Monthly View as at 31 May 2023

Overview

Uncertainty as to whether the US would raise its debt ceiling, thus averting a potential default, was a distraction for global financial markets in May. Conflicting US economic data, softening of Chinese economic activity, and ongoing rhetoric from US Federal Reserve (Fed) officials that interest rates may need to move higher also weighed on markets.

US debt negotiations concluded successfully in the end with the passing of the Fiscal Responsibility Act. The deal suspends the debt ceiling through to January 2025, after the next presidential election, and places caps on non-defence spending. Defence spending rises 3.0% this year.

In early May the Fed raised its policy interest rate 25 basis points to 5.25%, a 15-year high. They also softened their forward guidance, opening the door to pausing the interest rate hiking cycle. Softness in the US labour market is a key prerequisite for the Fed in ending interest rates increases and becoming confident that inflation is under control. Currently the US labour market is sending mixed measures. US job openings rose to a higher than expected 10.1 million in April. This saw the ratio of job openings to unemployed rise to 1.8, near historical highs, reflecting underlying the strength of the labour market. However, within the data, and a leading indicator that the labour market is softening, the job quits rate fell to a 14-month low. Less workers voluntarily leaving their job suggests less job security.

Although 339k new jobs were created in April the unemployment rate rose to 3.7% from 3.4% a further contractionary signal. The employment report also showed a further slowing in wage growth, which is required in containing inflation. US jobless claims (filings for unemployment benefits) have also moved higher in recent weeks, evidence of a weakening labour market and supportive of the view that the Fed may not necessarily need to raise interest rates further.

May witnessed further evidence that inflation pressures are easing globally. US inflation rose 0.4% in April, in line with expectations. The headline year-on-year inflation rate was 4.9%, the first sub-5% outcome since April 2021. European inflation has fallen to 6.1% year-on-year, down from 7.0%. Surveys of manufacturers in the US and Europe indicate a softening of pricing pressures, a sign that input cost increases are receding.

Globally economic activity remains weak. The British economy grew 0.1% over the first three months of this year. The German economy has slipped into recession as households cut spending due to higher energy and food prices. Chinese economic activity has softened after an initial boost from the opening of their economy following the relaxation of their zero-covid policy earlier in the year. Japanese economic activity surprised over the first quarter of this year, growing 0.4%.

Global Shares

Global share markets managed a small gain in May (+0.5%), led higher by the US and Japanese market. Most of these gains came late in the month after the agreement to lift the US debt ceiling was announced.

A key feature of recent months has been the small number of companies accounting for the bulk of the returns from the US share market. Since the beginning of the year the US S&P 500 index has returned close to 10%, seven technology companies account for most of these returns, Apple, Microsoft, Alphabet (parent company of Google), Amazon, Nvidia, Meta (parent company of Facebook), and Tesla.

The divergence in performance was very evident in May. The Technology heavy US Nasdaq index returned 7.7% over the month, compared to the "older world" Dow Jones index that fell -3.0%. This is amongst the largest monthly divergence in monthly performance between the two indices on record.

In May, US company Nvidia hit the headlines after significantly exceeding revenue expectations and highlighting the computer chip maker can capitalise on the artificial-intelligence (AI) boom. The market's hype on AI and speculation as to who will be the winners from AI, such as chip makers (semiconductor companies) and cloud-computing providers, was the key factor in the outperformance of the Nasdaq index for the month.

Australian Share Market

The Australian share market fell -2.5% in May and has returned 2.9% over the last twelve months.

Banking profit announcements dominated in May. Although positive, there was some disappointment with the results, particularly National Australia Bank whose share price was down 10.0% over the month. Resource stocks also struggled on the back of weak commodity prices. The Bloomberg Commodity Index fell -5.3% in May, resulting in weakness in the share prices for BHP (-5.4%) and Rio Tinto (-4.7%).

The Reserve Bank of Australia added to market uncertainty by hiking interest rates after pausing in the previous month, as they are concerned about the upside risks to inflation.

New Zealand Share Market

For May the New Zealand Share market fell 1.7% and has risen 5.4% over the past year.

The Reserve Bank of New Zealand (RBNZ) hiked the Official Cash Rate 25 basis points to 5.5% as was widely expected but they surprised the market with their outlook. The RBNZ signalled an end to raising interest rates and indicated that policy was restrictive enough to see inflation fall to within their 1.0% - 3.0% target range.

The Government's budget showed a deterioration in the accounts compared to the half-year update due to a combination of lower tax revenue and higher spending. Net debt is projected to rise by over $20 billion in the 2024 financial year.

Although the May corporate reporting season was better than expected overall, results highlighted New Zealand companies are facing high levels of cost pressures. At the individual company level Fisher & Paykel provided disappointing forward guidance, falling -16% over the month, and Mainfreight highlighted tougher trading conditions, declined -3.2% in May. On the positive side, no new issues were evident in the Ryman Healthcare result, providing relief for investors. This, along with improved sentiment toward house prices, saw the Ryman price rise 19.8% over the month.

Summary

While global financial markets were distracted by the US debt ceiling negotiations over the month, easing global inflation pressures and the probability that the Fed is likely to pause in raising interest rates supported markets over the shorter term. The resilience of the US consumer and better than expected economic data over the first three months of the year has helped underpin global share markets.

The outlook for inflation and softness in the US labour market are key for the direction of both fixed income and share markets. For the time being inflation remains too high for central banks, therefore any reduction in interest rates is some time away and likely be an ongoing source of volatility until it is back within central bank's target ranges.

Uncertainty remains, due to weak global economic activity and the risk of US recession remains high.

Focusing on your long-term goals while acknowledging that in the short-term, returns may be volatile, should reward investors.

Indices for Key Markets

As at 31 May 2023	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	-1.7%	-0.4%	5.4%	3.5%	7.3%
S&P/ASX 200 Accumulation Index (AUD)	-2.5%	-0.9%	2.9%	11.4%	7.5%
MSCI ACWI Index (Local Currency)	0.5%	4.3%	3.1%	11.2%	7.9%
MSCI ACWI Index (NZD)	2.2%	7.2%	9.8%	11.3%	10.2%
S&P/NZX 90 Day bank bill Total Return	0.4%	1.2%	3.8%	1.6%	1.6%