# Current Market View

**Investment Markets**

The global share markets finished stronger in local currency terms over December 2023 as global interest rates continued to ease and inflation data was mixed although most developed nations revealing an improving economic backdrop. Traditionally this is a quiet trading period as the festive season takes centre stage with skeleton staff on hand.

What is driving the performance is the belief that the **Federal Reserve Bank hiking cycle is over**.

**The US Federal Reserve Bank held the target range for the federal funds rate steady at 5.25%-5.0% at the FOMC meeting held on the 13th of December 2023, indicating that the target rate may end 2024 at around 4.6% (down around 0.75% from current level.** Interest rates rallied as investors focussed on 2024 and the potential for monetary policy easing once the real impact of all the interest rate hikes if felt by consumers. This is likely to occur in Q3 of 2024.



Source data: Lonsec as of 31st December 2023

From the chart above, you can gain an understanding of why investors over the past year have tilted their exposures towards shares over bonds given the higher risk score resulting in higher returns in most cases.

*The risk measure is simply the one-year annualised standard deviation of the monthly total return time series for each category. The total return is the share or bond price movement monthly including any cash dividends and coupons payable.*

The S&P/ASX200 volatility (VIX) pushed lower closing at 11.23 as of 29th December 2023. It is currently trading at 10.93 as at close of business 15th January 2024 (Source: S&P/ASX200 VIX). Looks like the market is expecting a quiet session in the month ahead.

Expectations for further interest rate hikes now appears to be far from Central Banks thoughts as the recent inflation numbers reflect the potential for an easing bias in the months ahead. The latest inflation print in the US has revealed a small reversal in the annual inflation rate to **3.4% in December 2023 up from 3.1% last month.** This did not cause a strong market reaction given the overall direction of inflation in recent months and the potential for interest rates to fall**.**

The issues at the forefront of investors thoughts included:

* Political conflict – the ongoing war in the middle east for Israel and Humas, along with Ukraine and Russia, has unsettled investors. While not panicking, the underlying impact of these events put doubt into expectations for any economic recovery.
* Global growth – for our region China is the focus with property developers in the spotlight. The ramifications are that if China stumbles then Australia will be impacted given, they are our biggest trading partner.
* Inflation now showing signs of abating however stubbornly above the target ranges of Central banks. The impact of monetary policy changes typically takes 12 to 18 months to be felt and so markets are watching the economic data closely for signals that will challenge growth expectations.
* Bond markets and their response to the latest inflation print and Central bank cash rate hold is helping settle the debt markets.
* Share market valuations are challenging along with economic indicators flagging downside risks; however, **investors are encouraged to hold their resolve**, navigate this period of uncertainty, and expect better conditions to prevail in the 2nd and 3rd quarter of 2024.

Locally the domestic house prices continued to stabilise and drift higher after the brunt of the interest rate rises as confidence returned to stressed market sectors. This year will be challenging however, **the broader economy is weathering the storm very well** given the mixed support from high immigration levels, commodity markets and the strong level of employment with unemployment sitting at 3.9% in January 2024.

The latest inflation print for the third quarter of 2023 in Australia was 5.4% which was down from the 6.0% in the second quarter of 2023 but still elevated. Despite the elevated level of inflation, the RBA voted to **hold the target cash rate at 4.35%** at this month’s board meeting on the 5th of December 2023.

Despite the political conflict and volatile interest rate markets, the investment fundamentals are still supportive of longer-term recovery but not without short-term downside risk. Investors have adjusted their risk appetite to **“hold”** short term and **“optimistic”** medium term as they await the next round of inflation data and Central Bank activity however, the signals are getting better and **opportunistic buying** is still on the agenda despite the threat of an economic slowdown is likely to occur at some future point, but the severity is now seen as limited. We are looking for a **soft landing** for Australia.

Ukraine and Israel conflict is still a major concern for investors however, we are a long way from the conflict zone and the global economic data is improving slowly but the main influence on our market remains from offshore, especially China. China is experiencing issues relating to growth and Property developers which is holding back the improving underlying market conditions.

**The following total returns across the asset classes are as of 31st December 2023:**



Source data: Lonsec as of 31st December 2023

The developed markets asset classes finished strongly for the month. The AUD/USD finished sharply higher as well (+2.89%) in the month which cost unhedged holdings.

With **reporting season getting underway in the US,** much now will depend on how companies faired over the fourth quarter in the lead up to the festive season. Analysts expect mostly positive results, but consumption will be a key indicator.

**Asset Class Performance**



Data Source: Lonsec as of 31st December 2023 & Fox Asset Management

**Investment Climate**

The underlying investment climate has now changed to **“hold”** in the short term as investors consider the recent impacts of the falling interest rates and the European and middle east conflict.

The risk is that the conflict may escalate and involve neighbours which could then inflame the situation. While this situation continues, investors will be cautious however and fall in interest rates will spur buying in asset classes that have been oversold in recent months (property)**.**

Consumption is showing signs of a slowdown which will impact demand in the short-term and while it will take time to settle, the world will pull through this period of uncertainty supported by the deep pockets of Central Banks and strong allies of the conflicted countries.

The **medium-term view remains positive** for returns overall although headwinds will prevail, now that the US Fed has effectively **signalled a pivot for their interest rates**, this is a strong indicator for interest rate expectations and clear a path going forward for investors.

**Longer term investors are optimistic** for a goldilocks period ahead. Global Central Banks continue to indicate a resolve to get inflation under control however, the economic data is showing signs of an easing in inflation and every indication is for future easing in monetary policy expectations for the latter part of 2024. Remember **markets are forward looking** so the support now is reflecting the expectations for conditions in September 2024.

**The following commentary is based on month-end closing prices as of 31st December 2023:**

Global markets surged higher over December much to the relief of investors. The changing economic conditions along with interest rates peaking supported investor confidence. The situation in Russia/Ukraine conflict remains unchanged however the latest conflict between Israel and Hamas has prompted investors to avoid that region. Unfortunately, a resolution to the regional conflict is a way off currently however, the underlying economies elsewhere are emerging with a more growth orientated momentum after such an extended period of uncertainty.

As mentioned, the Fed left the target cash rates at **5.25% - 5.50%** at the 13/14 December 2023 FOMC meeting:

*“Recent indicators suggest that growth of economic activity has slowed from its strong pace in the third quarter. Job gains have moderated since earlier in the year but remain strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated” (Source: Federal Reserve Press Release December 13, 2023).*

Other measures agreed to at the Fed meeting include:

* In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals.
* The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments. (Source: Federal Reserve Press Release December 13, 2023).

**The next Fed meeting is scheduled for 30/31 January 2024**. Most officials see US interest rates ending at 5%-5.5%.

**Investor Focus**

For Australia, investors focussed on the following issues:

* Cost of living expenses and the impact on **consumer spending**.
* **Company profits** given the expected slowdown in consumer activity post the festive season.
* The level of **interest rates** and the delicate position of the RBA given the elevated inflation print.
* **Inflation** remains stubbornly high at 5.4% although easing from 6.0% in the second quarter of 2023 which although heading in the right direction, infers higher interest rates for longer.
* China growth prospects – the PBOC efforts to boost the economic growth by adding liquidity to the market to offset the property developers’ losses and the slowdown in the GDP annual growth rate to 4.9% in the third quarter of 2023 down from 6.3% previously.

## Asset Class Returns

Returns across the various asset classes ended mixed over the month:



Source data: Lonsec as of 31st December 2023

## Global Share Returns

For share markets, the focus remains on **inflation** and the potential for Central Banks to look at interest rate **easing programmes** over the longer time should inflation data continue to drift lower. Unhedged global shares lost ground with the USD/AUD strengthening (0.6648 down from 0.6346) which had a negative impact of (-2.89%) on AUD returns over the month for unhedged investors.

The markets are looking to stabilise and regain a level of confidence. Investors welcome the obvious signs that Central Banks have “**pivoted”** now and future interest rates moves are likely to be down not up which will underpin company valuations and support markets.

Most investors are content to **stay invested and ride out the storm** and add to their holdings opportunistically which has proven the correct strategy over the last period.



Source data: Lonsec as of 31st December 2023

In AUD terms, the global share markets posted one month return of (+1.87%). The US posted returns of (+1.59%), Asia ex Japan (+1.72%), Japan (+1.43%), the UK (+1.57%), Europe (+2.04%) and the Emerging Markets (+1.01%).

**Australian Shares**

Australian shares posted super strong returns pulled along by the global trend. Shares finished (+7.26%) for the month and (+8.40%) over the last three months. The focus for investors was:

* **Cost of living expenses** and the impact on consumer spending.
* **Company profits** given the expected slowdown in consumer activity post the festive season.
* **Consumer confidence** post the recent interest rate increases.
* **Mortgage stress** and the impact on domestic house prices and banks.
* **Inflation** and the welcome response by the RBA to hold the target cash rate at 4.35%.

Commodity markets ended stronger with Iron Ore closing at US$136.37 per tonne at the end of December 2023 with a monthly gain of (+4.53%) and gains of (+12.90%) for the previous three months. Oil (WTI) closed sharply lower at US$71.65 a barrel at the end of December 2023 resulting in losses of (-5.67%) for the month and down (-21.08%) over the last three months. China remains our main export market followed by Japan.

## Australian Industry Returns

Industry sectors posted mixed results for December 2023. The industry sector performance results for the last month were:



Source data: Lonsec as of 31st December 2023

Over the last month, Real Estate Investment Trusts (REITS) were the best performing sector posting gains of (+11.51%).

Utilities was the worst performing sector finishing (+2.50%) for the month.



Source data: Lonsec as of 31st December 2023

## Debt Market Returns

Bonds and Fixed Interest markets finished higher as global bond prices firmed (down in yield) as the Central Bank hold on the cash rates in the developed countries and hints of future interest rate falls encouraged investors. In Australia, the short-dated 2-year Government bonds trading at **3.80%** on the 16th of January 2024 and longer dated 10-year bonds trading at **4.11%.**

Global Bonds ended up (+2.98%) and Australian Bonds ended up (+2.969%) for the month of December 2023 and up (+5.25%) and up (+3.78%) respectively for the previous three months.

The RBA left the **target cash rate at 4.35%** following the 5th of December 2023 board meeting and stated that:

*“Whether further tightening of monetary policy is required to ensure that inflation returns to target in a reasonable timeframe* ***will depend upon the data*** *and the evolving assessment of risks. In making its decisions, the Board will continue to pay close attention to developments in the global economy, trends in domestic demand, and the outlook for inflation and the labour market. The Board remains resolute in its determination to return inflation to target and will do what is necessary to achieve that outcome.” Michelle Bullock, Governor, RBA Monetary Policy Board meeting, 5th December 2023.*

The US Federal Reserve Bank (the Fed) paused their monetary policy tightening measures by holding the target range for **federal funds to 5.25% to 5.50%** on the 13/14 December 2023 meeting. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities.

The US 10-year Government bonds closed at (3.866%) for the month down in yield (-0.464%) from the previous month close of (4.33%).

The Australian Government 10-year bonds finished lower in yield in December 2023 at (3.967%) down in yield (-0.395) from (4.362%) in November 2023.



Source data: Lonsec as of 31st December 2023

## Currency

The $A closed stronger at AUD/USD 0.6840 at the end of December 2023 which cost investors who held offshore assets unhedged (-2.89%) over the month and (-5.92%) over the last three months.



Currency forecasters see the AUD/USD range between 0.6250 and 0.7250 cents in the medium term and most likely to trade within the 0.5500 to 0.7500 range in the longer term.

## Australian Economy

Australia’s latest GDP data for the third quarter of 2023 revealed an **annual growth rate of 2.1%** which was unchanged from the second quarter of 2023. Unemployment firmed to 3.9% in December 2023 from 3.7%. The **core Inflation rate fell to 5.2%** in the third quarter of 2023 which is above the Reserve Bank’s targeted 2% to 3% target range. The **inflation rate eased to 5.4%** in the third quarter of 2023 down from 6.0% in the second quarter 2023.

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## Current Market View

### Domestic View

The Australian share market continued to surge higher over December 2023 as Global interest rates rallied hard following the lead given by Central Banks that **interest rates have peaked** and may ease in the months ahead.

The latest inflation numbers indicated an easing in inflation related prices however the focus was on the potential for Central Banks to ease monetary policy in the months ahead. Pre-empting this move, **markets responded with renewed optimism and went on a buying spree**. Falling interest rates should lead to rising company valuations.

More aggressive investors are taking advantage of any pullback in markets to buy oversold companies in industries and entering **selective risk-on trades**. This activity is likely to be in response to conservative earnings guidance being achieved and future guidance being marginally positive.

The overall investment feeling for shares in the short-term is **“hold”** but remains **optimistic** **over the long run** as interest rates ease along with inflation.

### Global View

Global markets surged ahead over December 2023 in AUD terms despite the headwinds of a strengthening AUD/USD exchange rate which cost (-2.89%) on the performance results for unhedged investors. Inflation, interest rates and the political uncertainty remain the key focus. For China, it is a wait and see brief as domestically they wait to see any indication of global growth falling before looking to commit to expand their markets.

Despite the uncertain geopolitical situation with the Russia-Ukraine, Israel-Hamas conflict, and economic slowdown concerns, we expect the **medium-term outlook to reflect better opportunities for investors**. Short-term, we expect the start of 2024 to reflect **subdued trading conditions** as skeleton staff hold the trading desks while consumers tighten their belts. The next set of company and economic data will provide a better indication of what is in store for the investment markets over the coming months.

**Where to From Here?**

**For Australia**, what is happening in the global markets is directly impacting our markets as there is alignment in trade terms, but the fallout remains mitigated given our immigration, agricultural and resource assets. All eyes are focussed on the **Middle East political unrest.** Let us hope the situation will be contained and a solution that ceases further aggression and violence is forthcoming.

The latest rhetoric from Central Banks now **confirms the change to monetary policy thinking**. We may not have seen the real impact of the interest rate rises just yet but the first half of 2024 should provide a strong indication of where we are heading in terms of soft or hard landing for the global economies.

Markets have already weathered tough conditions over 2023 and now there is economic evidence pointing to a potential mild global recession in the US and Europe down the track. **Markets are forward looking**, so it is likely they have **found a bottom and consolidating** before starting to recover longer term. We suspect we have just seen the start of that recovery process.

Fingers crossed that this latest changes to monetary policy direction in the developed countries, will lead to a moderation in prices and the start of a more stable growth platform.

**Footnote**

This market update written by Graham Fox for and on behalf of HNW Planning on 16/01/2024. Graham Fox is an external asset consultant and consults to the HNW Investment Committee. Graham has enjoyed a career in financial services covering several private, corporate and investment banking institutions including, Genesys Wealth Advisers (research), Standard & Poor’s Australia (fund ratings), Westpac Private Bank (research, strategy and product), Gold Link Capital (sales and marketing), Challenger Financial Services Group (COO asset management), Deutsche Funds Management (head of treasury), Canadian Imperial Bank of Commerce (regional head of FX), Banque Nationale de Paris, (F/X) and Commercial Bank of Australia (International and Treasury). Graham references material made available from HNW Planning’s' contracted research houses including Lonsec and Morningstar.