

# Market Update

## View from the Investment Team

August 2024

### Summary

**Global share markets began the month of August with a sharp correction, before recovering to finish strongly, gaining approximately 1.8%.**

**The US Federal Reserve signalled that interest rate cuts are coming, and they expect to start in September. In the absence of a collapse in the labour market this is expected to be 0.25%. In Australia, the outlook is less dovish with the Reserve Bank remaining on hold.**

**Bond markets rallied in August as interest rate expectations fell. Major bond indices gained approximately 1% globally and in Australia.**

### MARKETS

Global equity markets rose by approximately 1.8% (in local currency terms) in August, recovering from a sell-off of over 5% earlier in the month. The US and Germany were the top performing markets, whilst China and Japan were the weakest. The sell-off was triggered in part by some weaker US employment data and an expectation that Japan would raise rates again after doing so in July. This triggered a liquidation of very large 'carry trades' where investors fund US dollar holdings by borrowing the lower yielding Japanese yen.

The S&P500 market volatility index, or 'VIX', jumped by the largest intraday amount in its history. The Japanese Nikkei index also fell almost 20% in the first few days of August before recovering most of those losses over the rest of August amid the Bank of Japan issuing dovish statements.

The US earnings season has been generally strong. Earnings growth for 2024 is expected to be around 11%. Notable gains were made in Financials and Healthcare, whilst IT remains the strongest sector (albeit dominated by Nvidia). The election appears to be a larger issue than potential recession based on mentions in earnings calls, notably around energy policy.

Australia's share markets were marginally positive at around 0.5% with a weak resources sector acting as a drag. Iron ore and copper both remained weak. The Australian dollar strengthened toward US\$0.68 as relative interest rates moved in Australia's favour.

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## **DATA AND EVENTS**

Global GDP growth expectations have improved to above 3% at present. This is mixed with developed economies lower at under 2%, with some laggards such as the Eurozone tracking at less than 1% and Australia just above 1%. Global inflation continues to fall in most developed economies back toward targets. The US is now under 3%, whilst the Eurozone is heading below 2.5%. Australia remains stubbornly high at around 3%, hence the more hawkish tone from the RBA.

In the US, focus has shifted toward employment and growth. Unemployment moved upwards to 4.3% and along with other data prompted a pivot from the Federal Reserve that rate normalisation was now appropriate. US macro and surprise data are both negative at present suggesting a slowing but not a freefall economy. US manufacturing PMI's have been below 50 for the last 4 months (above 50 signals expansion), adding to the case for interest rate cuts.

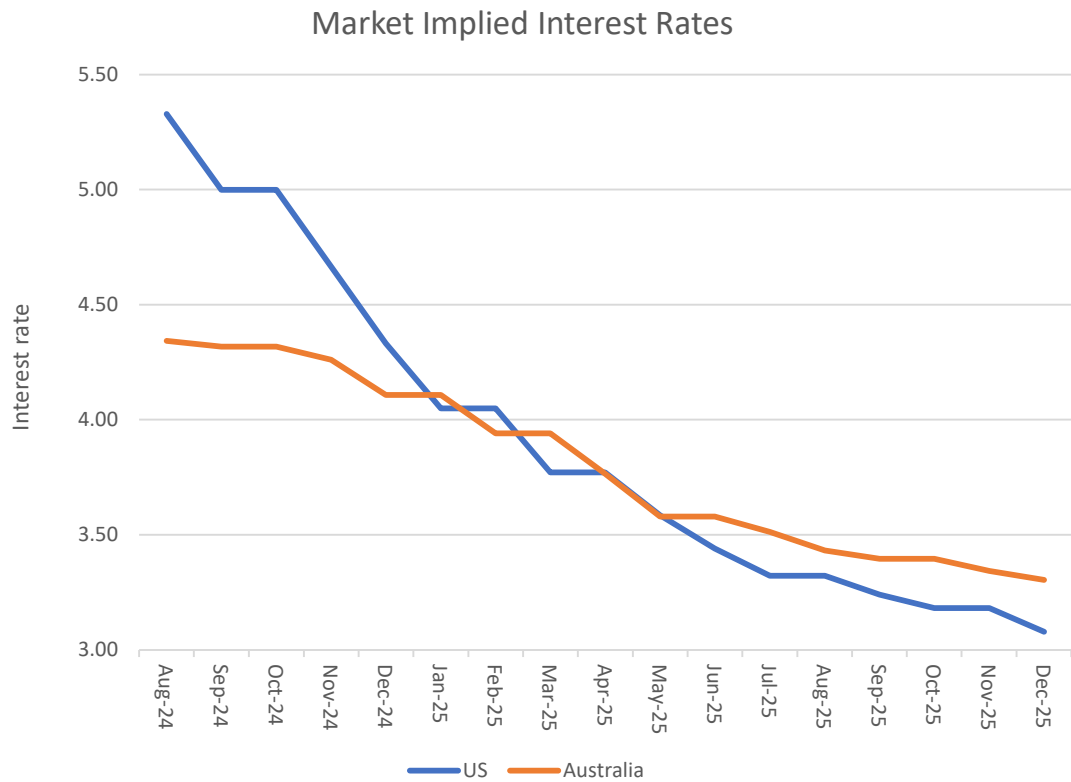
Eurozone growth data has been disappointing versus expectations and remains soft. The manufacturing PMI survey is still below 46, whilst surprise indices have dipped below 0 again, signalling data is not meeting expectations.

China continues to struggle economically with further deterioration in property prices. One measure of Chinese new commercial residential prices has fallen every month for the last 14 months. Most measures of demand, consumption and fixed asset investment look weaker this year from last, and although export growth is high it is also weakening. Despite that growth is still expected to be 4.8% in 2024 and 4.1% in 2025.

Australia's Q2 trimmed mean inflation number for August came in slightly softer than expected. The headline inflation figure was in line with expectations. This allowed the RBA to stay on hold. Australia's data remains soft overall with an uptick in unemployment, weaker job ads, mixed retail sales numbers and weak residential investment.

CHART OF THE MONTH

The US has around nine interest rate cuts priced by the end of 2025 whilst Australia has only about four. However, as Australia never raised rates as much, the path of future rates largely converges by the end of 2024. Australia has averaged higher cash rates than the US over the last 30 years and may end up with slightly higher rates again based on current expectations.



Source: Bloomberg

## **SOME KEY THEMES and EVENTS**

### **1. US election impacts**

The US election in November is approaching and the entry of Kamala Harris as the Democratic candidate has 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.

Whilst the details are too involved and uncertain to fully run through here, the general view is that if either side has a clean sweep, then the US budget deficit will continue to increase - Democrats through extra care spending, Republicans through full tax cut extensions.

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 (with gridlock) probably leans to the status quo which would imply health care and IT would benefit. Democrat gridlock would also be more likely beneficial to US bonds and wider asset volatility.

### **2. Australian earnings season**

Australian earnings season has wound up with most results in line with expectations. Australian earnings growth is expected to remain flat to modestly positive in 2024 and 2025, which is well below global market levels.

Unlike the realised results, guidance from companies relative to market expectations was generally poor. Only 25% of companies upgraded expectations, while over 40% downgraded. Sectors dragging down the market include energy and resources. From the peak for 2024, expected earnings have been downgraded over 15% for 2024. Australia's PE valuation at 18X 2024 earnings looks high historically.

With Australian GDP growth languishing somewhat, and a central bank that is not yet ready to pivot to monetary easing, domestic catalysts for recovery in fundamentals appear lacking at present.

### **3. The Australian dollar**

The Australian dollar doesn't screen as the cheapest in terms of currency models. It is also a well-known underperformer at times of slowing growth and is especially sensitive to how well China is doing. On the other hand, Australia's terms of trade seem OK despite weaker copper and iron ore prices, and the Australian government has one of the best budget balances across the developed economies.

Given that Australia was a laggard in raising rates and is now behind the curve in cutting them (relative to other major economies), it seems like the Australian dollar has an opportunity for a step higher providing growth holds up and our central bank

is on hold, or at least a less accommodative stance versus global peers. It rose circa 4% against the US dollar in August.

#### **4. Property prices**

Australian commercial property prices have been under pressure for the last couple of years due to a combination of high valuations, Covid-19 impacts, higher interest rates, and selling pressure across the market.

As at mid-year, property prices have on average fallen by almost 20% with retail and office sectors around 26% each, and industrial sectors by around 10%.

Valuations now appear closer to their listed counterparts where trading is simpler and faster, and closer to simple valuation models. Whilst property valuations do not appear to be bargains just yet, and there is more selling in the pipeline due to fund redemptions, they are closer to fair value and absent a recession the worst looks over.

#### **5. US recession watch**

Several historically reliable recession indicators have been triggered in recent times (or not so recent) including inverted yield curves, SAHM rule employment rules, negative leading indicator indices (US Conference Board Ten leading Indicators), whilst in many other areas there are areas of tightness that have often preceded downturns such as US Loan Officer surveys showing tightening lending standards (although less so recently) or rising delinquencies in US credit card debt. Despite this, US GDP is still tracking at around 3% at present and is only expected to ease toward 2% over the next 12 month. US consumers also continue to spend.

The pandemic has distorted a lot of data and historical relationships, including the US labour market where supply of labour returning to the market may initially push employment numbers higher, however job losses and lower hiring rates are also real, and recession odds have risen even if the timing remains uncertain.

#### **6. Bank valuations**

Australian banks have returned over 30% to date this year whilst earnings growth is lacklustre. At face value their valuations appear to have driven performance, however historically they are still well within normal ranges. As a group they have a price-to-book value of just under two. Historically this is marginally above average, and relative to US banks it is about average. Without solid earnings growth it is hard to see banks continue to rise at this rate, and there are cheaper bank markets around the world, but they aren't any overtly ominous signals as yet.

## MARKET RETURN SUMMARY

Asset class (% change)	1 month %	3 months %	1 year %	3 years (% p.a.)
Australian shares	0.47	5.74	14.90	6.73
Smaller companies	-2.02	-0.01	8.51	-2.90
International shares UH	-1.24	4.44	18.83	9.61
International shares H	1.75	5.33	22.66	6.51
Emerging markets UH	-2.20	3.84	9.84	-0.62
Property – Australian listed	0.57	7.62	25.21	5.88
Property – global listed	5.53	12.46	15.32	-3.26
Infrastructure - global listed	3.26	8.40	16.28	3.61
Australian fixed interest	1.21	3.50	5.15	-1.79
International fixed interest	0.99	3.69	5.97	-2.15

Source: AMP (index values from multiple vendors are received via external providers such as Factset, Bloomberg). Returns are shown on a total return basis as at 31 August . Past performance is not a reliable indicator of future performance.

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