Market Update

View from the Investment Team

September 2024

Summary

Global share markets rallied in September on the back of a new rate cutting cycle in the US and step up in China stimulus.

The US Federal reserve cut rates by a full 0.5% and signaled more to come. In Australia the RBA remained on hold.

The Australian Dollar rallied 2.2% against the US Dollar, helped by relatively higher interest rate expectations in Australia coupled with some positive sentiment towards China.

Gold continued its strong run in 2024, rising 5.2% as tensions in the Middle east escalated.

MARKETS

Global equity markets rose by 1.5% in local currency terms in September, following a similar pattern to August when they recovered from a 5% sell-off early in the month to close modestly higher. China was by far the strongest performing market with the CSI300 surging to a 19% gain. Australian and the US returned 2.2% and 2.0% respectively and Japan was among the weakest performing equity markets, posting a 1.9% loss as investors came to terms with a new ruling-party leader being anointed in Shigeru Ishiba, who is believed to prefer a more hawkish monetary policy stance.

Sector level returns painted a mixed picture. The MSCI World Utilities index was the best performing sector at +5.1%, followed by Consumer Discretionary at +4.9%. Energy and Healthcare were the worst performing sectors at -3.5% and -3.3% respectively. Of notable mention, a key benchmark of Chinese Property Developers increased by 155% following a string of fiscal and monetary policy announcements by Chinese authorities (more on this under 'Data and Events').

As mentioned, Australia's share market rose a little over 2.0%. Developments in China served as a boon to the Australian Materials and Resource sectors, which led the broader market returning 13.1% and 11.5% respectively. The developments in China also prompted a rotation out of Australian bank shares later in the month into more cyclical and China-sensitive sectors locally and into China stocks directly as some investors had been using Australian banks as a less risky proxy to the Chinese economy until meaningful stimulus was delivered there. The Australian dollar strengthened 2.2% to finish just above US$0.69 as relative interest rate differentials coupled with investor sentiment moved in Australia's favour.

DATA AND EVENTS

The Federal Reserve moved to 'recalibrate' monetary policy, cutting its target interest rate by 0.5%. It was a larger interest rate cut than many in the market were anticipating and Chair Powell's supporting commentary was equally decisive, declaring 'the direction of travel for policy adjustments is clear'. The central bank also highlighted a desire to avoid a sharp move higher in the unemployment rate, which had previously been seen as a pre-requisite for bringing inflation under control. The benchmark interest rate in the US is now expected to fall to 2.5-3% in 2026 (from 5.25% prior to September 2024).

On the economic front in the US, GDP remains steady, tracking at around 2.5% for 2024, however manufacturing data remained weak with the US PMI Manufacturing gauge remaining in contraction territory at 47.2. Despite this, the trend of US economic data as measured by economic surprise indices trended positively throughout September.

In Australia, September saw monthly CPI come in at 2.7% year on year, as expected. Despite some noise, the trend for inflation in Australia remains down. The RBA's preferred trimmed mean year-over-year measure has been falling for 6 consecutive quarters now to June, at 3.9%, and the September report is expected to show inflation running at 3.4% - the lowest level since Q1 2022. To borrow a 'Powell-ism', the direction of travel for inflation in Australia also seems clear and ought to come as welcome news to households and businesses alike. Market pricing is forecasting the RBA to cut interest rates by up to 1% over the coming 12 months.

The RBA's Financial Stability review was published in September. It noted that stress in Australia's financial system remains low, but there were some ongoing increases in loan delinquencies, lower disposable income, and lower income segments also continue to bear the brunt of higher cost of living.

Economist are forecasting Australian GDP to come in around 1.2% and 2.1% year over year in 2024 and 2025 respectively. Recent stimulus announcements in China have the potential to see upwards revisions to GDP throughout 2025 provided they can translate to credit growth within China and, in turn, improved terms of trade for Australia. As yet it remains too early to draw any definitive conclusions.

On China, the easing of financial conditions in the US has seemingly opened the door for China to adopt a more accommodative policy stance without the risk of a meaningful currency devaluation. In September, the Chinese central bank cut key interest rates and relaxed mortgage financing requirements in further attempts to stoke demand in its ailing property sector. These moves were partnered with incentives for companies to buy-back their own shares and a government stimulus package that included direct share purchases.

While many commentators are questioning the durability of these measures with respect to China's medium term economic and corporate growth prospects, and the extent of the equity market rally thus far, they do signify a change in policy direction, and it is reasonable to speculate that more substantive measures are in the works. Only time will tell.

CHART OF THE MONTH

Source: Bloomberg, AMPI

SOME KEY THEMES and EVENTS

1. China

The Chinese central bank cut key bank interest rates again rates in September, loosened the requirements necessary for financing first and second mortgages, injected liquidity into the stock market, relaxed collateral standards for bank borrowing and encouraged and supported share buybacks. It also issued bonds equivalent to around 1.5% of GDP to finance investment and family support measures. For even the most ardent of China-sceptics, these measures were undeniably significant and positive.

While the size of the scheme isn't of the shock and awe scale of previous US or Chinese programs, it is larger and more comprehensive than recent interventions, and by embracing more 'Western' mortgage and share buyback policies, it is a marked change in approach. Delivered in the context of such low hopes and expectations, it is little wonder that Chinese equity markets ended the month nearly 20% higher in the case of the CSI300 and HSCEI indices.

Given the Chinese share market is cheaper than say India - on 10 times 2024 earnings for the HSCEI versus 24 times for India's Sensex, many investors are rightly re-considering their China allocation again after years of it being perceived as 'uninvestable' in some quarters. One thing that hasn't changed however is that investing in China requires an acknowledgement of the 'two-fail tails problem', which refers to the statistical properties of the potential return profile. There is great upside potential if recent stimulus continues and generates the type of economic momentum sought after by policymakers. Equally, there exists significant downside risk if the stimulus falls short.

2. US Election

The US election in November is approaching and the entry of Kamala Harris as the Democratic candidate evened up the odds for the presidency, Democrats are probably slightly ahead in the House and facing an uphill battle in the Senate. A Harris presidency would therefore most likely see a gridlocked government and more status quo. A Trump win would be somewhat more likely to see a sweep of both houses.

Based on previous actions and policy platforms, a Republican sweep would appear beneficial to real estate, materials, energy, and financials. It would probably not be beneficial to emerging market equities, trade and export heavy US trade partners.

A Democrat platform probably leans to the status quo which would imply health care and IT would benefit. Democrat gridlock also poses less of an inflation risk and so is likely more beneficial to US bonds and wider asset volatility.

3. Equity-Bond Correlations Normalising

Most people consider government bonds to be 'safe' or defensive. There is little risk of losing your money, and the return from the bonds is highly predictable - the market yield you buy the bonds at defines the majority of its future return expectation.

The other component is that bonds have historically done well when riskier assets are doing badly. Bond values rise when interest rates fall, so if growth is weaker and interest rates are being reduced, bonds tend to gain in value. If there is a 'risk-off' event, investors also tend to look for safety in bond markets and central banks often cut rates in emergencies providing a bigger return kicker. This is mirrored on the other side: when economic growth is strong, share markets tend to do well however interest rates rise, on average, meaning bond prices fall.

This negative correlation dynamic between equities and bonds is one of the core tenets of portfolio diversification. After a tumultuous period of higher inflation and interest rates, mostly throughout 2022, which saw bond and equity prices fall, negative correlations are more likely again going forward. This is welcome news for investors and bonds should be defensive again.

4. Gold in Focus

Warren Buffet has some famous quotations on gold as an investment. These include him opining that if you "own one ounce of gold for eternity you will own one ounce at the end", and "I have no views as to where gold will be (in the next five years), but the one thing I can tell you is it won't do anything between now and then except look at you".

The allure of gold as an investment stems from a few key assumptions and historical tendencies. Gold is supposed to be a hedge against inflation. It is also supposed to be influenced by real interest rates; if real rates are higher, investors should sell gold and move into higher yielding financial assets. Real interest rates have been rising this year and are set to rise further as inflation drifts lower… yet the gold price is up 30% in 2024! So, what gives?

Gold has relatively little substantial industrial use so it's price movements can typically be explained by who is buying and selling, and by far the biggest participants are central banks, especially China and India. Both China and India have been buying steadily for the last few years and that buying reached a record 480 tonnes in the first half of 2024. A portion of this buying can be attributed to a desire to reduce their reliance on the US dollar. The pace of buying has since slowed however the price of gold has continued to climb, driven by escalating tensions in the Middle East and, to a lesser extent, a falling US dollar.

With real interest rates declining, the rate of foreign central bank buying having slowed, and the US dollar already having fallen substantially over recent months, it stands to reason that the key driver of gold today is the Israel-centric conflict in the Middle East. If and when that conflict reaches a crescendo, support for the price of gold could quickly vanish. At the very least, one should expect the near-term outlook for gold to be volatile given the absence of traditional fundamental drivers.

MARKET RETURN SUMMARY

Asset class (% change)	1 month %	3 months %	1 year %	3 years (% p.a.)
Australian shares	2.97	7.79	21.77	8.45
Smaller companies	5.06	6.53	18.79	-0.57
International shares UH	-0.47	2.30	23.21	10.57
International shares H	1.48	4.63	30.59	9.88
Emerging markets UH	4.33	4.66	17.27	1.76
Property – Australian listed	6.45	14.30	45.93	8.82
Property – global listed	2.59	13.78	26.51	1.04
Infrastructure - global listed	2.05	13.32	27.15	6.11
Australian fixed interest	0.31	3.02	7.11	-1.19
International fixed interest	1.07	3.99	9.11	-1.48

Source: MorningstarDirect, AMPI. Returns are shown on a total return basis as at 30 September 2024.
Past performance is not a reliable indicator of future performance.