AMP

WEEKLY MARKET UPDATE

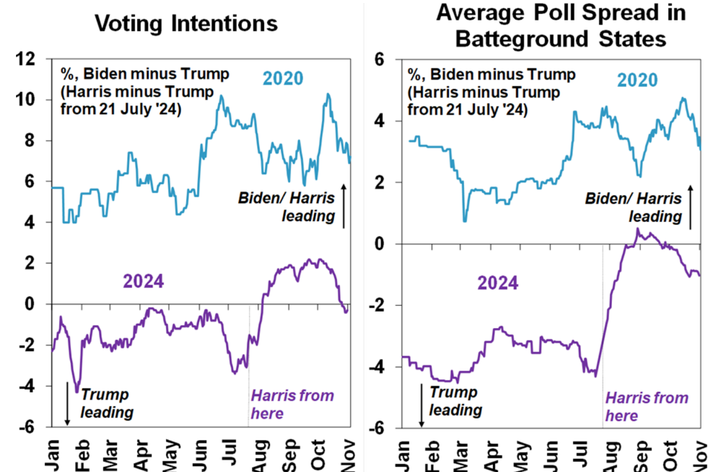
01 NOVEMBER 2024

Investment markets and key developments

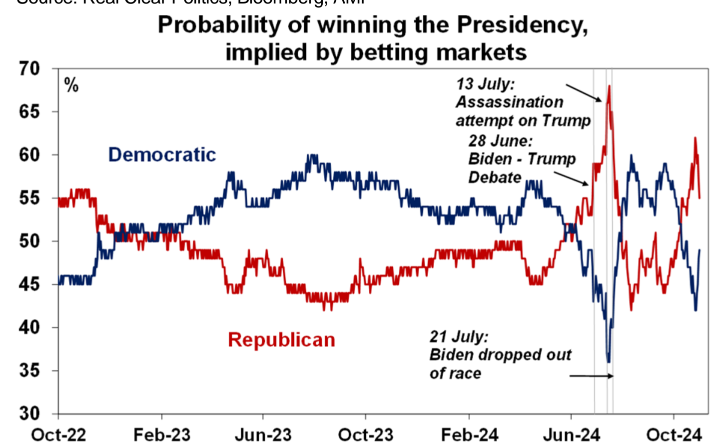
Global share markets remained under pressure over the last week not helped by mixed US earnings news and ongoing increases in bond yields not helped by uncertainty ahead of the US election. US, European and Chinese shares fell but Japanese shares rose slightly. Reflecting the weak global lead along with slightly higher than hoped for underlying inflation dashing hopes for a pre-Christmas rate cut saw Australian shares fall around 1.2% with falls led by consumer staples, utilities, health and financial shares. Oil prices initially fell sharply as Israel focussed on military targets in its retaliation against Iran's missile attack but then reversed some of their falls on reports that Iran may still counter-retaliate. Metal and iron ore prices fell and the $A fell despite a slight fall in the $US.

Over the next 6-12 months we continue to see shares heading higher as central bank rate cuts bolster economic growth, but gains are likely to be more constrained and the risk of another correction is high. In particular, stretched share market valuations made worse by the rise in bond yields through October leave them vulnerable at a time when recession risk remains high, the Middle East conflict is still at high risk of escalating in a way that disrupts oil supplies (with reports Iran is planning a retaliatory attack on Israel through it proxy militias in Iraq) and the US election could trigger more volatility.

Trump is ahead going into the US election, but it's very close. Historically a strong share market, low unemployment and falling inflation would point to a win by the incumbent party, but this is not foolproof and the cost of living surge and immigration blow out appear to be weighing against her. The Real Clear Politics average of national voting intentions polls now has Trump ahead by 0.3%, the RCP poll averages show Trump ahead in five of the seven battle ground states and betting market odds have Trump and the Republican's ahead although the odds have narrowed to 55%. However, the "shy Trump voter" phenomenon is probably not as much of an issue now and pollsters have reportedly improved their methods so betting markets may be exaggerating his odds as his poll leads are within their margin of error. But this is very different to 2016 though where Trump was the outsider and his win surprised markets whereas now markets have moved to allow for a Trump win as evident in the rise bond yields (where his policies threaten to increase the budget deficit and inflation), the $US (on the back of his tariff policies and potentially higher Fed interest rates than would otherwise be the case) and Bitcoin (where he is seen as more favourable to crypto).



Source: Real Clear Politics, Bloomberg, AMP



Source: Bloomberg, AMP

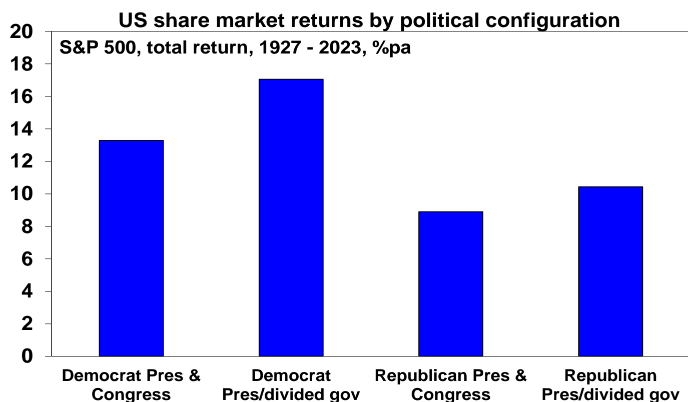
What the US election might mean for markets and Australia. In terms of key policies impacting the economy and investment markets Harris is promising higher corporate and capital gains taxes, higher taxes for those earning more than $US400,00 and more social spending, whereas Trump is promising lower taxes, deregulation, lower immigration and big tariff hikes. With Trump ahead markets have been starting to factor his policies in as reflected in the rise in the $US, Bitcoin and bond yields. Of course what the president can do will be partly dependent on what happens in Congress. In terms of election outcomes:

- **Harris with Republican control of the House and/or Senate is basically more of the same**. As with Biden she won't be able to raise the corporate and capital gains tax rates. Bond yields, the $US and Bitcoin may reverse some of their recent gains and Trump exposed shares may too. It will mean periodic fights over raising the debt ceiling and financing the Government, but this will also constrain spending. Beyond the initial reaction to the election, this is the most benign outcome for share markets and Australia.
- **Harris with Democrat control of Congress (which is unlikely) would be taken negatively by share markets** and

would likely mean more upwards pressure on US bond yields as it would mean more spending and the hike in corporate taxes and CGT tax could be passed (although not necessarily as Biden policy couldn't get it done when he had control of Congress in his first two years.)

- **Trump with Republican control of Congress would mean tax cuts and deregulation which may initially be good for shares but tariffs and potentially higher labour costs from his immigration policies will be drags so it depends on which policies Trump focusses on first**. And don't forget Trump is no longer the outsider and is now somewhat favoured to win so a kneejerk surge in shares like seen after his surprise 2016 victory is not assured. What's more the tariffs he is talking about this time would take average US tariffs 5 to 6 times above where they got to in his first term so it could end being a lot more threatening to US shares via the hit to the economy and as other countries retaliate (with reports that Europe is planning to hit back quickly). This outcome would likely mean more upwards pressure on US bond yields and the $US. A global trade war would be bad news for the Australian economy, particularly via its impact on China.
- **Trump with Democrat control of the House and/or Senate**. This could be worse for shares and the US economy as it means tariff hikes without the stimulus from tax cuts. As such it would be the most negative scenario for Australia. It would likely still mean upwards pressure on US bond yields and the $US.
- **A contested election** – of course this would drive market uncertainty until the outcome is decided either by finalisation of results/court cases in close run states resulting in an election college majority or if there is no majority in the electoral college it will be decided by a vote in the House with each group of state members getting one vote – which is likely to lean to Trump as the GOP will likely control a majority of states. A close loss by Trump would likely also lead to social unrest

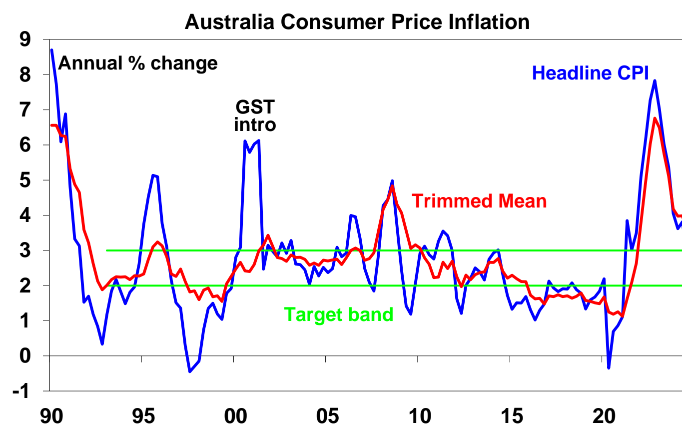
History tells us the best outcome on average for shares has been a Democrat president with divided Congress.



Source: Bloomberg, AMP

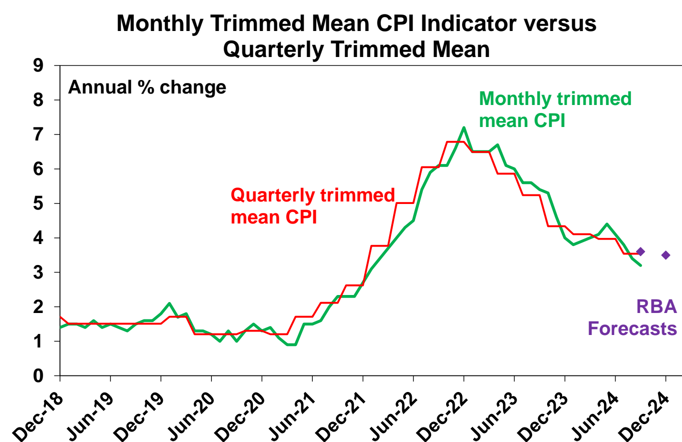
Here's a great song from the Trump 1.0/Brexit era – [Give Stupidity a Chance] by The Pet Shop Boys.

Good news on Australian inflation – but not good enough for an RBA rate cut in the week ahead. September quarter CPI inflation fell to 2.8%yoy, down from 3.8%yoy in the June quarter, so its back in the target range. However, the plunge was largely driven by electricity rebates and lower petrol prices so it's best to focus on measures of underlying inflation like the trimmed mean which fell to 3.5%yoy from 4%yoy, its lowest since the March quarter 2022. **Headline and underlying inflation are both fractionally below RBA forecasts but are unlikely to be low enough to tip the RBA into a rate cut in the week ahead as it will regard underlying inflation as still too high and services inflation at 4.6%yoy still too sticky and with the labour market remaining tight will not see any urgency to cut rates just yet**.

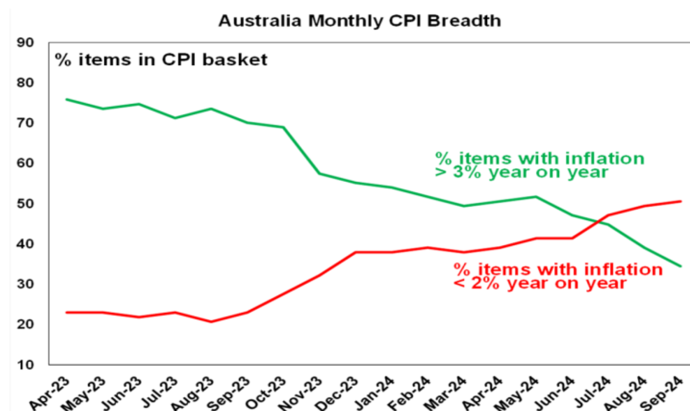


Source: ABS, AMP

However, we are getting closer to RBA rate cuts with inflation clearly heading down. While underlying inflation is still too high its trend is clearly down. The trimmed mean in the September Monthly CPI dropped to 3.2%yoy and is running below RBA forecasts. See the first chart below. And the breadth of high inflation increases is narrowing with the Monthly CPI data showing that the proportion of CPI basket items with inflation below 2%yoy is now well above the proportion with inflation above 3%yoy. See the second chart below.

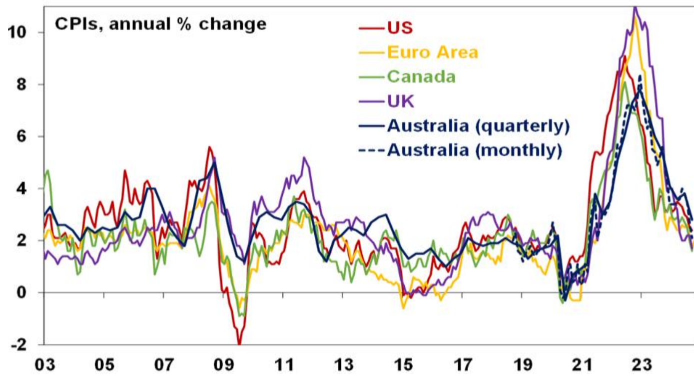


Source: ABS, AMP



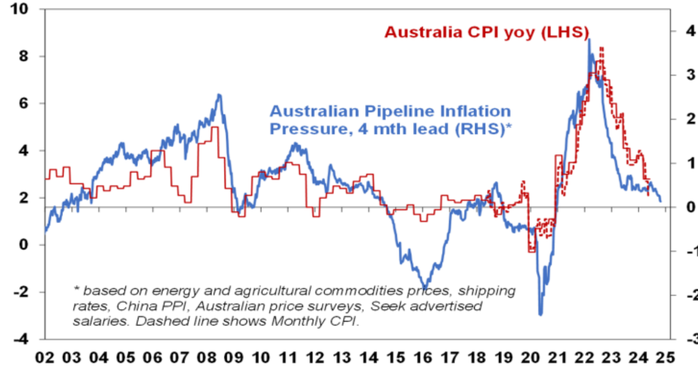
Source: ABS, AMP

What's more Australian inflation is continuing to look like that in other countries – albeit with a lag on the way down just as we saw on the way up in 2021-22. Monthly trimmed mean inflation of 3.2%yoy is similar to core inflation in the US of 3.3%yoy and 3.2%yoy in the UK – so it's hard to say that Australia has more of an inflation problem than other comparable countries do.



Source: Bloomberg, AMP

And our Australian Inflation Indicator points down for inflation.

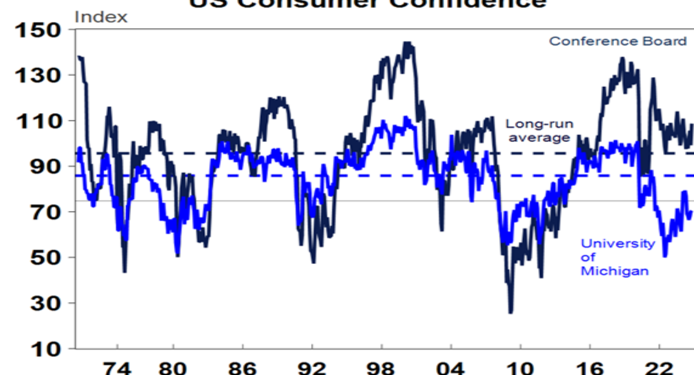


Source: Bloomberg, AMP

So, the RBA is not there yet for a rate cut but it's getting closer. Our base case remains that the RBA won't start cutting rates until February as it will want to see another quarter of lower underlying inflation before having enough confidence that inflation is moving sustainably to target. This means waiting for the December quarter inflation data which won't come out till late January. That said we are heading in the right direction and a December rate cut is still possible, but it would require October monthly inflation data due late this month to show a further drop in trimmed mean inflation to less than 3%yoy and for unemployment to have another leg up.

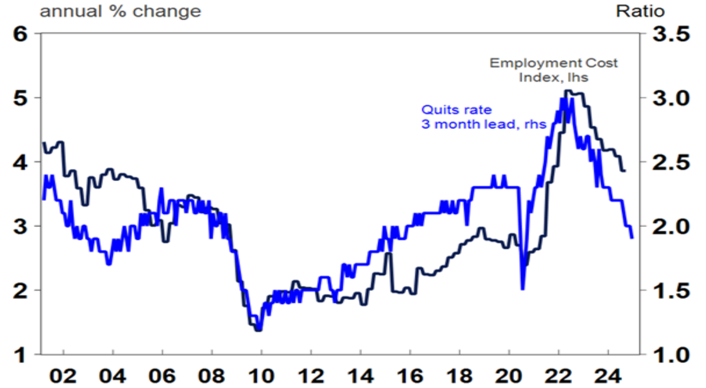
Major global economic events and implications

US economic data was mostly strong over the last week. September quarter GDP came in at a solid 2.8% annualised with strong domestic final sales growth of 3% annualised and detractions from inventory and net exports. Consumer spending growth came in at a strong 3.7% annualised. Consumer confidence as measured by the Conference Board also rose, remaining above its long run average although the University of Michigan measure which includes more financial variables remains weaker. Personal spending & income also saw continued solid growth in September.



Source: Macrobond, AMP

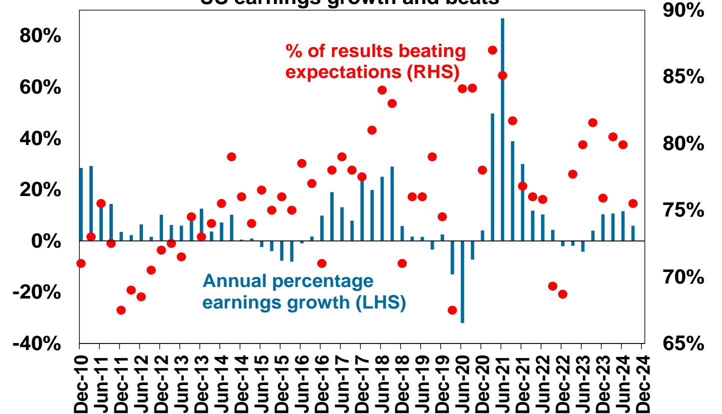
On the soft side though, most forward looking labour market indicators are continuing to trend softer. Jobless claims remain low. But job openings fell sharply in September, and this may also have been impacted by storms but the trend is clearly down and quits also fell. Consumer perceptions of whether jobs are plentiful or not rose but remain in a steep downtrend. All are pointing to softer jobs growth ahead and slower wages growth as seen in the relationship between quits and the Employment Cost Index, with the latter slowing further to 3.9%yoy in the September quarter.



Source: Macrobond, AMP

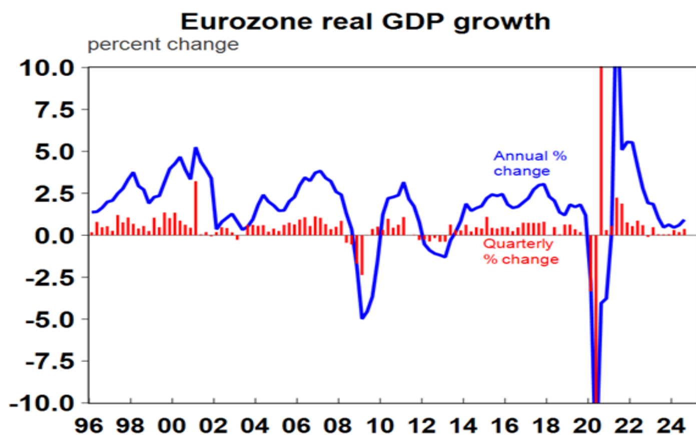
Core private final consumption deflator inflation was unchanged at 2.7%yoy in September, but the last three months was 2.35% annualised which is getting closer to the Fed's 2% target. Benign inflation and labour cost readings leave the Fed on track to cut by 0.25% in the week ahead and again in December.

Slower US earnings growth? 70% of US S&P companies have reported September quarter earnings and results have been okay but softer than for recent quarters. So far 75.5% of results have surprised on the upside which is just below the norm of 76% and the consensus earnings growth expectation is for 5.9%yoy. The final earnings growth number should come in around 7%yoy, down from 11.6%yoy in the June quarter but still solid.



Source: Bloomberg, AMP

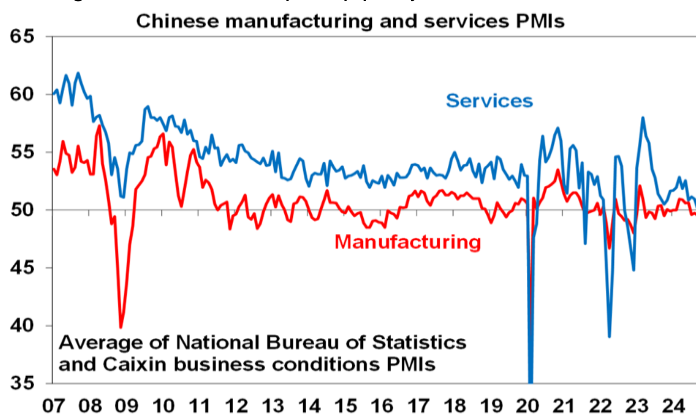
Eurozone GDP growth grew more than expected in the September quarter with a rise of 0.4%qoq or 0.9%yoy with Spain's economy up 0.8%qoq, France up 0.4%, Germany up just 0.2%qoq and Italian GDP flat. Its still pretty soft though with economic confidence in October remaining subdued consistent with recently released business conditions surveys. That said unemployment was unchanged at a downwardly revised 6.3% in September which is actually pretty low for Europe. Eurozone CPI inflation rose to 2%yoy which is at target, with core inflation flat at 2.7%yoy, which is likely to keep the ECB gradual and on track to cut rates by 0.25% in December, and not by 0.5%.



Source: Macrobond, AMP

The Bank of Japan left monetary policy on hold as expected with the cash rate remaining at 0.25% and BoJ economic forecasts little changed, but Governor Ueda's comments were hawkish pointing to another hike in December or January. The Japanese election saw the ruling LDP led coalition lose its majority and will likely lead to a LDP led minority government with somewhat easier fiscal policy to keep smaller parties onside. This could in turn result in a slightly more hawkish BoJ. Japanese economic data was mixed with a fall in consumer confidence and retail sales but a fall in unemployment and a stronger than expected rise in industrial production.

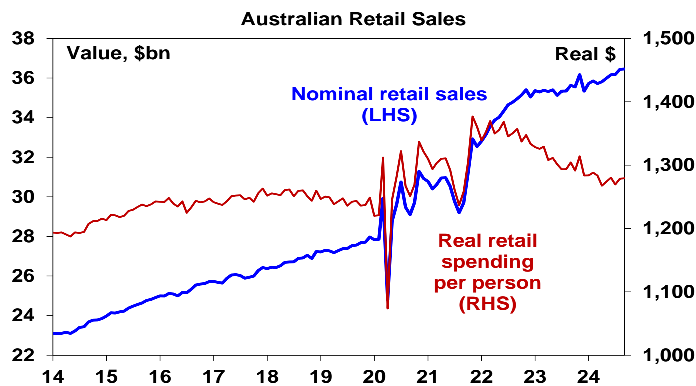
China's business conditions PMIs improved slightly in October, but the composite remains soft although it might be starting to benefit from ramped up policy stimulus.



Source: Bloomberg, AMP

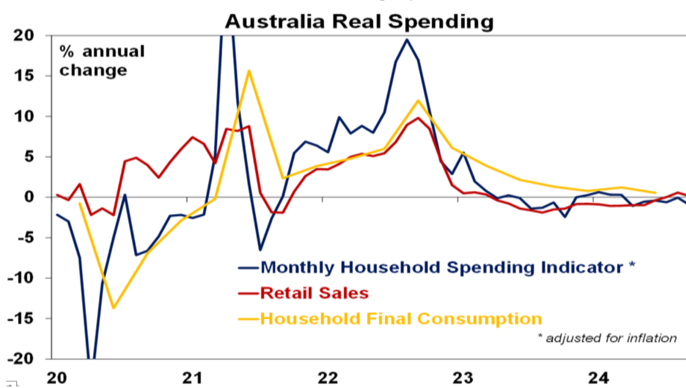
Australian economic events and implications

Australian economic data releases over the last week suggest the economy is continuing to muddle along with weak growth. Retail sales rose a softer than expected 0.1% in September after warmer than normal weather boosted sales in August. Real retail sales rose 0.5% in the September quarter though, which is only their second gain in the last eight quarters and suggests the tax cuts and improving real wages may be providing some support. That said warmer weather in August was likely the main factor boosting real sales in the quarter, real retail sales per person fell again after allowing for continuing strong population growth of 0.6%qoq and strong growth in household bank deposits suggest that the bulk of the tax cuts have been saved.



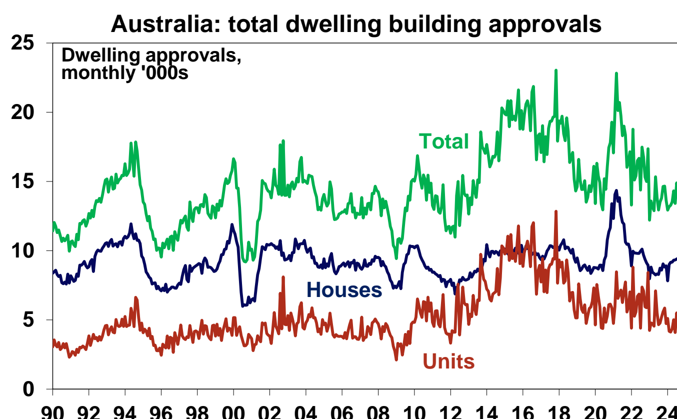
Source: ABS, AMP

The ABS's Monthly Household Spending Indicator – which covers far more spending than retail sales – fell in September after just a 0.2% rise in August and a flat July consistent with the view that the tax cuts have largely been saved for now.



Source: ABS, AMP

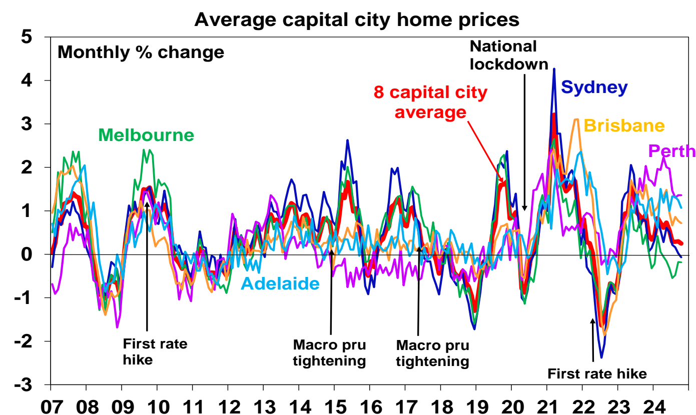
Home building approvals rose 4.4% in September which was stronger than expected. Units appear to be bouncing sideways, but houses are trending up. The rising trend in approvals is good news but they are currently running around 173,000 pa, well below Government's commitment to build 240,000 homes a year & population driven demand for around 250,000 homes a year. And so far, the rising trend is in houses whereas to speed up the supply of affordable dwellings we need to focus more on units.



Source: ABS, AMP

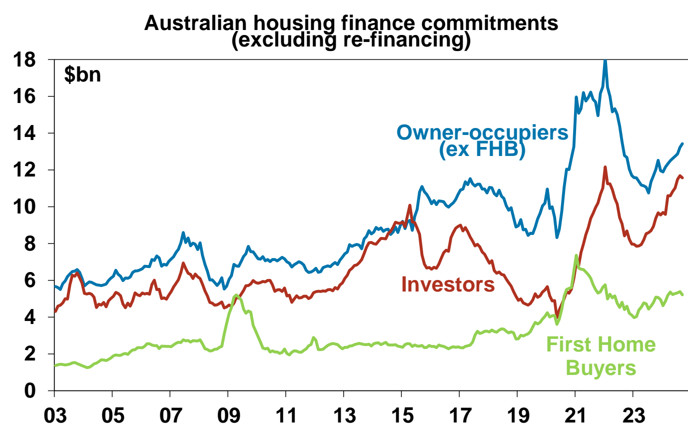
Home price growth slowed in October according to CoreLogic, with even Sydney prices now falling slightly. Divergence across cities remains but Perth, Adelaide and Brisbane are also slowing to varying degrees. The fundamental housing shortfall remains but is being offset by poor affordability and ongoing high interest rates. Signs of softness also remain evident in: subdued auction clearance rates; rising listings in excess of the normal seasonal rise; lower quartile and unit prices leading growth; and properties taking longer to sell. We expect a 5% average rise in prices through 2025,

but price growth will likely slow further with further falls in some cities like Sydney and Melbourne in the near term ahead of stronger conditions next year after rates start to fall, providing unemployment doesn't rise sharply.



Source: ABS, AMP

Housing finance fell slightly in September, possibly consistent with other signs of a slowing in the property market. Slowing property sales point to a further slowing in housing finance commitments ahead.



Source: ABS, AMP

What to watch over the next week?

The focus in the week ahead will primarily be on the outcome of the US election which we discussed earlier. But its also going to be a busy week for central banks with the Fed, RBA, Bank of England and Swedish central bank all meeting.

In the US the Fed (Thursday) is expected to cut the Fed Funds rate by another 0.25% taking it to the range of 4.5-4.75%. This is in line with its September dot plot which projected another 0.5% in cuts by December and its guidance for gradual cuts in the face of inflation falling to target but economic conditions remaining solid heading off the need for a faster pace of easing. We expect its guidance to remain dovish consistent with further gradual rate cuts. On the data front, expect the services conditions ISM for October to have fallen to a still solid reading of 53.

In the Eurozone expect September retail sales growth (Thursday) to have remained sluggish.

The Bank of England and Swedish central bank (also both Thursday) are expected to cut by 0.25% and 0.5% respectively, taking their policy rates to 4.75% and 2.75% with both likely to provide dovish guidance.

In China the focus will be on the National People's Congress Standing Committee meeting which ends on Friday and is expected to announce details around the size of the stimulus package and to hopefully include significant support for consumers. Some reports indicate that extra bond issuance of 10trillion Renminbi spread over 3 to 5 years will be announced which would amount to around 2.5% of GDP per annum. Our view remains that policy stimulus will provide a short-term cyclical boost but won't really address China's longer term structural problems. Trade data is likely to show continued weak growth in exports and imports. Inflation data for September (Saturday) is likely to show continued producer price deflation and CPI inflation of just 0.3%yoy.

In Australia, the RBA (Tuesday) is expected to leave rates on hold at 4.35% for the 12th month in a row. While inflation fell again in the September quarter, the RBA will likely regard underlying inflation at 3.5%yoy as still too high with services inflation remaining sticky and will see still low unemployment as meaning that there is no urgency to cut. But the continuing progress in getting inflation down may see it become a little less hawkish in its commentary and it may make small downwards revisions to its inflation and growth forecasts for next year. As noted earlier our base case remains for the first cut to come in February, although there is still a possibility of a December cut if monthly underlying inflation in October falls sharply and unemployment rises. **On the data front, the trade surplus for September (Thursday) is likely to have slipped to around $4.8bn.**

Outlook for investment markets

Easing inflation pressures, central banks cutting rates, China ramping up policy stimulus and prospects for stronger growth in 2025-26 should make for reasonable investment returns over the next 6-12 months. However, with a high risk of recession, poor valuations and significant geopolitical risks particularly around the Middle East and US election, the next 12 months are likely to be more constrained and rougher compared to 2023-24.

Bonds are likely to provide returns around running yield or a bit more, as inflation slows, and central banks cut rates.

Unlisted commercial property returns are likely to start to improve next year as office prices have already had sharp falls in response to the lagged impact of high bond yields and working from home.

Australian home prices are likely to see some further slowing over the next few months as the supply shortfall remains, but still high interest rates constrain demand and unemployment rises. Lower interest rates should help the market next year though and we see average property prices rising by around 5% in 2025.

Cash and bank deposits are expected to provide returns of over 4%, reflecting the back up in interest rates.

A rising trend in the $A is likely taking it to $US0.70 over the next 12 months, due to a fall in the overvalued $US and a narrowing in the interest rate differential between the Fed and the RBA. A recession and/or a Trump victory are the main downside risks.

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