View from the hill

FEBRUARY 2024

Market update

The table below provides a summary of investment returns for the major asset classes for the month ending 31 January 2024.

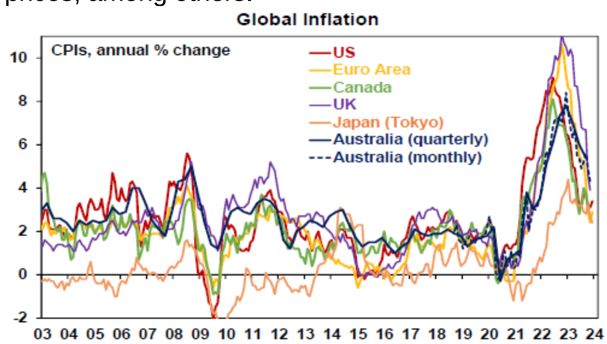
Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	1.2	14.0	7.1	9.6
Smaller companies	0.9	15.8	2.1	1.3
International shares (unhedged)	4.5	11.2	25.1	13.6
International shares (hedged)	1.8	14.8	17.9	9.6
Emerging markets (unhedged)	-1.6	2.5	3.5	-2.8
Property - Australian listed	1.2	25.1	9.5	7.8
Property - global listed	-3.4	14.3	-2.5	1.7
Infrastructure - global listed	-2.1	7.2	-4.0	3.4
Australian fixed interest	0.2	6.0	2.5	-2.5
International fixed interest	-0.3	6.0	2.8	-3.0
Australian cash	0.4	1.1	4.0	1.8

Past performance is not a reliable indicator of future performance.

Overview & Outlook

Markets have had a reasonably strong start to the year, regaining some of last quarter's buoyancy. Both US and Australian shares have reached all-time highs driven by continuing declines in inflation and notably strong earnings growth from the US technology sector. In fixed interest, the bellwether US 10-year bond yield ended 2023 at 3.8% having declined from an October high of 5% due to heightened expectations of interest rate cuts. The decline in 10-year government bond yields that occurred between mid-October and mid-December was the largest decline outside of the Global Financial Crisis, European Sovereign Debt Crisis, and the COVID-19 crisis of Q1 2020. Strong jobs data in January pared these expectations back somewhat with 10-year yields rising to 4% - more detail on why will be explained in the fixed income section below.

Inflation is surprising in terms of the rate of decline. In major developed countries it peaked around 8 to 11% p.a. and most developed countries have now seen inflation decline to approx. 3-4% p.a. The major causes of this welcome decline back towards central bank inflation targets include a combination of tight monetary policy, pandemic support measures ending, savings run down and easing supply chain pressures. Australia's inflation rate has not declined as fast as overseas is mainly a reflection of Australia lagging higher inflation rates due to a later reopening from the pandemic and slower pass through of electricity prices, among others.



Source: Bloomberg, AMP

It is important to note is that there are some risks for inflation being more volatile and temporarily surprising on the upside over coming months. These risk factors include the ongoing conflict in the Middle East, which has disrupted the Red Sea/Suez Canal shipping lanes and poses the risk of protracted and increasing military activity in the region and may jeopardise oil supplies.

Currently the global economy appears to be on track for a so called ‘soft landing’ where inflation falls back into the target range without casing considerable damage to economic growth. The current environment is positive for shares and bonds, however persistent inflation or wage growth risk a prolonged tightening and place the current rally in jeopardy. Similarly, if the rate of growth declines faster than the current trajectory then earnings resilience will be challenged.

Equities

Equity sector returns - Global	1m	3m	12m
MSCI World/Comm Services	+4.7	+17.4	+35.7
MSCI World/Information Tech	+4.3	+22.9	+45.9
MSCI World/Health Care	+3.3	+12.2	+7.8
MSCI World/Financials	+2.3	+17.4	+9.8
MSCI World/Consumer Staples	+1.2	+6.2	+2.3
MSCI World/Industrials	+0.7	+16.7	+18.4
MSCI World/Energy	-0.5	-2.0	-0.7
MSCI World/Consumer Disc	-0.8	+13.8	+17.8
MSCI World/Utilities	-2.6	+5.3	-2.2
MSCI World/Materials	-3.6	+8.6	+0.5

Equity sector returns - Australia	1m	3m	12m
S&P/ASX 200 Energy	+5.2	+0.8	+7.9
S&P/ASX 200 Fincl Ex A-REIT	+5.0	+17.8	+10.5
S&P/ASX 200 Health Care	+4.3	+27.1	+4.1
S&P/ASX 200 Cons Discretionary	+2.5	+14.2	+14.1
S&P/ASX 200 Telecom Svcs	+2.1	+6.4	+3.7
S&P/ASX 200 Info Tech	+1.2	+16.6	+25.8
S&P/ASX 200 Industrials Sector	+0.0	+13.1	+8.6
S&P/ASX 200 Consumer Staples	-0.0	+4.3	-4.4
S&P/ASX 200 Utilities	-1.5	-5.1	+4.7
S&P/ASX 200 Resources	-3.6	+5.9	+1.1
S&P/ASX 200 Materials	-4.8	+8.8	+1.6

The January market performance in Australia was a tale of two cities with the Energy sector up 5.2% off the back of a monthly 5% increase in WTI crude oil, while on the downside the Materials/Resources sector shed -4.8% as the iron ore price retreated 6.9% in January. Investors also remained concerned that China will continue to record slowing growth as bank solvency issues mount, thereby impacting demand for resources.

Globally shares rallied 4.5% with Information Technology and Communication Services leading the way up 4.3% and 4,7% respectively due to the magnificent seven continuing their run into the new year. Similar to Australia, the International Materials sector was the worst performer, falling 3.6% for the month.

US equity earnings are expected to grow around 11% in 2024 while earnings in Australia are expected to flat due to weak earnings in the bank and resources sector. Valuations will likely remain supported if interest rate cuts come more quickly and there is no global recession.

It is notable that US share market concentration continues to climb with the top 10 stocks making up 1/3 of the S&P 500. Whilst these stocks are highly profitable and are growing earnings, they are at levels not seen since the early 70’s and constitute an additional risk to the outlook should earnings falter.

Fixed Income

Change in key interest rates, basis points				
Interest rate	Aus	US	Eurozone	UK
Cash rate	0	0	0	0
2yr Govt bond	-3	-4	2	27
10yr Govt bond	6	3	14	26

*Note that bond prices rise when yields fall

Fixed interest performance stayed relatively muted in January compared to the previous 2 months. Australian Fixed Interest gained 20bps as yearly Australia inflation came in under at 4.1% p.a. versus consensus estimates of 4.3%. International Fixed Interest fell as yields rose across the US and Eurozone as economic activity in the US came in stronger than expected and yearly inflation was a little hotter than expected at 3.4% (consensus 3.2%).

In Australia, the December quarter CPI rise of 0.6% represented the smallest quarterly rise since the March quarter in 2021. While this is welcome news, there remain some concerns around the contributions to inflation at this time –items such as insurance (+16%), rent (+7.3%), electricity (+6.9%) and new dwellings (+5.1%) continue to push higher and these increases can weigh heavily on Australian household disposable income.
Interestingly as most fixed-rate mortgages have now rolled off (approximately 80% according to the AMP Economics & Investment Strategy team) to higher rates, house prices continue to hold or edge forward, with national property prices recording +0.4% growth in January. Record immigration and lacklustre supply outweighing the headwind of more restrictive monetary policy for the time being.

Property & Infrastructure

Off the back of strong performance in December, Australian listed property values rose again in January with Australian Property returning 1.21%. Again, it was the narrative around potential rate cuts in the second half 2024 which boosted the attraction of the asset class. An important test for the Australian commercial property market will be Mirvac’s sale of 255 George Street, currently valued at A$800 million, expected to go through in February. Pricing here will help serve as a useful reference for the office property sector more broadly. Listed Infrastructure returned -2.1% in January.