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Monthly View as at 31 January 2024

After a very strong performance over the final two months of 2023, global share markets moved higher in January, led by the US share market which reached historical highs. The US S&P 500 Index surpassed its highest level reached two years ago and has gained 38% from its October 2022 low.

Market sentiment has improved over the last three months due to inflation falling faster than anticipated, central banks nearing the end of their interest rate hiking cycle, and the ongoing resilience of the US economy.

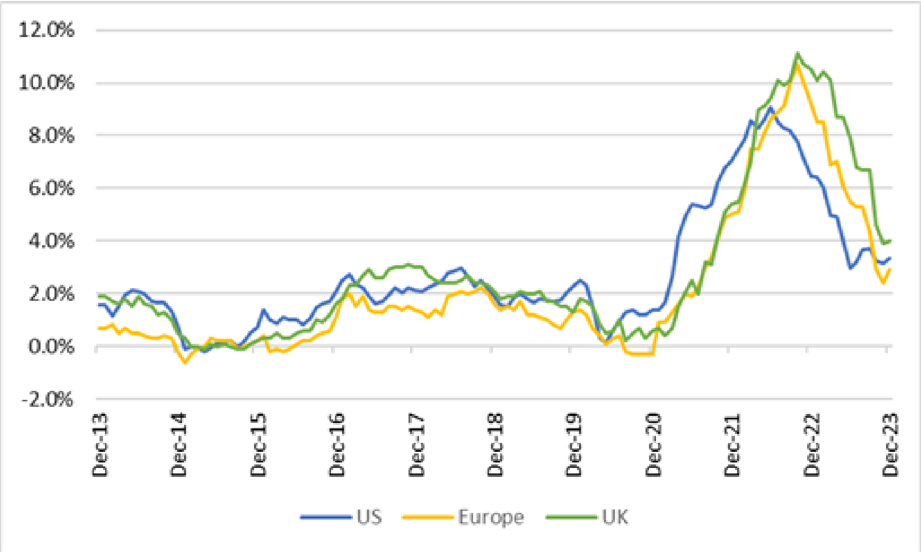
The US Federal Reserve (Fed) surprised markets at their December meeting. Although they held rates at 22-year highs, they suggested an end to the most aggressive rate hiking cycle in four decades and focused on the risk of causing unnecessary harm to the US economy.

The Fed is now focused on when interest rate reductions would be appropriate and in managing the two-sided risks they face. The Fed risks maintaining interest rates too high for too long and causing unnecessary harm to the US economy, versus cutting rates too early and reigniting inflation. They have provided no indication of the likely timing of interest rate reductions.

Other central banks are likely to join the Fed in reducing interest rates in 2024. Although the Bank of England, European Central Bank (ECB), and Bank of Canada all kept rates steady in their most recent policy updates, market expectations are for them to commence rate cuts later in the year, reflecting falling inflation and weak economic data.

A key dynamic changing the outlook for interest rates has been the dramatic decline in inflation globally over the second half of 2023 (see graph below). In many countries and regions including the US, Europe and New Zealand, inflation has fallen more quickly than anticipated by central banks. Inflation is anticipated to decline further over 2024 providing the opportunity for central banks to begin easing policy interest rates.

Global Headline inflation rates (YoY)



Source: Bloomberg, JMI Wealth

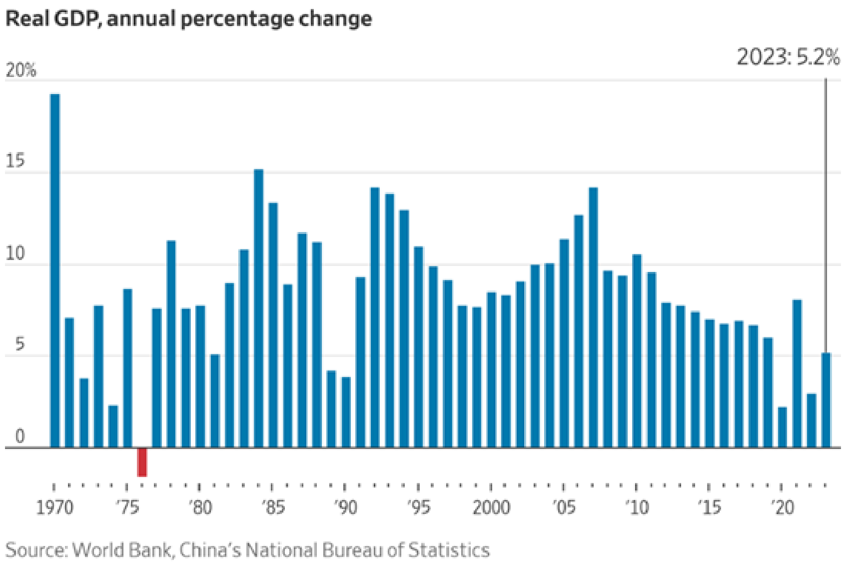
New Zealand's inflation rose 0.5% in the fourth quarter of 2023, and 4.7% on a year-on-year basis. Annual inflation was running at 7.2% a year ago. Inflation has undershot the Reserve Bank of New Zealand's (RBNZ) projections for five consecutive quarters.

From an interest rate perspective, while inflation remains too high for an imminent reduction in the Official Cash Rate (OCR), a run of weak economic data supports the view that further interest rate hikes by the RBNZ are unwarranted and that interest rate cuts are likely to occur earlier than 2025 as currently anticipated by the RBNZ.

Economic activity has surprised to the upside in the US. Based on initial estimates, the US economy expanded at a 3.3% annualised rate in the fourth quarter of 2023, much better than the 2.0% anticipated and this follows a larger than expected 4.9% annualised rate in the third quarter. The resilience of consumer spending in the face of higher interest rates has led to better-than-expected economic outcomes in the US.

Economic data continues to underwhelm across Europe. The European Union experienced no economic growth over the final three months of last year, and this follows a 0.1% contraction in the third quarter. Chinese economic data has continued to disappoint. The Chinese economy expanded 5.2% in 2023. Apart from the three-year period during the global pandemic, this is the slowest annual economic growth rate since 1990.

Chinese economic growth



Source: WSJ

New Zealand Share Market

New Zealand's economy contracted 0.3% in the third quarter of 2023, much lower than the +0.2% consensus forecast. The domestic economy has contracted three of the last four quarters. Economic data (e.g., retail card spending and surveys of manufacturing activity) over the final three months of 2023 was consistent with ongoing weakness in New Zealand's economy.

The New Zealand share market[1] rose 0.9% in January, primarily driven by offshore events. Summerset Group (+7.2%) was one of the better performing stocks over the month after they announced they had sold a record number of units in 2023. KMD Brands (-6.7%) underperformed after delivering a weak sales result, reflecting the challenging retail conditions currently in New Zealand.

Australian Share Market

The Australian share market[2] rose 1.2% in January in line with global markets. As has been the case in other countries, Australia's inflation surprised to the downside. Annual Headline inflation rose to 4.1% in December, lower than the 4.3% anticipated. Higher interest rates are impacting on consumers, retail sales fell 2.7% in December, which was worse than the 1.9% decline expected. That is biggest monthly decline in retail sales since pandemic lockdowns in mid-2020.

In corporate news, Resmed (+14.8%) was one of the better performing stocks after announcing a better-than-expected profit result. Mining and resource stocks e.g., BHP (-6.2%) were among the weaker performers on lower commodity prices.

Global Share Markets

Global share markets[3] rose 1.2% in January and are up 13.8% 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 finished hiking interest rates, and the US economy can avoid recession in 2024.

The US fourth quarter 2023 earnings season also commenced in January which provided further support to share prices. Although the performance of the US market is broadening, the focus remains on the Magnificent Seven companies (Alphabet (parent company of Google), Amazon, Apple, Meta (Facebook), Microsoft, Nvidia and Tesla) which drove global share markets higher in 2023. Over the month, Microsoft, Meta and Nvidia all hit record highs, but so do did non-tech names Caterpillar, MasterCard, and Visa. During the month Microsoft's market value rose above US$3 trillion for the first time.

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[1] S&P NZX 50 gross index
[2] S&P ASX 200 total return
[3] MSCI ACWI in local currencies

However, within the Magnificent Seven there was a divergence in profit announcements and performance over the month. Tesla underperformed after a disappointing profit result. Although Microsoft, Apple, Alphabet, and Nvidia delivered solid profit results, their results called into question expected growth rates and costs involved in delivering market-leading Artificial Intelligence (AI) products and services. Meta and Amazon produced much better than anticipated profit updates. Meta's stock price soared 20% on the day of its profit announcement, adding US$205 billion to its market value.

Another possible encouraging signal for US markets over of the course of 2024 is the "January Barometer". The term "January Barometer" refers to the belief held by some investors that the investment performance of the S&P 500 Index in January can predict its performance for the rest of the year. For example, proponents of this view believe that if the S&P 500 rises between Jan 1 and Jan 31, this will foretell a positive result for the remainder of the year. Similarly, it holds that if the market fares poorly in January, it will likely perform poorly thereafter as well. Since 1950 the "January Barometer" has had an accuracy ratio of 84.9%. Critics of the January Barometer theory will point out that similar phenomena have not been consistently found outside of the United States and therefore that it may be an anomaly specific to U.S shares markets.

In Europe, chip equipment maker ASML, software company SAP, and automakers Ferrari and Volvo all delivered better than expected profit results, rounding out what has been a good start to the year for global shares.

Conclusion

Market sentiment has improved over the last three months with inflation falling faster than anticipated, central banks nearing the end of their interest rate hiking cycle, and the ongoing resilience of the US economy.

These factors are expected to continue into the New Year, providing a constructive environment for both fixed income and share markets.

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 that central banks will commence interest rate reductions.

The combination of stability in longer-term interest rate markets and central banks cutting policy rates would be positive for global share markets. Although US economic activity is expected to slow from its robust pace during 2023, the prospects for the US economy have improved in recent months. Against this backdrop, and in the absence of US recession, the outlook for global share markets is positive.

Indices for Key Markets

As at 31 January 2024	1 Month	3 Months	6 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	0.9%	10.5%	-1.1%	0.1%	-2.5%	6.6%
S&P/ASX 200 Index (AUD)	1.2%	14.0%	5.8%	7.1%	9.6%	9.7%
MSCI ACWI Index (Local Currency)	1.2%	13.8%	4.7%	15.6%	7.8%	11.0%
MSCI ACWI Index (NZD)	3.9%	9.1%	5.4%	20.6%	11.8%	12.8%
S&P/NZX 90 Day bank bill Total Return	0.5%	1.4%	2.9%	5.5%	2.8%	2.1%