Monthly View as at 31 July 2023

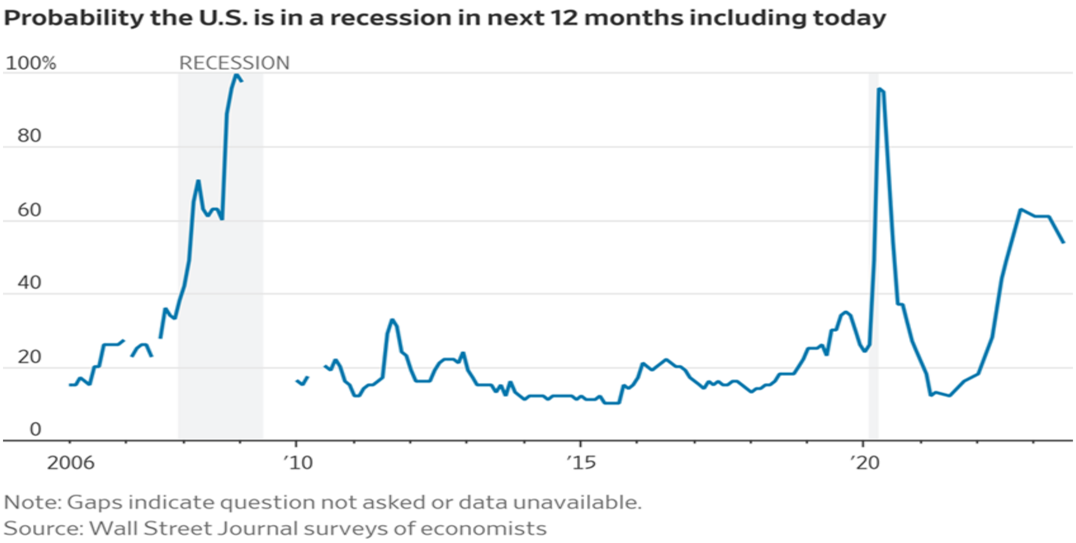
Overview

Global share markets moved higher over July on the lowering of US recession risks, continued softening of inflation, and better than expected corporate earnings.

Based on initial estimates, the US economy grew at a 2.4% annualised rate over the second quarter of 2023, supported by solid consumer spending and strong business investment. This was above expectations and follows a stronger than forecasted 2.0% annualised growth rate over the first three months of this year.

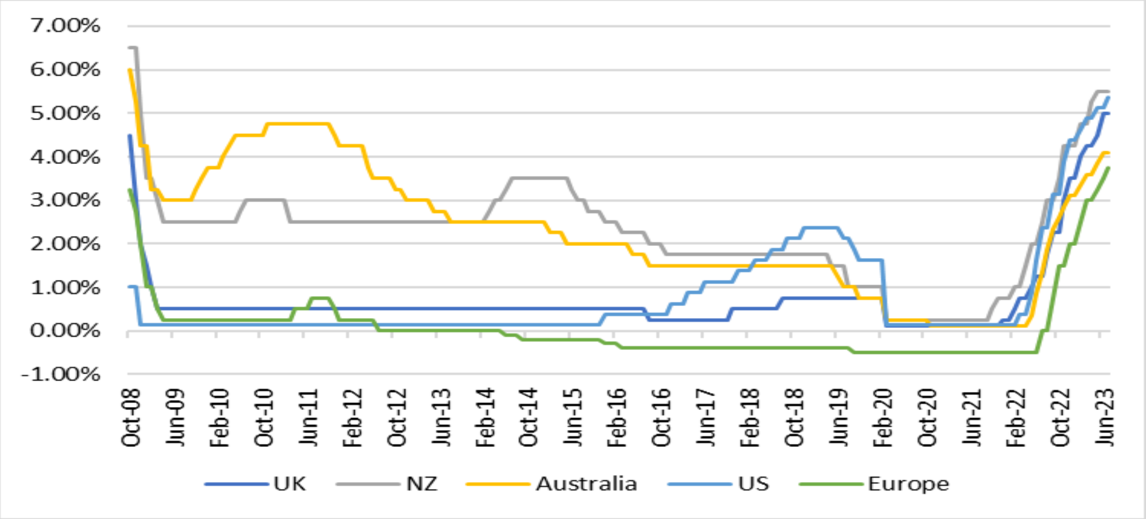
US headline annual inflation fell to 3.0% in June from 4.0% in May which is the slowest rate of annual inflation since March 2021, and below expectations. Core inflation, which excludes the more volatile food and fuel price impacts, also fell, recording 4.8% and an 18-month low.

Economists are dialing back US recession risks due to easing inflation, a still-strong labour market, and resilience of the economy to higher interest rates. Results from a recent Wall Street Journal survey saw the probability of a U.S. recession in the next 12 months amongst respondents fall to 54% from 61% in the prior survey. This is still high by historical comparisons. Although risks remain of a US recession, survey respondents see a recession more likely to occur in 2024 and be milder than previously anticipated. The decline in recession probability was based primarily on expectations inflation will continue to slow.



Measures of inflation are falling around the world, including Europe, UK, and Australia. In New Zealand, annual headline inflation fell to 6.0% in the June quarter of 2023, down from 6.7% over the first quarter. New Zealand's inflation outcome was firmer than anticipated, driven by a stronger than expected level of non-tradable inflation (which is more representative of price pressures based on domestic factors rather the global influences).

The easing of inflation has resulted in several Central Banks shifting their rhetoric. Although both the US Federal Reserve (Fed) and European Central Bank raised interest rates recently to 22-year highs, they have signaled that future interest rate hikes are dependent on economic data outcomes, particularly inflation and labour market activity, including wage growth. This indicates a slowing of likely interest rate increases by central bank and nearing the end of the interest rate hiking cycle.



Most major central banks continue to maintain a bias toward raising interest rates further, as they wait to see if inflation is clearly falling toward their target (in most instances 2.0%). On this basis, a reduction in short term interest rates is some time away.

In contrast to the US, economic data has been weak in Europe and China and below expectations. Although returning to growth, the Euro zone grew at an annualised rate of 1.1% in the second quarter of this year. Rising interest rates, stagnate Chinese demand for European goods, the war in Ukraine, and higher costs of living provide headwinds for European economic growth.

The pace of Chinese economic activity is slowing. The Chinese economy grew 0.8% over the June quarter of this year, down from the 2.2% pace over the first three months of 2023. The annual growth rate was 6.3% versus estimates of 7.1%. Sluggish retail sales and softening exports weighing on second quarter economic activity.

New Zealand

The Reserve Bank of New Zealand kept the Official Cash Rate (OCR) at 5.5% in July as expected. While they gave no indication that interest rates will need to increase again, they also don't see the OCR being reduced anytime soon. Domestic economic data remains weak. The ANZ Business outlook survey paints a picture of subdued domestic economic activity and a trend of moderating inflation pressures. Business capacity constraints are reducing, primarily due to the easing in finding labour.

The New Zealand share market rose +1.2% in July and has returned +5.8% over the last twelve months.

Ryman Healthcare and Mainfreight both presented a cautious tone at their respective annual shareholder meeting reflecting the challenging economic environment. Ryman hit a cautious tone by noting that higher interest rates work with a lagged impact on the housing market. Ryman's profitability is sensitive to movements in residential property prices. Despite this, Ryman provided profit guidance in line with market expectations and their share price rose 3.5% in July. Mainfreight surprised investors with profit forecast less than anticipated reflecting falling volumes and rising costs. Their share price was down -4.2% over the month.

Australia

The Australian share market rose 2.9% in July and has returned 8.5% over the last year. The market benefited from the positive global investment sentiment, rising oil prices, and a better-than-expected inflation outcome.

Australia's annual inflation rate fell from 7.0% in March to 6.0% in June, the quarterly rise of 0.8% was the smallest increase since September 2021. The outcome buoyed markets from the perspective the Reserve Bank of Australia may not need to raise interest rates much further. The Australian share market rose to a 5-month high on the inflation news with interest rate sensitive companies such as the financial stocks outperforming. Commonwealth Bank and ANZ returned 5.4% and 8.6% respectively over the month.

The oil price rose 16% in July, as measured by the US WTI futures price index, benefiting from falling inventories due to recent production cuts by Saudi Arabia and anticipated demand given the declining fears over US recession. Woodside Petroleum, an oil and gas producer, rose 10.3% in July.

Global Markets

Global share markets continued their strong performance in recent months, gaining 3.2%. They are up 10.5% and 12.2% over the last six and twelve months respectively.

US share markets have led global markets higher, rising on growing confidence the US can avoid recession, declining inflation, and better than expected corporate earnings results. The US S&P 500 index rose 3.1% over the month. The S&P has risen for five-straight months. With a 20% gain so far this year, the benchmark index capped its best performance through the first seven months of the year since 1997.

To the end of July, 80% of US companies that had reported earnings had surpassed expectations. In aggregate corporate earnings have fallen 7.0% compared to a year ago. Earnings are expected to recovery over the second half of this year.

Emerging markets performed strongly in July, returning 5.3%. The Chinese share market gained 5.4% on growing expectations the government will announce a series of policy initiatives to support economic growth, including tackling the high level of youth unemployment, support measures for the property sector, and easing of credit restrictions on local governments.

Summary

Positive investment sentiment continues, driven by the resilience of the US economy, falling global inflation, and central banks nearing the end of their interest rate hiking cycle. This environment is likely to remain supportive of global share markets in the months ahead.

The outlook for inflation remains the key for the direction of both fixed income and share markets over the second half of this year. Further declines in inflation will allow central banks to pause interest rate hikes and in time commence interest rate reductions. Such an outcome would be positive for global bond markets and provide further support for share markets in an environment of likely softer economic activity.

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 July 2023	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	1.2%	0.4%	1.2%	5.8%	1.7%
S&P/ASX 200 Index (AUD)	2.9%	2.0%	1.2%	11.7%	12.0%
MSCI ACWI Index (Local Currency)	3.2%	8.5%	10.5%	12.2%	11.5%
MSCI ACWI Index (NZD)	2.3%	7.9%	14.4%	13.8%	12.8%
S&P/NZX 90 Day bank bill Total Return	0.5%	1.4%	2.6%	4.4%	1.9%