Market Update

View from the Investment Team

October 2024

Summary

Global share markets retraced some of the exuberance from China's stimulus announcements

Yields on bonds in the US and Australia continued to rise creating negative returns for bond markets

Bitcoin began to rally again in October and broke out through $70,000

MARKETS

Global equity markets fell on the back of a China hangover. Australia fell circa 1.3% led by a Resources sector that fell over 5%. This brings resources in Australia back to flat over last 12 months.

The US also fell by almost 1%, Europe by over 3%, however Japan bucked the trend and rallied almost 2%. Not surprisingly China and Emerging markets were weak.

The Australian dollar also reversed its China gains and fell around 4.8% relative to the US Dollar. Gold continued to rally climbing toward USD 2800 an ounce. Oil spiked early in the month on Israel's attack on Iran before that too reversed back to starting levels.

US third quarter earnings are looming and expectations for the quarter fell from a bullish 7% to around 3%. This isn't unusual in an historical context however the actual results will be interesting. The only 2 sectors to improve were tech and communications. The growth expectation for 2025 remains solid at around 15%. It is notable that the Magnificent 7 large technology stocks continue to dominate earnings growth in the US market, although not to the degree that was apparent in 2023.

Somewhat surprisingly given equity market weakness, high yield bond spreads (the extra yield priced in to compensate for the risk of defaulting) rallied in over the month toward historically tight levels.

DATA AND EVENTS

US economic data improved on average, with outcomes improving in an absolute sense and also relative to expectations. Some of the key releases were in:

- Employment data via the nonfarm payrolls grew by 254k, well above expectations and above 155k in August. This 'de-triggered' the SAHM rule recession indicator which has not been seen before. Despite this other data does show ongoing weakness, so a clear trend is yet to emerge.
- Inflation data maintained its downtrend however US CPI did tick slightly higher and the Cleveland 'CPI Now' measure also ticked back up.
- Together with the better-than-expected employment data bond yields climbed again and the US 10-year bond yield rise by around 0.5% back to 4.3%. The number of expected rate cuts by mid-2025 also dropped by 2 and a half cuts

In Australia economic data has been marginally improving relative to expectations. In October key releases were:

- Inflation data shower headline inflation slightly lower than expected whilst other measures were in line. Australia's CPI is tracking below 3%, however is likely not falling enough (yet) to kick start rate cuts
- Retail sales were slightly improved early in the month however overall consumer spending is flat month on month and subdued on a yearly basis

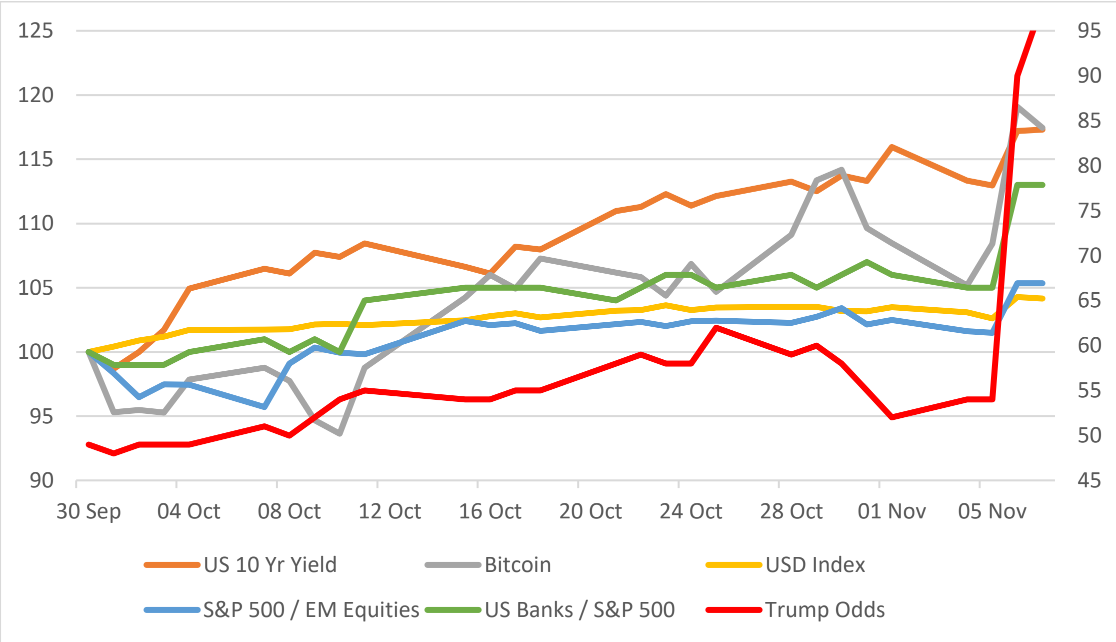
Globally:

- Global GDP is running at just above 3% and appears stable for the moment. Northern Europe continues to struggle with Germany in a mini recession.
- Several central banks cut rates around the world including the ECB (-25bp), Bank of Canada (-50bp) and RBNZ (-50bp).
- The IMF characterized global growth as subdued in its 3rd quarter report noting China's slowing trajectory, geopolitical tensions, rising protectionism, and risks arising from fiscal pressure.

CHART OF THE MONTH

As the Trump campaign odds improved through October, many 'Trump trades' responded accordingly. These included bond yields, the US Dollar, Bitcoin, US banks outperforming the market and emerging market equities underperforming US equities. No doubt these will fluctuate as policies are announced, however bond yields rising aggressively and equity markets rising, in the absence of very strong growth, is not sustainable.

Source: Bloomberg, AMPI



SOME KEY THEMES and EVENTS

1. Nuclear

There has been much debate in Australia around Nuclear Energy and its potential role in our future energy mix. Whilst Australia has some barriers, and existing natural benefits in alternative power sources, the worlds demand for electricity is growing and nuclear power is likely going to be required to be part of that solution. The benefits of nuclear power are clear. It is stable, more efficient, clean (in terms of emissions), less reliant on critical minerals, and cheaper to build in terms of raw materials used. It has headwinds as well including public perception, waste disposal, lack of investment, lack of design standardization, and lack of trained staff.

Given that the global share of electricity consumption from data centers is expected to grow from around 6% today to over 12% in the next 5-10 years (driven by AI in large part), it is very clear that investment into nuclear is set to expand rapidly over the next decade. Large tech companies are already completing deals to develop their own nuclear capabilities. That investment will continue and has the potential to fuel an ongoing price surge in uranium mining and uranium prices.

2. US Election

The US election is being decided at the time if writing this note. Currently it would appear that the Republican party are en-route to a clean sweep, a bullish outcome for equity markets, the US Dollar, and Bitcoin. It is also a bearish market for areas like emerging markets and US Bonds. Given the world retains the US Dollar as its reserve currency, any severe sell off in Treasuries is unlikely to be sustainable. If it were to be validated, along the lines of a collapse in confidence in the US governments finances, then equity market rallies are also at risk.

Positioning data for US investors also suggests that bullish positions had been increasing in recent weeks. This implies that the overall rally size may be limited, but there is room for rotation, suggesting small cap and cyclical sectors have room to run.

3. Valuations

Starting point valuations (not surprisingly) play a strong role in likely medium-term returns from different investments. Over say 10 years, they are very important, but over shorter periods of say a year or 2 they have less impact. Today valuations in equity markets around the world are somewhat high, notably in the US, whilst they are better in emerging markets and Europe. In the US where valuations such as the PE ratio are toward the upper end of their history, returns for the next 10 years on average) are looking somewhat constrained. Australian shares look a little better, although the valuation relationship arguable is a little less strong. What is also apparent is that bonds and cash look stronger relative to shares than they did a few years ago. The equity risk premium, the amount of return required by investors to justify the higher share market risk, are close to zero, suggesting expensive markets. Europe and emerging markets look stronger.

4. Fixed Income

Typically, when looking at bonds, investors think of pricing in different components. This boils down to the risk-free part, that is the yield that an equivalent government bond would pay, and an additional yield 'spread' that represents compensation for the risk of default by the corporate bonds Those 2 yield components typically work in opposite directions. If growth is falling, government bond yields fall (i.e. prices rally), but the credit component widens (i.e. default risks increase).

Over time corporate debt outperforms as it carries higher risk, but the combination of the 2 also provides a nice diversification benefit.

At present, yields on US 5-year government bonds are around 4.2%, and the compensation for liquid corporate debt is quite tight at around 0,8%. The relative tradeoffs between government and corporate bonds appear to favour risk free debt at present.

MARKET RETURN SUMMARY

Asset class (% change)	1 month %	3 months %	1 year %	3 years (% p.a.)
Australian shares	-1.31	2.10	24.89	8.01
Smaller companies	0.80	3.77	26.65	-0.61
International shares UH	3.92	2.14	29.31	11.39
International shares H	-0.93	2.23	31.63	6.16
Emerging markets UH	1.21	3.26	21.13	3.17
Property - Australian listed	-2.57	4.31	50.82	7.66
Property - global listed	-3.98	3.98	26.68	-3.71
Infrastructure - global listed	-0.17	5.24	23.63	4.00
Australian fixed interest	-1.88	-0.39	7.08	-0.62
International fixed interest	-1.51	0.53	8.37	-1.89

Source: AMPI. Returns are shown on a total return basis as at 31 October 2024. Past performance is not a reliable indicator of future performance