Monthly View as at 30 November 2023

Dramatic change in investor sentiment

November witnessed a dramatic change in investor sentiment. Global share and fixed income markets delivered strong positive returns over the month.

Several factors drove the sharp bounce in financial markets, chief among them were better than expected inflation data, increased confidence the US Federal Reserve (Fed) has finished raising interest rates, better than forecasted corporate earnings, and growing expectations the US is likely to avoid slipping into a recession.

Developments in November pave the way for markets to continue to perform in the months ahead, as is typical when central banks end their hiking cycle and inflation is anticipated to decline. The ongoing resilience of the US economy provides further support for global share markets as we enter the New Year.

There was no change in the US Headline inflation index in October, which was better than the anticipated 0.1% increase. Annual inflation fell to 3.2%, down from 3.7% in September. Softer US labour market data helped reinforce expectations that US inflation pressures are easing, and inflation will continue to decline. Jobs growth of 150k in October was less than the 170k anticipated. The US unemployment rate rose to 3.9%, the highest level since January 2022. Importantly, wage growth slowed further. Average hourly earnings increased 0.2% in October, which is considered consistent with a 2.0% inflation rate (the Fed's target rate of inflation).

Although forecasts for the outlook for the US economy have improved, the biggest risk remains US recession. Six months ago, the consensus among economists surveyed by the Wall Street Journal was that the US economy would enter a recession over the next twelve months. In October's survey, the average forecast of economists was for no recession next year. The pace of US economic activity is forecasted to slow from the 5.3% annualised rate in the third quarter. Rising real incomes, a recovery in the manufacturing sector, and ongoing expansion in the Services sector, supported by government spending, are expected to underpin economic momentum into 2024.

Global inflation is falling

There was no change in the US headline inflation index in October, which was better than the anticipated 0.1% increase. Annual inflation fell to 3.2%, down from 3.7% in September. US inflation is expected to continue to decline.

Shelter inflation (e.g. rents), which represents around 30% of the inflation index, has remained elevated and lags actual market data. Based on current market data, shelter inflation is forecasted to ease substantially in the months ahead, leading the broader inflation index lower.

Softer US labour market data helped reinforce expectations that US inflation pressures are easing. Jobs growth of 150k in October was less than the 170k anticipated. The US unemployment rate rose to 3.9%, the highest level since January 2022. Importantly wage growth slowed further. Average hourly earnings increased 0.2% in October (which is considered consistent with a 2.0% inflation rate). Annual wage growth fell to 4.1%, the lowest since June 2021.

There is growing evidence globally that central banks are making progress against inflation. European inflation fell to 2.4% year-on-year in November, down from 2.9% in October, and the slowest annual pace since July 2021. Inflation fell sharply in the UK, falling to 4.6% in the year to October, down from 6.7% in the year to September. On an annual basis New Zealand's headline inflation fell to 5.6% in the September quarter from 6.0% in June, well below expectations of 6.0%. Preliminary New Zealand inflation data has been weaker than expected, food prices fell 0.9% in October, and domestic and international airfares declined 9.4% and 7.5% month-on-month respectively. This data suggests a likely lower than anticipated inflation outcome for the last quarter of 2023.

Central banks are hitting the pause button

Better than expected US inflation outcomes and softer labour market data supports the view the Fed has likely finished raising interest rates in this cycle.

At its most recent meeting the Fed left interest rates unchanged for the second consecutive meeting. The Fed noted that the rise in longer-term interest rates had tightened US financial conditions which would help in bringing inflation down towards its 2.0% target. In providing forward guidance, the Fed said they will proceed carefully and that it is appropriate that interest rates remain at current levels for some time. The Fed gave no indication of cutting rates anytime soon.

The European Central Bank (ECB) kept its deposit rate at 4.0% in October, ending a streak of 10 consecutive rate hikes.

The Reserve Bank of New Zealand (RBNZ) maintained the Official Cash Rate (OCR) at 5.5% at its November meeting. The RBNZ raised the OCR to 5.5% in May 2023. The RBNZ took a stronger tone on the outlook for interest rates than anticipated, focusing on the upside risks to inflation. Their concern is the upside risk to inflation from the strong net migration New Zealand has experienced over the last twelve months. The RBNZ noted if inflation pressures were to be stronger than forecasted, they would likely need to raise the OCR further. This took investors by surprise.

New Zealand Share Market

Although there has been some improvement in business confidence, on the back of a change in government, the domestic economic backdrop remains sluggish. Softness in the labour market and ongoing weakness in the manufacturing sector supports the view that further interest rate hikes by the RBNZ would be unwarranted.

The New Zealand share market rose 5.4% in November, primarily driven by offshore events and better-than-anticipated corporate earnings updates. Trading updates that surprised to the upside from Mainfreight (+17.9%) and Fisher & Paykel Healthcare (+13.2%) led the market higher.

Australian Share Market

The Australian share market rose 5.0% in November on stronger global share markets and falling longer-term interest rates. In contrast to the other major central banks, the Reserve Bank of Australia (RBA) increased their cash rate to 4.35% in November, after being on pause for 4 months. The RBA is anticipated to leave rates at this level for some time.

Financial stocks (Commonwealth Bank of Australia +8.0%) and property stocks (Character Hall +20.0%) outperformed benefiting from lower longer-term interest rates. Woodside (-9.5%) and Santos (-9.9%) underperformed, declining due to a fall in the oil price (-6.1%)

Global Share Markets

Global share markets rose 8.1% in November and are up 1.4% over the last three months. Share markets rose on growing confidence that inflation will continue to fall, the belief that most major central banks are likely finished hiking interest rates, and the US economy can avoid recession.

A stronger New Zealand dollar in November detracted from global equities returns. In New Zealand dollar terms global equities rose 3.3% over the month. The New Zealand dollar rose 6.1% versus the US dollar in November. The strength in the NZ dollar was more about US dollar weakness as investors moved away from the “safe haven” qualities of the US dollar and were prepared to take on more investment risk.

Summary

There was a positive shift in market sentiment in November, which is expected to be maintained as we enter the New Year.

Both fixed income and share markets have benefited from better-than-expected inflation, an easing of US labour market conditions, and a slowing of US economic activity. This backdrop provides support to the view the Fed has likely finished raising interest rates in this cycle.

The outlook for global and domestic fixed income remains attractive despite recent gains. Fixed income offers an attractive yield with the potential for capital gains from further declines in interest rates. Longer term interest rates are forecast to decline over the next twelve months given expectations that inflation will continue to ease, and central banks have finished raising interest rates.

Stability in longer-term interest rate markets and an ending of interest rate hikes by central banks would be positive for global equity markets. Although US economic activity is expected to slow from its robust pace earlier in the year, the prospects for the US economy have improved in recent months. Against this backdrop, and in the absence of a recession, global share markets are likely to continue to build on their recent gains.
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 30 November 2023	1 Month	3 Months	6 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	5.4%	-1.5%	-3.6%	-1.0%	-3.2%	5.9%
S&P/ASX 200 Accumulation Index (AUD)	5.0%	-1.8%	2.0%	1.5%	7.1%	8.7%
MSCI ACWI Index (Local Currency)	8.1%	1.4%	8.1%	11.3%	7.2%	9.7%
MSCI ACWI Index (NZD)	3.3%	-1.8%	5.4%	13.5%	10.5%	11.5%
S&P/NZX 90 Day bank bill Total Return	0.5%	1.4%	2.9%	5.3%	2.5%	2.0%