired impact of slowing growth and consumer spending.

Economies seem to be showing resilience but growth expectations for 2023 are being lowered with some form of a recession seeming to be inevitable. If the central banks are able to manufacture an economic slowdown with a short and shallow recession, this will be the ideal outcome and markets will look at this very positively.

Clients should continue to focus on their long-term goals while acknowledging that in the short term, returns may be volatile.

Indices for Key Markets

As at 30 November 2022	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	1.9%	-0.1%	-8.4%	1.4%	8.0%
S&P/ASX 200 Accumulation Index (AUD)	6.6%	6.0%	5.0%	5.9%	8.2%
MSCI ACWI Index – Global Shares (local currencies)	6.3%	3.2%	-8.5%	7.7%	7.5%
MSCI ACWI Index – Global Shares (NZD)	0.5%	1.5%	-3.5%	7.7%	8.4%
S&P/NZX 90 Day bank bill Total Return	0.3%	0.8%	1.9%	1.0%	1.3%