Market Update

View from the Investment Team

November 2024

SUMMARY

Global share markets rallied strongly in November on the back of a clean sweep by Republicans in the US presidential election. This the most bullish possible outcome for markets.

Bond markets also produced gains as bond yields peaked and retraced their recent rises.

The pro-crypto stance from President-elect Donald Trump saw assets such as Bitcoin make major advances. Bitcoin leapt from the USD 70k level towards the USD 100k mark.

MARKETS

In November share markets were led higher by the US (+5.9%), notably US banks (+13.4%) and cyclical areas such as US small caps (+10.9%). The US earnings season was also strong, with a fifth consecutive quarter of earnings growth of 5.8% year-on-year for the September quarter.

The Australian market was also strong, with gains concentrated in industrials, consumer discretionary and banks. Resources stocks fell further as China failed to maintain stimulus momentum. Australian banks continued to dominate the index and have outperformed resources by almost 60% over the past year. (Earnings account for approximately only a third of this, while increases in bank valuations were the main driver. The Australian market is near record highs in terms of valuations).

Outside the US the news was less positive. European markets were flat, while China and emerging markets fell by around 3%.

Credit markets continued to tighten. Credit spreads (the amount of yield paid to compensate for the risk of default) tightened to the lowest levels in 30 years, a reflection of strong corporate balance sheets but historically unattractive valuations.

Real assets continued to rally during the month. Global listed real property returned around 3%, bringing one-year returns to over 20%. Listed infrastructure rallied by similar amounts over the month and the year.

The Australian dollar weakened slightly against the US dollar, towards 65 cents. In other currencies the trend has been for a stronger US dollar as relative interest rates favour the greenback.

DATA AND EVENTS

In Australia, monthly inflation readings came in slightly softer than expected, helped lower by subsidies in rent and electricity. Trimmed mean inflation, however, remains above target at 3.5% p.a. and is likely to continue to keep the Reserve Bank of Australia (RBA) on hold, although the trend remains downwards. Australian data overall has improved marginally from weak levels. Household spending improved on monthly figures but is tracking weakly at around 1.3% year-on-year. Unemployment remains unchanged, while PMI survey data shows manufacturing contracting slightly and services expanding slightly. Housing prices overall have shown a circa 6% growth rate over the last year.

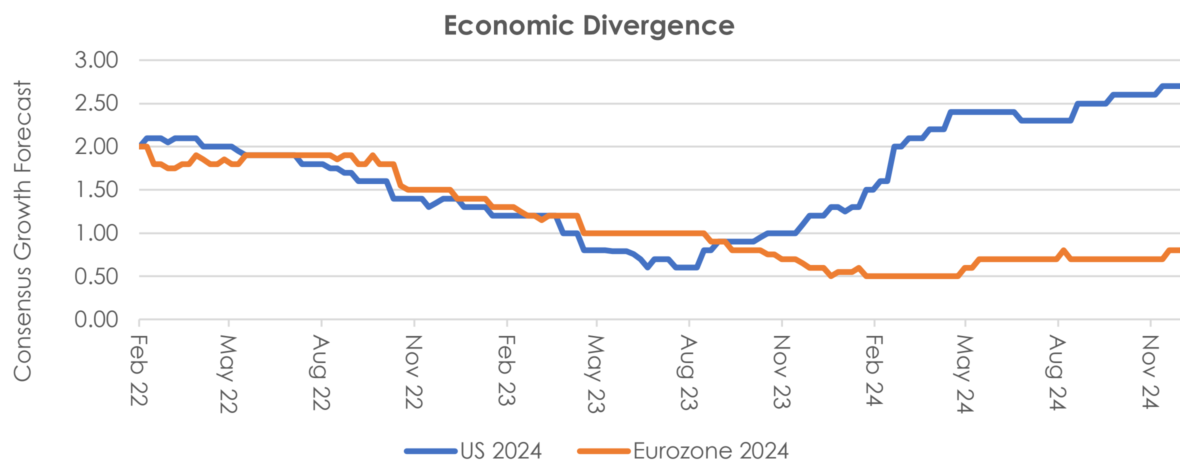
US data has continued to improve relative to expectations, but at a pace where historically it has started to undershoot expectations. Presently, however, there have been improvements in areas such as personal spending. Unemployment is unchanged and GDP growth is running at a little under 3%.

Europe remains weak with Germany in recession. Inflation and growth data is weakening and is likely to trigger a larger and earlier rate cut than currently anticipated.

China has been improving relative to expectations, possibly a combination of previous stimulus impacts and a desire to frontload production before President-elect Trump takes office. However, the same problems around weak property prices, weak industrial profits and the consumer persist. In November, figures released show retail sales improving against expectations, and industrial production remaining strong. Industrial profits, however, fell 10% year-on-year and house prices fell by around 0.5%.

Japan appears to have a case for raising interest rates in December or January, as inflation is firm, and its currency has weakened again. Any surprise hikes have the potential to create volatility in the same way that occurred in July.

CHART OF THE MONTH



Source: Bloomberg, AMPI

KEY THEMES AND EVENTS

1. US earnings

The US earnings season is largely complete, with the results strong. Year-on-year growth for the September quarter was around 5.8%, the fifth straight quarter of growth. This was around 1.5% better than expected at the start of October. In the December quarter, earnings growth is expected to jump to around 12%, the highest rate in three years. Improvements are coming from financials (39%), commercial services (20%), IT (14%), and utilities. The health care and consumer discretionary sectors both increased by around 12-13%.

Some of the big gains in the data are coming from banks who have benefited from accounting and financial reporting changes from the Federal Deposit Insurance Corporation that allow them to report earnings in a much better light – i.e. higher and with less volatility.

2. What does AI do to markets?

The development of AI Large Language Models is permeating all aspects of how financial markets operate (as well as helping drive parts up substantially). The impacts are in many ways an extension of the impacts that quantitative techniques have been having for many years – just at a faster pace. Some examples include:

a. AI should make markets more efficient by incorporating information into prices at a much faster pace than has been historically possible. Most information today (such as earnings calls or central bank minutes) are processed and traded on in real time.
b. AI will probably increase activity and therefore liquidity most of the time. Active AI associated ETFs are hugely more active than non-AI active ETF's.
c. AI will potentially increase short-term market volatility, the same algorithms that trade more often also reduce or stop activity when something adverse is happening
d. Trading activity may become harder to observe as non-bank actors such as hedge funds and trading firms are more able to participate in the trading activity, while traditional banks will find it harder due to regulations and capital requirements.

3. US policy impacts

The incoming US administration has threatened much higher tariffs than those implemented during Donald Trump's first term. At the time, tariffs were implemented on steel (25%), aluminum (10%) and a range of others on over USD 350 billion. This time a universal tariff of 10-20% has been proposed, while a significantly higher tariff of 60% has been proposed on Chinese goods.

It is estimated that, if implemented, this could shave approximately 1% from US GDP and add some one-off jumps to price levels. In short, growth negative and inflation positive.

In addition, the expected impact of cutting back immigration is significant. Immigration of around three million in the US has helped growth and wage inflation. Cutting back these numbers by over 50% through harder entry and deportation threatens an undersupply of labour that would be stagflationary.

Markets would not look through the impacts of lower growth and higher inflation and these would be negative for equities and bonds alike, but not as bad, or potentially good for inflation-linked bonds.

4. Are Australian yields attractive?

Australia currently has weaker growth than the US. We also have had higher inflation than the US. Our trimmed mean measure has been as high as 1% above, as our inflation basket has been stickier, with a greater influence from regulated items. Currently, our inflation is trending down relative to the US and is likely going to be below US inflation by next year.

Our 10-year bond yields are currently higher than US Treasuries by around 0.2%. In a world with lower growth, a delayed rate cutting cycle, and lower inflation, Australian bonds appear more attractive than US Treasuries equivalents heading into 2025.

5. Expectations for 2025

There are many strategy pieces written each year discussing risks and opportunities for the year ahead. A recent article summarised all major strategists from Wall Street and beyond to gain a consensus view of what the world will looks like in 2025.

The summary was:

- e. The S&P 500 is set for more modest gains
- f. US 10-year bond yields will stabilise at 3.5-4% p.a.
- g. The US Federal Reserve will cut rates more gradually towards 3.5% p.a.
- h. The US dollar will weaken slightly
- i. Europe’s recovery will be slow
- j. China’s growth will be capped at 4-4.5% p.a.
- k. The G10 divergence will widen
- l. Commodities will see a moderate improvement

Any developments around weaker growth and higher inflation in the US would have the capacity to upset these assumptions.

MARKET RETURN SUMMARY

Asset class (% change)	1 month %	3 months %	1 year %	3 years (% p.a.)
Australian shares	3.8	5.5	23.4	9.6
Smaller companies	1.3	7.3	19.9	-0.1
International shares UH	5.2	8.8	30.2	11.9
International shares H	4.9	5.4	27.9	8.4
Emerging markets UH	-3.1	2.4	13.9	1.6
Property - Australian listed	2.5	6.5	40.5	7.3
Property - global listed	3.0	1.5	19.2	-2.5
Infrastructure - global listed	5.4	7.4	20.5	6.9
Australian fixed interest	1.1	-0.5	5.2	-0.9
International fixed interest	1.2	0.7	6.2	-1.8

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

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