WEEKLY MARKET UPDATE

16 DECEMBER 2022

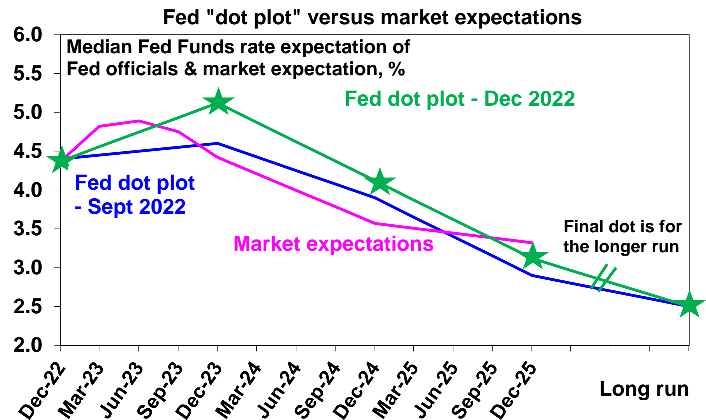
Investment markets and key developments

Global share markets fell back again over the last week as key central banks were more hawkish than expected adding to recession fears along with weak economic data. For the week US shares fell 2.1%, Eurozone shares lost 3.2%, Japanese shares fell 1.3% and Chinese shares fell 1.1%. The negative global lead saw Australian shares pull back by 0.9% for the week, with the falls led by utility, material, health and consumer discretionary shares. Bond yields fell in the US but rose in Europe and Australia. Commodity prices were mixed with oil up, but iron ore and metals down. The $A fell back to around $US0.67, despite little change in the $US.

While the risks remain high around inflation, interest rates, recession, the war in Ukraine and China, the Santa rally normally kicks in around mid-December on the back of festive cheer and new year optimism, the investment of any bonuses, low volumes and no capital raisings at this time of year. Over the last 15 years the period from mid-December to year end has seen an average gain of 0.8% in US shares with shares up in this two-week period 11 years out of 15. In Australia, over the last 15 years the average gain over the last two weeks of December has been 1.5% with shares up 10 years out of 15. It has tended to be weaker or less reliable in years when the market is down year to date though.

Central banks downshift their rate hikes, but still hawkish. The past week saw a bunch of central banks raise rates again – in the US, Europe, UK, Switzerland, Norway, Taiwan and the Philippines. The goods news is that the Fed, ECB and BoE slowed their hikes to 0.5% (which allows more time for lags to impact) but the bad news is that many were still very hawkish – notably the Fed and ECB.

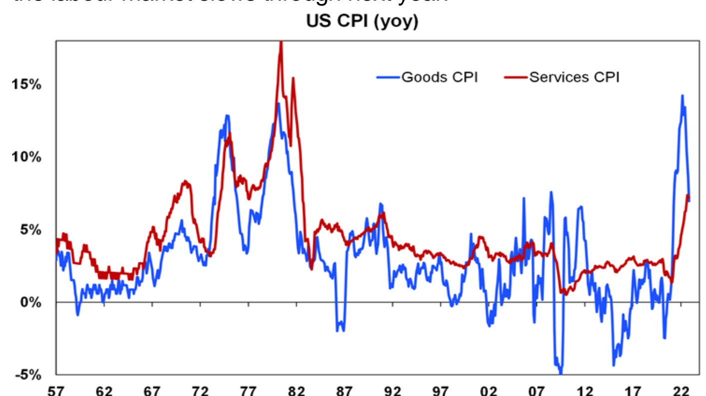
Starting with the Fed as it will be key for markets - it downshifted its rate hike from 0.75% to 0.5% taking the Fed Funds rate to 4.25-4.5% to (according to Chair Powell) "allow us to feel our way" and "better balance the risks", but it increased its "dot plot" of Fed officials' interest rate hikes (implying +0.75% more of rate hikes to go) on the back of upwards revisions to its inflation forecasts with Powell noting "we still have some ways to go". The downshift in rate hikes is good news as it reduces the risk of overtightening but the Fed was still more hawkish than expected.



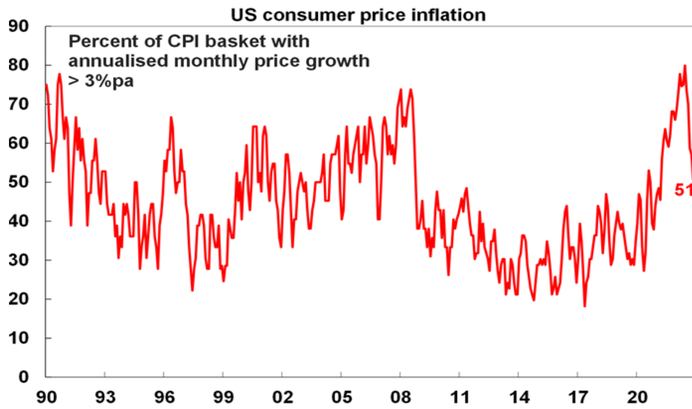
Source: Bloomberg, AMP

However, just as the Fed was too dovish a year ago (signalling just 0.75% of rate hikes for this year when it turned out to 4.25%), its likely now too hawkish. Its understandable that it now wants to err on the side of hawkishness to keep inflation expectations down, to stop financial conditions from easing too quickly (read shares rising too quickly) and it doesn't want to get caught out as being too dovish again. And its concerns about the still strong jobs market driving services inflation are understandable. **But the Fed's upwards revisions to its inflation forecasts looks too pessimistic and with growth slowing & more signs of peak inflation, we see it as likely to be able to stop hiking from around March**.

US inflation continuing to fall. Headline and core inflation for November came in weaker than expected with headline inflation at 7.1%yoy now well down from the 9.1%yoy peak seen mid-year. While the slowdown is concentrated in goods inflation, it leads services inflation at major turning points, CPI rents are still rising rapidly but should fall next year following the fall in rents for new leases now occurring and the breadth of rapid price rises has collapsed with only 51% of CPI components now seeing monthly annualised inflation above 3%. Services inflation ex housing remains the Fed's main concern now, but its already slowing and likely to slow further reflecting the lead from goods inflation and as the labour market slows through next year.

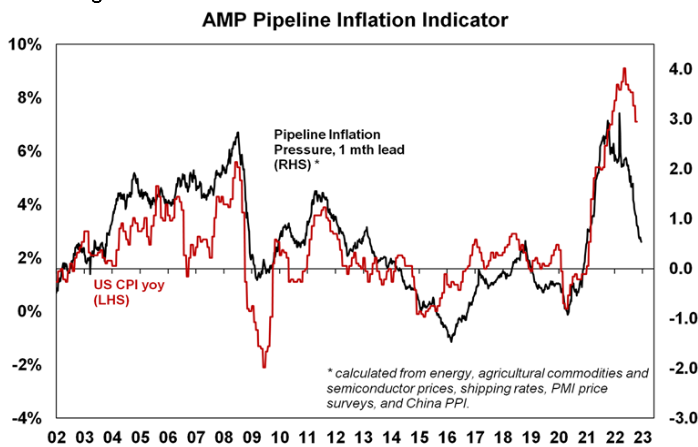


Source: Bloomberg, AMP



Source: Bloomberg, AMP

Consistent with this our Pipeline Inflation Indicator continues to point down for US inflation. We remain of the view that US inflation will slow faster than the Fed is expecting, so see the Fed Fund's rate topping out earlier and lower than its "dot plot" is indicating.



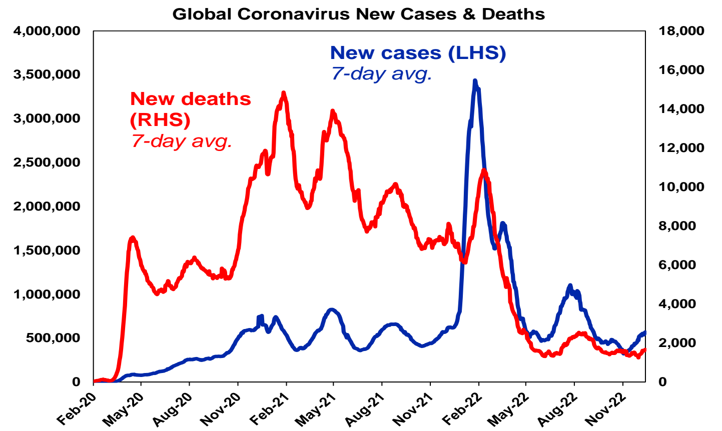
Source: Bloomberg, AMP

The downswing in US inflation is likely to flow through to Europe with a lag. The ECB, Bank of England, Swiss National Bank and Norwegian Central bank all leaned hawkish warning of more hikes to come. This was less so for the BoE, but the ECB was particularly hawkish expecting to raise rates "significantly" higher, revising up its inflation forecasts and announcing that quantitative tightening will start in March. Bear in mind though that the ECB and the Swiss National Bank were both late to start tightening and that the roll over in US inflation is likely to lead to a rollover in European and UK inflation with a six month lag particularly if gas prices remain down from their highs and Europe slips into a mild recession soon. So the peak in European interest rates will likely lag the Fed, but is likely to be reached in around the September quarter.

Fortunately, despite all the economic and financial gloom the Christmas break will soon be here and there is nothing like a good Christmas song to lift the spirits (well mine anyway!) So here (again) is my list of top 9 Christmas songs: #1 Kelly Clarkson Under the Tree; #2 Mariah Carey All I Want for Christmas is You; #3 The Beach Boys Little Saint Nick; #4 Paul McCartney & Wings Wonderful Christmastime; #5 Elvis Presley Merry Christmas Baby; #6 Jose Feliciano Feliz Navidad; #7 The Pet Shop Boys It Doesn't Often Snow At Christmas; #8 Kylie Minogue Christmas Isn't Christmas 'Til You Get Here; #9 Darlene Love Christmas (Baby Please Come Home).

Coronavirus update

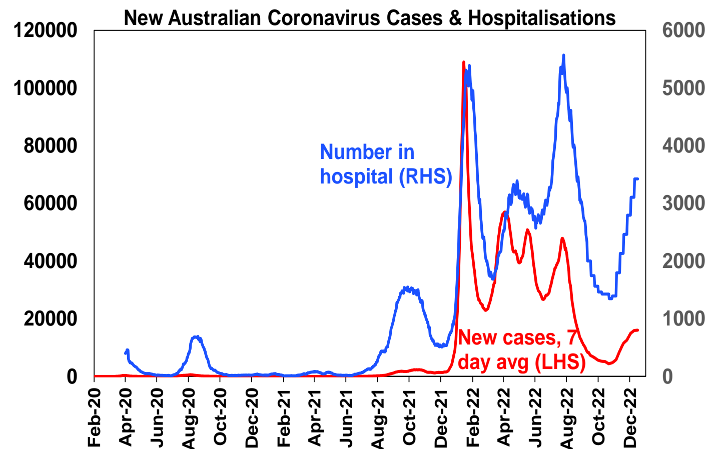
New global Covid cases are still rising, albeit from a low level.



Source: ourworldindata.org, AMP

While China has seen new Covid cases fall sharply this may reflect reduced testing as it eases Covid restrictions. Just as Australia and other countries saw when they reopened, its likely to see a sharp spike in new cases, hospitalisations and deaths in the months ahead but this should settle down by around the June quarter allowing - along with the likely further removal of restrictions & more stimulus measures - a strong rebound in economic growth.

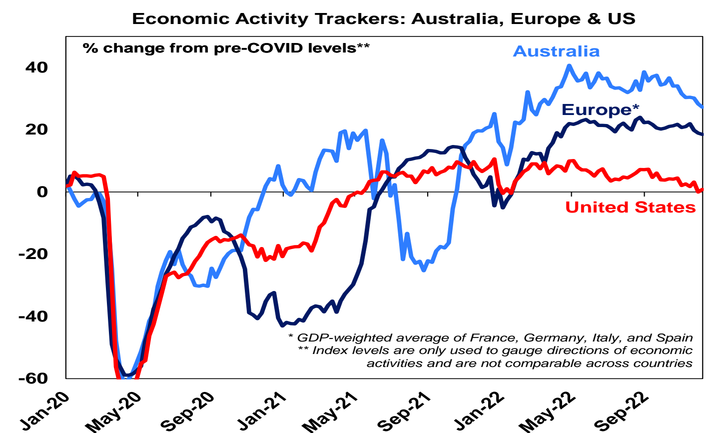
New cases and hospitalisations are still rising in Australia. New cases appear to have slowed but this could reflect the ongoing fall in reporting and changing access to PCR tests.



Source: covidlive.com.au, AMP

Economic activity trackers

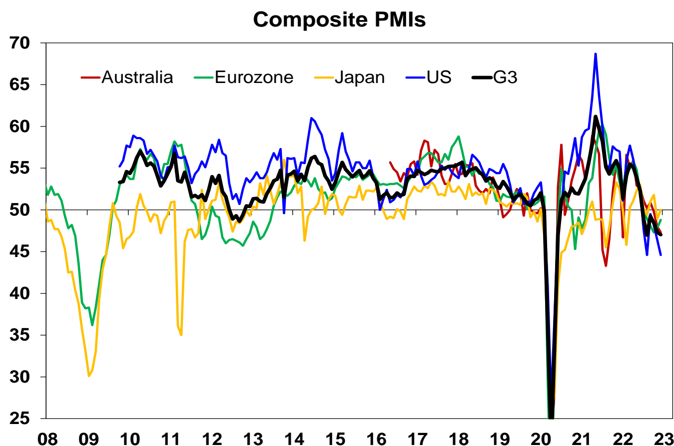
Our Australian Economic Tracker fell again over the last week with falls in confidence, hotel and restaurant bookings and job ads. Our European Activity Tracker also fell whereas our US Tracker rose slightly. All are showing a clear loss of economic momentum from earlier this year.



Levels are not really comparable across countries. Based on weekly data for eg job ads, restaurant bookings, confidence, credit & debit card transactions and hotel bookings. Source: AMP

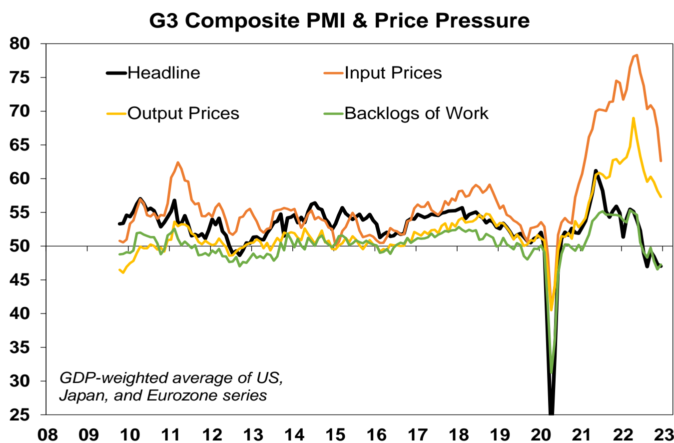
Major global economic events and implications

Continuing soft business conditions PMIs point to slowing growth. While December composite PMIs surprisingly rose in Europe, the UK and Japan they remain weak, and they fell further in the US and Australia. Europe is proving surprisingly resilient though with the US far less so. (Note that PMIs are business conditions surveys, and the composite refers to all business sectors.)



Source: Bloomberg, AMP

The good news is that inflation pressure continues to ease. The PMIs showed a further easing in input and output prices and reduced work backlogs and delivery times compared to 12-18 months ago. This adds to signs that inflation pressures are easing.



Source: Bloomberg, AMP

Other US economic data was also soft. Industrial production fell slightly in November, regional manufacturing conditions indexes and small business optimism remain weak and retail sales fell 0.6%mom. Capacity utilisation edged down and looks to have peaked and price pressures mostly fell in the manufacturing surveys and are well down from their highs.

UK CPI inflation fell a bit more than expected and looks to have peaked but remains high at 10.7%yoy, with core at 6.3%yoy.

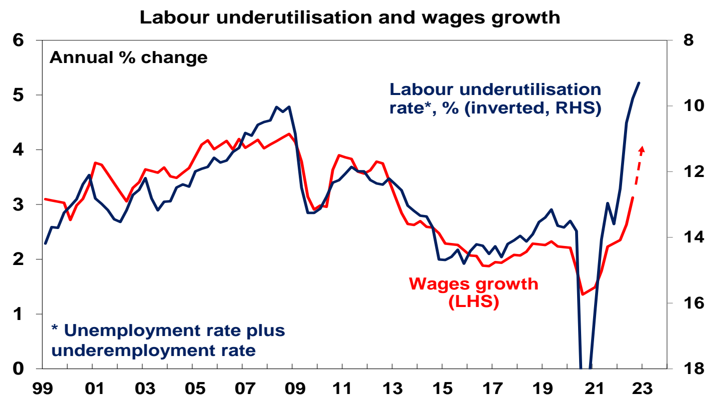
Japan's Tankan business survey showed slightly weaker conditions for large manufacturers but stronger conditions for large non-manufacturers.

Chinese economic and credit data weakened more than expected in November, with retail sales growth in particular falling sharply to -5.9%yoy and unemployment rising, reflecting the resurgence in Covid cases. Expect a rough ride in the months ahead but then a rebound from the June quarter reflecting reopening and more stimulus.

Source: Bloomberg, AMP

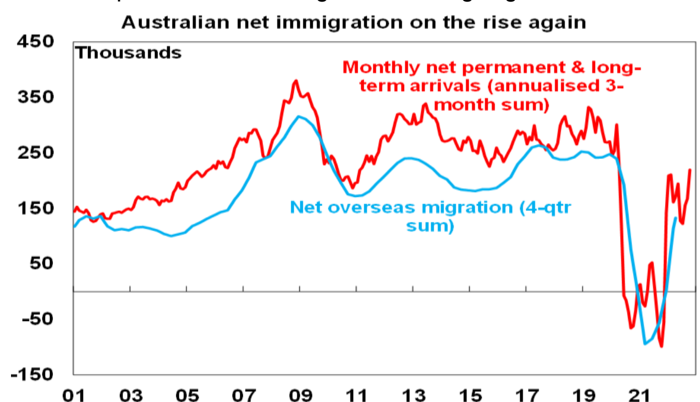
Australian economic events and implications

Australian jobs data was strong again in November. Employment surged by 64,000 but unemployment was unchanged at 3.4% as labour force participation rose to a new record high. The boost to employment looks partly due to the return of immigration (particularly foreign students) filling job vacancies and this should go some way to reducing labour market tightness over time. However, right now the labour market still looks very tight and the further fall in underemployment and underutilisation continues to point to a further rise in wages growth ahead. This in turn will continue to put pressure on the RBA for more rate hikes. There is another jobs report to go before the next RBA meeting and the labour market is a lagging indicator so there is a danger in relying too much on it particularly when other data is pointing to a sharp slowdown in growth. **Our base case remains that the cash rate has peaked, but the risk is high of one more hike to 3.35%.**



Source: ABS, AMP

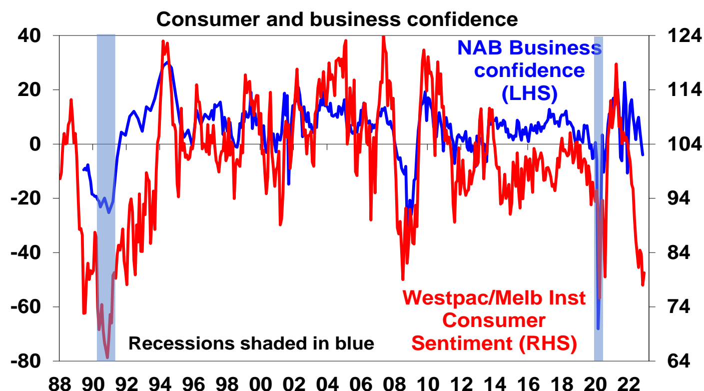
Australian population growth rebounded to 1.1%yoy over the year to the June quarter reflecting the rebound in immigration. Monthly net arrivals points to a further recovery ahead. This should help reduce the shortage of workers going forward.



Source: ABS, AMP

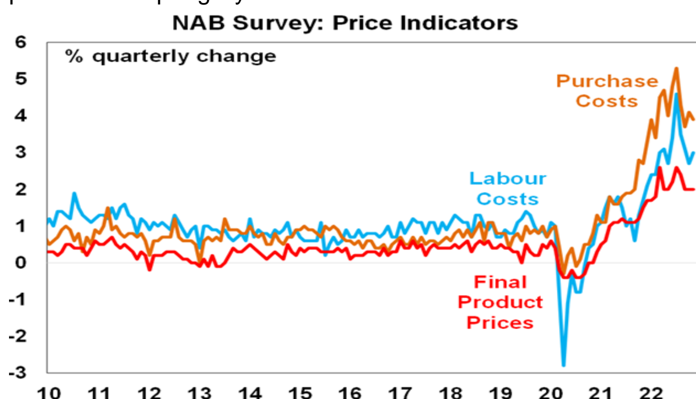
Business confidence catching down to consumer confidence. Consumer confidence rose slightly in December possibly helped by

the slowing in rate hikes and talk of a pause, but it's still very weak. Meanwhile, business confidence fell again. Business remains more upbeat than consumers but this may change as consumer spending slows over the year ahead. The Judo Australian PMI also points to weakening conditions in Australia with the composite falling another 0.7 points in December to a weak 47.3.



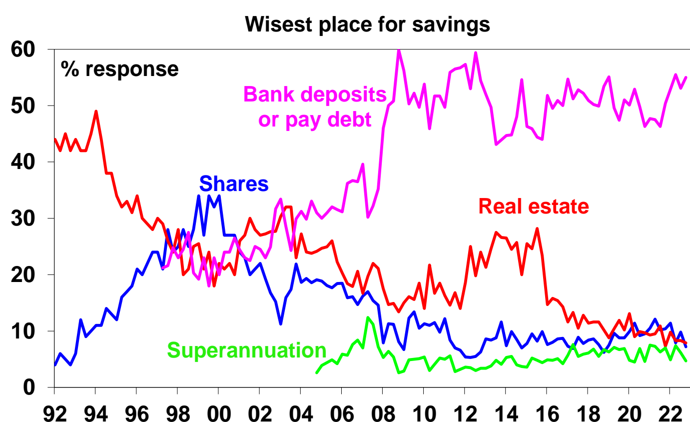
Source: NAB, Westpac/MI, AMP

Price and cost pressures according to the NAB business survey are still high, but at least they are in a downtrend. PMI data also showed a further easing in cost pressures in Australia with input prices, backlogs and delivery times all easing although output prices ticked up slightly.



Source: NAB, Westpac/MI, AMP

Surveyed consumers in the Westpac/Melbourne Institute survey continue to favour bank deposits and paying down debt with super, shares and real estate remaining out of favour. Shares and super have been out of favour for a long time which unfortunately means that many have missed the solid average returns they have provided over many years.



Source: Westpac/MI, AMP

What to watch over the next few weeks?

In the US, Congress is edging towards passing a Government spending and funding package covering the period through to 30th September next year before year end. If it can't then there is a high risk of another partial Government shutdown as it will be harder to agree once the new Congress takes over in January. On the data front, expect continuing falls in housing starts (due 20 Dec) and home sales (21 Dec), a slight rise in still weak consumer confidence (21 Dec), a softening in core private final consumption deflator inflation (23 Dec) to 4.7%yoy, further falls in home prices (27 Dec), weak ISM business conditions indicators (4 Jan and 6 Jan), a further decline in job openings (4 Jan) and a further slowing in payroll jobs growth (6 Jan). The minutes from the December Fed meeting will be released on 4 January but are unlikely to say anything new.

Eurozone core inflation for December (7 Jan) will likely show a further rise.

The Bank of Japan (20 Dec) is expected to leave monetary policy on hold. Japanese core inflation for November (23 Dec) will likely also show a further rise in core inflation but only to around 1.8%yoy and Japanese jobs data will be released on 27 December.

China's business conditions PMIs (due 31 Dec and early Jan) will likely remain weak reflecting Covid related disruptions.

In Australia, November credit growth (30 Dec) is likely to show a further slowing in housing credit, CoreLogic home price data for December (3 Jan) will likely show a further 1.3% fall in home prices leaving capital city prices down 7% for 2022. The minutes from last RBA meeting (20 Dec) will be watched to see how close the RBA might be to pausing interest rates.

Outlook for investment markets for 2023

2023 is likely to see easing inflation pressures, central banks moving to get off the brakes and economic growth weakening but proving stronger than feared. This along with improved valuations should make for better returns in 2023. But there are likely to be bumps on the way – particularly regarding recession risks – & this could involve a retest of 2022 lows or new lows in shares before the upswing resumes.

Global shares are expected to return around 7%. The post mid-term election year normally results in above average gains in US shares, but US shares are likely to remain a relative underperformer compared to non-US shares reflecting still higher price to earnings multiples (17.5 times forward earnings in the US versus 12 times forward earnings for non-US shares). The $US is also likely to weaken which should benefit emerging and Asian shares.

Australian shares are likely to outperform again, helped by stronger economic growth than in other developed countries and ultimately stronger growth in China supporting commodity prices and as investors continue to like the grossed-up dividend yield of around 5.5%. Expect the ASX 200 to end 2023 at around 7,600.

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

Unlisted commercial property and infrastructure are expected to see slower returns, reflecting the lagged impact of weaker share markets and higher bond yields (on valuations).

Australian home prices are likely to fall further as rate hikes continue to impact, resulting in a top to bottom fall of 15-20%, but with prices expected to bottom around the September quarter, ahead of gains late in the year as the RBA moves toward rate cuts.

Cash and bank deposits are expected to provide returns of around 3%, reflecting the back up in interest rates through 2022.

A rising trend in the $A is likely over the next 12 months, reflecting a downtrend in the now overvalued $US, the Fed moving to cut rates and solid commodity prices helped by stronger Chinese growth.

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