WEEKLY MARKET UPDATE

15 NOVEMBER 2024

Investment markets and key developments

Global share markets were weak over the last week, not helped by the ongoing rise in bond yields and a wind back in Fed rate cut expectations after some elevated US inflation data and slightly hawkish comments from Fed chair Powell. For the week US shares fell 2.1% and have now reversed 60% of their post-election rally, Eurozone shares fell 0.2%, Japanese shares lost 2.2% and Chinese shares fell 3.3%. Australian shares also fell, albeit only by 0.1%, reflecting the weak global lead along with a further pushing out of expectations as to when the RBA will start cutting rates and a further fall in iron ore and energy prices weighing on resources shares. Apart from falls in resources companies the falls were led by consumer staple and health care stocks, more than offsetting gains in IT, utility, property and retail stocks. Bond yields rose in the US, UK, Japan and Australia but fell in Europe. Oil, metal, gold, iron ore prices and the $A all fell not helped by a further rise in the $US. The 8% pull back in gold from its October high looks like a correction after a strong run higher but is not being helped by the surge in Bitcoin, as crypto is likely taking investors away from gold, along with prospects for less Fed rate cuts.

Donald Trump's election win and implications remains the key focus for many investors. Firstly, it's now confirmed that the Republicans have a Red Sweep with control of the House and the Senate making it easier to pass legislation. Some budget related measures will require 60 votes in the Senate to pass but with the GOP only having 53 the process known as "budget reconciliation" will likely be used again to pass the proposed tax cuts as it only requires a simple majority providing the measures can be "shown" to be budget deficit neutral, eg that the tax cuts will drive more tax revenue as people are inspired to work harder. They may also be partly offset by tariff revenue.

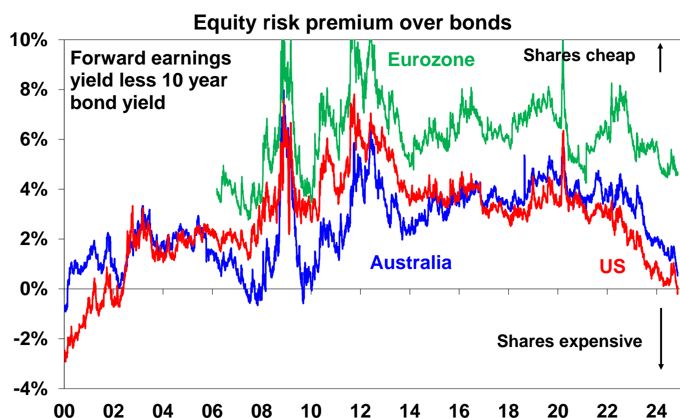
Secondly, Trump's team appointees so far are consistent with his policies and suggest implementation will proceed quickly. For example: China hawks Marco Rubio as Secretary of State and Mike Waltz as National Security Adviser signal a tough on China approach including via tariffs; Tom Holman for border control signals a border shutdown from Day 1 and a quick move to deportations (although that will face several constraints); Elon Musk and Vivek Ramaswamy to lead a Department of Government Efficiency (this sounds like a joke play on Dogecoin but is for real) to cut federal spending and bureaucracy suggesting a big cut to public servants and regulation (we had something similar in Australia with the Abbott Government's National Commission of Audit in 2013-14 but it didn't get too far as the government did not control the Senate); and indications are that the process to impose tariffs will start from Day 1 using executive authority with protectionists Robert Lighthizer or Peter Navaro likely to head that up. In terms of the tariffs, indications so far appear to be that they will be phased in over time allowing US businesses to decouple and adjust, which suggests something more lasting than just using them as a maximum pressure bargaining tool. What is less clear is whether the Trump Administration leans more to populism (with a focus on tariffs) or more to Reagan like supply side reforms. The appointment of Musk to rationalise bureaucracy and possibly Wall Streeters like Scott Bessent to Treasury could be a sign of the latter and would suggest a Trump Administration will be sensitive to the message from higher bond yields (ie not to add to inflation and blow out the deficit). It's still too early to tell though.

We remain of the view that Australia will see minimal *direct* impact from US tariffs - as only 4% of our goods exports go to the US and we will likely be exempted maybe after some argy bargy because we have a trade deficit with the US. Rather the negative impact will come *indirectly*, via the impact on China of US tariffs (which will be partly offset by more stimulus in China) and a global trade war that Trump's tariffs will likely trigger (with indications that China and Europe will retaliate more aggressively this time) all of which threaten weaker global growth and less demand for our exports. Trying to model this in advance is a guessing game though.

Meanwhile, the initial knee jerk market response to Trump's victory has become a bit more nuanced over the last week – bond yields remain well up on fears his policies will drive higher inflation, higher than otherwise Fed interest rates and a higher US budget deficit; this has seen the $US surge to its highest in more than a year; Bitcoin and other crypto currencies have surged higher (notably Dogecoin which has doubled) as Bitcoin broke its downtrend since March and on expectations a Trump government would be more supportive of crypto (along with Musk's appointment to co-run the DOGE); but shares are starting to have a tougher time with US shares reversing 60% of their post-election surge not helped by higher bond yields, a possible new inflation scare and potentially less Fed rate cuts; and non-US shares have been underperforming since the election on concerns higher US tariffs will be bad news outside the US.

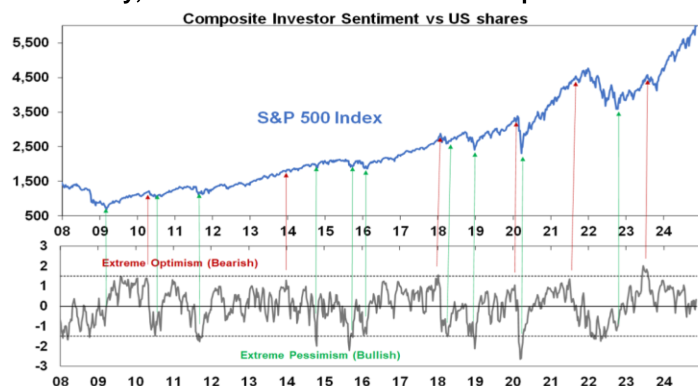
Our assessment is that the boost to US shares may have further to run in the near term but it is vulnerable to the rise in bond yields and the mix of tax cuts and deregulation (which are positive) versus tariffs (which are mostly negative) which is likely to contribute to a more volatile ride as we go through next year. Stretched valuations – with US shares now offering a negative risk premium to bonds following their recent rally and the further rise in bond yields – highlight the vulnerability of the US share market. Australian shares are also stretched on this measure, but not as much and European shares look relatively cheap. The next chart also indicates that valuations for both US and Australian

shares are far less attractive now than was the case when Trump last won in 2016 when shares were actually quite cheap.



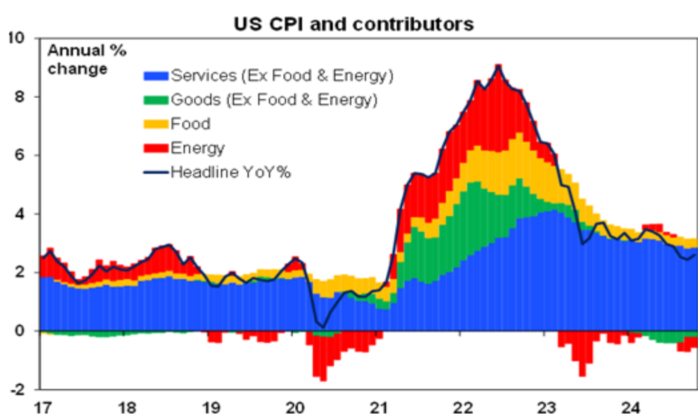
Source: Bloomberg, AMP

Fortunately, US investor sentiment is not at euphoric levels.



Source: Bloomberg, AMP

Another US inflation scare? US underlying CPI and producer price inflation were both a bit elevated in October, raising concerns that progress in getting inflation down has stalled again. Core CPI inflation was 0.28%mom leaving annual core inflation stuck around the 3.2-3.3%yoy range for five months now, with strong gains in shelter, autos and airfares and services inflation remaining sticky. And this combined with slightly higher than expected core producer price inflation suggests that core PCE inflation for October will be around 0.3%mom taking the annual rate up to 2.8%yoy.



Source: Bloomberg, AMP

A further Fed rate cut is still likely next month, but further cuts through next year are contingent on core inflation resuming its slowing trend. We think this is likely as shelter inflation looks set to slow further with softer asking rents and services inflation is likely to slow with the cooling jobs market. But Fed Chair Powell while still signalling confidence that inflation remains in a downtrend on a "bumpy path" also indicated the strong economy means the Fed does not have to hurry to cut rates and that it can be careful. Another Fed cut is still likely in December but it's now a close call and a slower pace of easing is likely next year, particularly given that Trump's policies regarding tariffs and more tax cuts provide some upside threats to inflation on a 1-3 year view.

In Australia, the mix of data seen over the past week is unlikely to move the RBA either way, so our view remains that the RBA won't start cutting till February. Wages growth slowed more than expected in the September quarter, cost and price pressures slowed further in the latest NAB business survey and jobs growth slowed in October consistent with the next move in rates being down. But unemployment and underemployment remain low and consumer and business confidence rose. All of which provides no reason for the RBA to hike rates but no pressure to start cutting them either. So, a December rate cut is now extremely unlikely and we still expect the first rate cut in February by which time jobs data is likely to be weaker and December quarter inflation data is likely to have shown a further step down in underlying inflation. We concede there is a risk it could be delayed even further, with the money market now not fully pricing in a rate cut until July, but it looks like its fluctuations are partly being driven by US interest rate expectations.

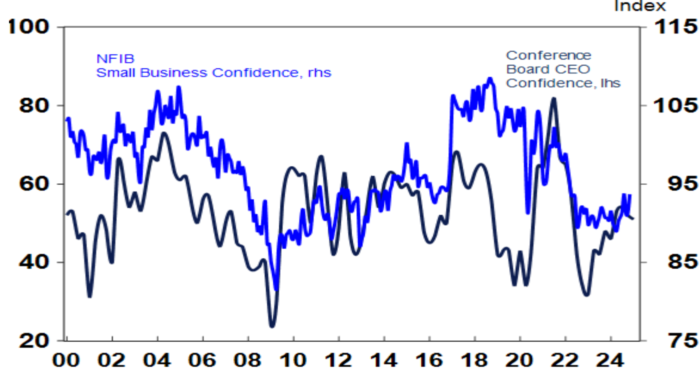
In terms of the impact of Trump's policies on the RBA it's too early to be definitive as to what impact they will have as we don't know the timing or quantum of the policy changes and they will work in opposite directions with US tax cuts potentially adding to US and hence global inflation (pointing to higher than otherwise RBA rates) but tariff hikes and a trade war potentially slowing global economic activity and demand for our exports (pointing to lower than otherwise RBA rates). And while the tariff hikes may impact earlier, the tax cuts may not start until 2026.

The "cost of living crisis" cost Harris and Democrats the US election. Will it cost Albanese and Labor the upcoming Australian election? The good news for Australian workers is that wages growth at 3.5%yoy in the September quarter is above inflation at 2.8%yoy resulting in real wage growth. The bad news is that it will take a long time to close the gap between the rise in prices since 2020 of 18.7% and the rise in wages of 12.9%, which has left real wages down nearly 6% over four years. This is the "cost of living crisis" in a nutshell which was the main factor behind Trump's victory in the US and threatens Labor in Australia. Both the Biden and Albanese governments arguably paid more attention to preserving jobs than controlling inflation but far more voters are affected by inflation and the cost of living than unemployment.

Source: Bloomberg, AMP

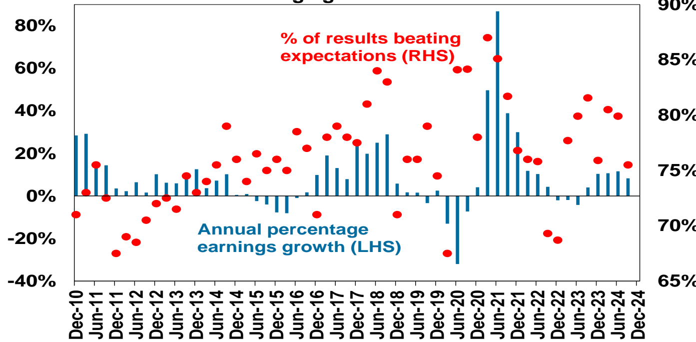
Major global economic events and implications

US economic data was mostly consistent with continued solid growth. Manufacturing conditions surged in the New York region in November possibly reflecting Trump optimism and pre-tariff orders, small business optimism improved slightly in October but remains subdued and jobless claims remain low suggesting the labour market is still strong even though job openings and quits have softened. Retail sales were mixed with underlying sales close to flat in October, but September sales revised up to be strong. On the weak side though, industrial production fell in October.



Source: Macrobond, AMP

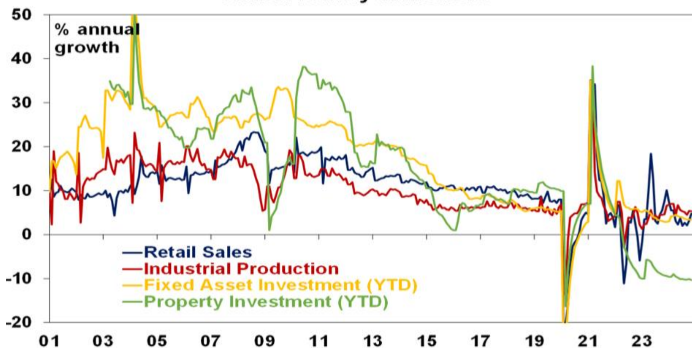
It was a rough start but US earnings growth is coming in much better than expected. 92% of US S&P companies have reported September quarter earnings and 75.5% of results have surprised on the upside which is just below the norm of 76%. The good news though is that consensus earnings growth expectations are for 8.3%yoy, up from 4%yoy expected at the start of reporting season.



Source: Bloomberg, AMP

Japanese September quarter GDP rose just 0.2%qoq and is only up 0.3%yoy with strong consumer spending but a fall in business investment and a detraction from trade.

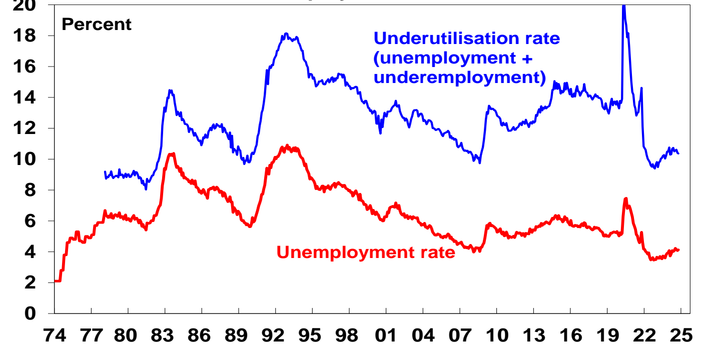
Chinese economic activity data for October was on balance a little bit better than expected. Stimulus measures to boost consumer spending is still required though. Growth in investment was weak and unchanged and growth in industrial production slowed slightly but growth in retail sales accelerated more than expected to 4.8%yoy. Property related data was all weak though with ongoing falls in investment, sales and home prices. Chinese credit picked up in October, but annual credit growth slowed further to 7.8%yoy from 8%yoy.



Source: Bloomberg, AMP

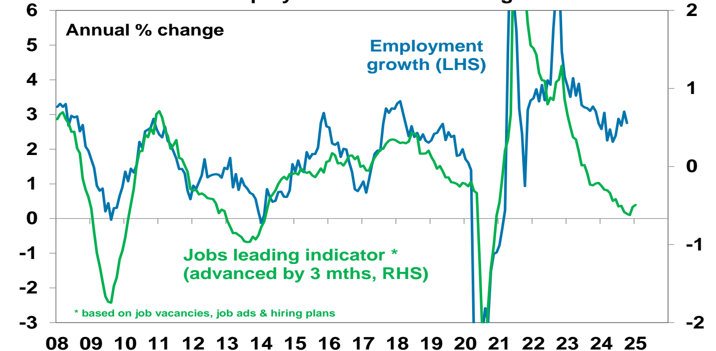
Australian economic events and implications

Jobs growth slowed in October, but the labour market still remains tight. Employment growth slowed to 15,900 its weakest in seven months but this could just be noise and while unemployment and underemployment are up from their lows in 2022 they remain low suggesting that the labour market remains relatively tight.



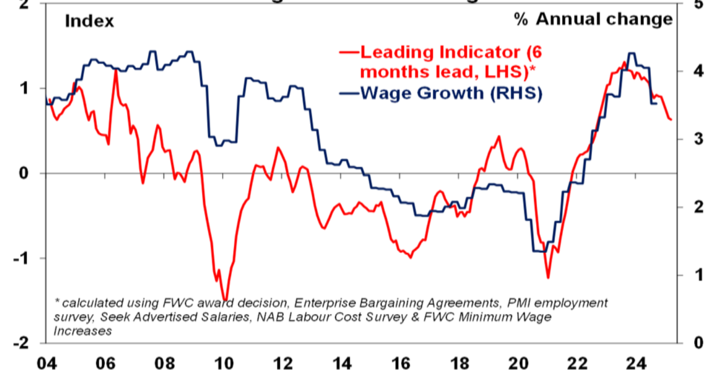
Source: ABS, AMP

However, falling job vacancies and business hiring plans evident in our Jobs Leading Indicator continue to point to slower employment growth ahead. It's been too pessimistic over the last few years, but this possibly partly reflects businesses hoarding workers given the issues around labour shortages.



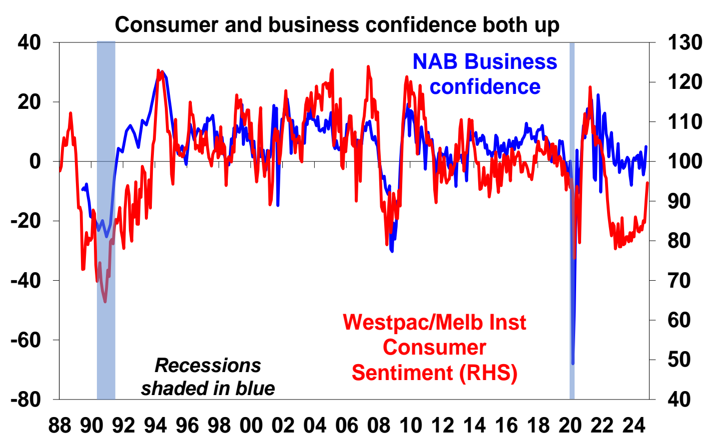
Source: ABS, AMP

Despite the still tight labour market wage growth is slowing faster than expected, likely reflecting the decline in the number of job vacancies. September quarter data showing wages growth of 0.8%qoq and 3.5%yoy adds to evidence that wages growth peaked in the December quarter last year at 4.3%yoy. Not only was this year's rise in award wages less than last year's increases but rates of growth in wages under individual and enterprise bargaining agreements have slowed too compared to a year ago. The share of jobs that saw a 4% or greater annual wage rise slowed from 46% in the June quarter to 31%. Apart from the smaller rise in award wages, the slowdown reflects the cooling in job vacancies and hiring plans along with the population driven rise in the supply of workers. Our Wages Growth Leading Indicator points to a further slowing in wages growth ahead reflecting falling job vacancies and hiring plans reducing worker bargaining power. Another 0.8%qoq rise this quarter will see annual wages growth slow to 3.2%yoy, which is less than the RBA is forecasting.



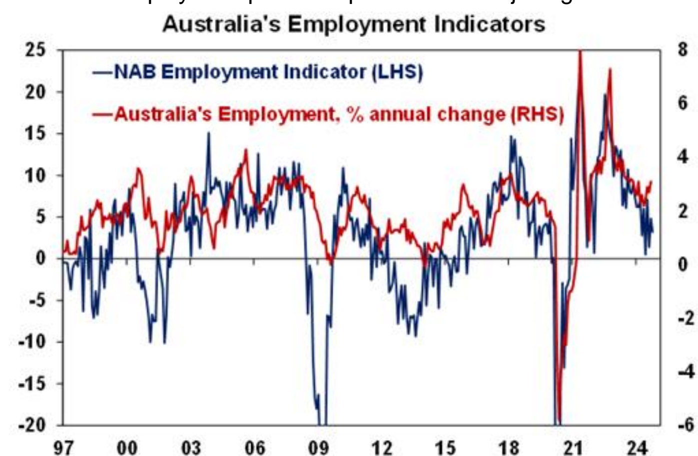
Source: Bloomberg, AMP

Consumer confidence rose another 5.3% in November. Its still soft but well up from its lows helped by expectations that rates have peaked and better growth in household disposable income.



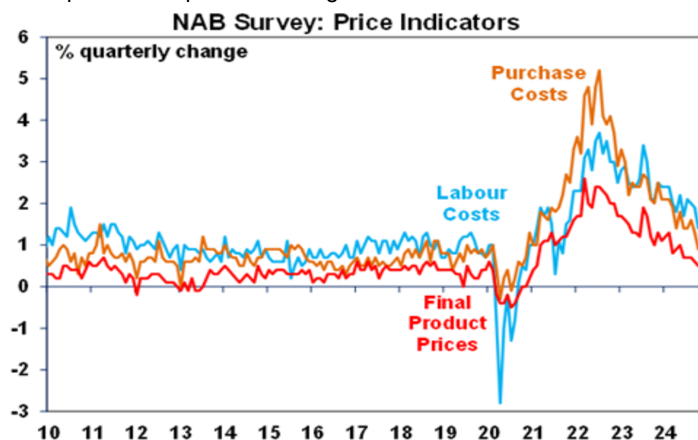
Source: Westpac/Melbourne Institute, AMP

The October NAB business survey showed unchanged business conditions but a rise in confidence. Orders remain weak and employment plans still point to weaker jobs growth.



Source: ABS, NAB, AMP

The really good news though is that the NAB survey showed a further easing in cost and price pressures. Labour cost growth slowed further consistent with slowing wages growth, purchase cost growth also slowed and final product price growth slowed to back to the top end of its pre-Covid range.



Source: NAB, AMP

What to watch over the next week?

The week ahead will see business conditions PMIs released for November on Friday. These are likely to remain at okay levels on average but with strength in the US and softness in Europe, Japan and Australia and with services strong but manufacturing weak. Key to watch will be whether the broad-based weakness in manufacturing conditions starts to flow through to services.

In other data in the US, expect home building conditions (Monday) and housing starts (Tuesday) to remain softish along with a slight fall in the Philadelphia regional manufacturing index (Thursday).

Canadian inflation for October (Tuesday) is likely to rise slightly to 1.9%yoy with underlying measures remaining around 2.4%yoy.

UK inflation for October (Wednesday) is likely to also rise slightly to 2.2%yoy with core inflation falling slightly to 3.1%yoy.

The minutes from the last RBA meeting (Tuesday) are likely to confirm a neutral bias with no inclination to move rates either way at present. A speech by Governor Bullock (Thursday) will likely reiterate the RBA's cautious but balanced view.

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 still high risk of recession, poor valuations and significant geopolitical risks particularly around the Middle East and Trump's policies, 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 as inflation slows, and central banks cut rates. They could face more losses in the near term though given uncertainty around Trump's policies.

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 rise in cash 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 US tariffs under Trump are the main downside risks.

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