WEEKLY MARKET UPDATE

29 NOVEMBER 2024

Investment markets and key developments

Despite lots of noise around Trump, including tariff posts, political uncertainty in France and another elevated inflation reading in the US, the combination of mostly solid US economic data, ongoing expectations for central bank rate cuts and news of a cease fire between Israel and Hezbollah saw global shares continue their trend higher over the last week. For the week, US shares hit a new high and rose 1.1%, Eurozone shares rose 0.3% and Chinese shares rose 1.3% helped by rumours of more stimulus but Japanese shares slipped 0.2%. Helped by the positive US lead and optimism about stronger earnings ahead Australian shares rose to a new high and ended the week up 0.5% led by gains in health, property, IT and consumer stocks. Bond yields fell helped by news that hedge fund manager Scott Bessent has been nominated as US Treasury Secretary and that Trump's tariff plans may be tempered. Oil prices fell on the back of the Israel/Hezbollah cease fire and gold prices also fell but metal and iron ore prices rose. Bitcoin fell but as with the recent pullback in gold its fall looks like a correction ahead of further gains which will likely take it above $US100,000. The $A rose slightly with the $US falling.

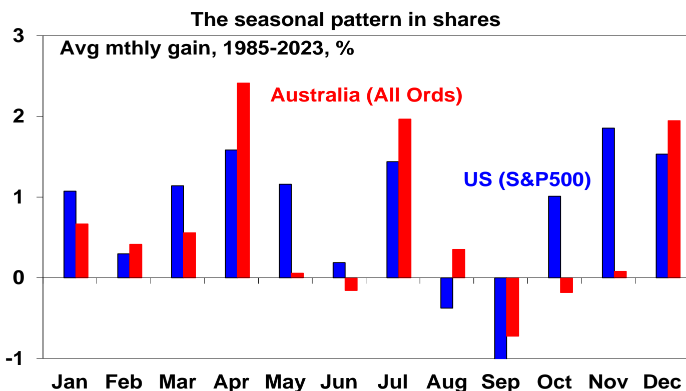
November saw strong gains in share markets with global shares up nearly 5% and Australian shares up 3.4% helped by optimism around Trump's win. However, there was a big divergence between the US share market which rose 5.7% and Eurozone and Japanese shares which fell 0.1% and 2.2% respectively partly on concerns about the negative impact on their exports from Trump's tariffs.

Trump tariffs are coming, but there will be lots of twists and turns. Trump's social media posts indicating a 10% tariff on China and 25% on Canada and Mexico from day one created a bit of volatility causing a brief refocus on the negative aspects of his policies. Here are nine key points regarding his tariffs:

1. We are back to social media posts as the new channel for US presidential announcements. But Trump's comments can be erratic and contradictory as Trump likes to be unpredictable to unsettle the other side, so they need to be treated with caution.
2. The tariffs cover 43% of US goods imports and could add up to 0.9% to US core (ex food and energy) prices.
3. That the tariffs were linked to the flow of drugs from China and drugs and immigrants (from Mexico and, oddly, Canada) rather than economics and trade makes it look like these tariffs are a negotiating tactic and may not be implemented or may be quickly removed if deals are struck on drugs and immigration. In 2019 Trump announced a similar tariff on Mexico only to back down when an immigration deal was reached.
4. Consistent with this while Trump is saying from day one its likely he will give countries a chance to negotiate before the tariffs hit.
5. While a 10% tariff on China is far less than the 60% talked about in the campaign – which may be seen as good news for Australia given our exposure to China - the fact that its related to drugs and not trade suggests there is still more to come. And this applies to other countries.
6. The threatened tariffs on Mexico and Canada indicate countries with free trade agreements with the US may not be safe – this may include Australia although the US' trade surplus with us may ultimately see us spared from Trump's general tariff.
7. The team he has chosen including his Trade Representative, Jamieson Greer, all support the use of tariffs to varying degrees.
8. While these tariffs may not ultimately be implemented the uncertainty they cause, with likely more to come, will be a dampener on business confidence, which will likely cause bouts of volatility in investment markets even if the tariffs escalate and then de-escalate as deals are struck.
9. Finally, and looking through the short term noise, various constraints should help to limit how much Trump can do on the tariff front: Trump won the election on cost of living concerns and if he adds to the cost of living via higher prices there will be a popular backlash; Trump is sensitive to the share market and if it starts to fall he will back off like he did in 2019 after a plunge in the second half of 2018 partly on the back of the then trade war; and his nomination for Treasury Secretary, hedge fund manager Scott Bessent, qualifies as an "adult in the room" and is likely to try and limit anything that causes a sharp rise in US bond yields. Of course, Bessent is just one voice.

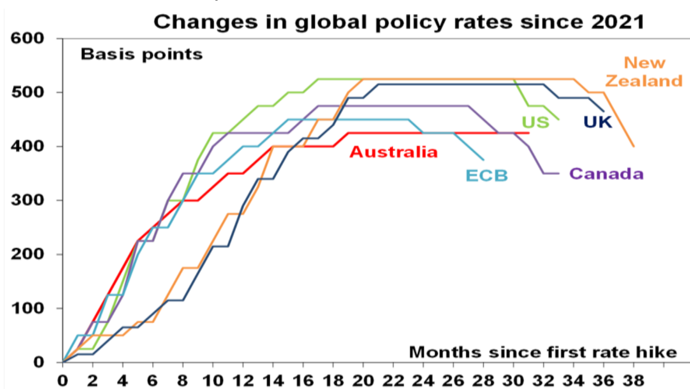
The bottom line is that there is a long way to go regarding tariffs in the US, the story could take various twists and turns, this could cause significant volatility in investment markets but ultimately various constraints will limit what Trump can do on tariffs versus his more market friendly policies regarding tax cuts and deregulation.

In the meantime, shares remain torn between the negatives of rich valuations, rising bond yields, uncertainty as to how much central banks will cut rates and uncertainties around Trump's trade policies and geopolitical risks on the one hand versus the positives of global central banks still being in an easing cycle, goldilocks economic conditions particularly in the US and optimism that Trump will invigorate the US economy. And we are now in a seasonally strong period of the year for shares. Our overall assessment remains that the trend is still up, including for Australian shares, but expect a more volatile and constrained ride.



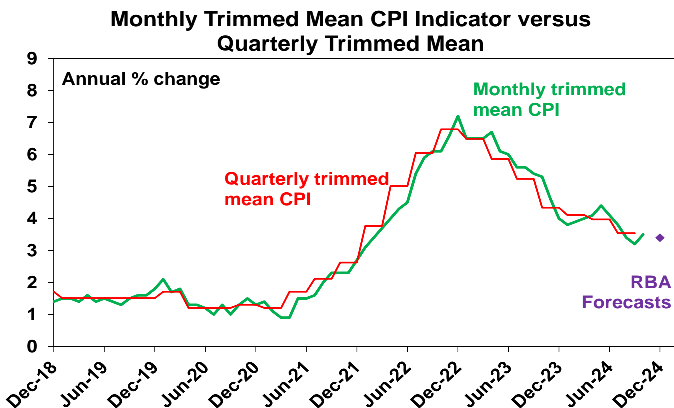
Source: Bloomberg, AMP

Global interest rates still falling, but with potentially increasing divergence. The past week saw the once ultra hawkish RBNZ cut its cash rate by another 0.5% in the face of a weak economy and falling inflation. Against this there is increasing uncertainty about when and how much further the Fed will cut given somewhat elevated inflation data for October, strong US economic growth, uncertainty as to how much Trump's policies will boost growth and inflation and the Fed minutes emphasising a desire to lower rates "gradually". We continue to see another cut next month but it's a close call and other central banks like the ECB, Bank of Canada and RBNZ are likely to cut more next year given weaker growth and the threat from Trump's tariffs.



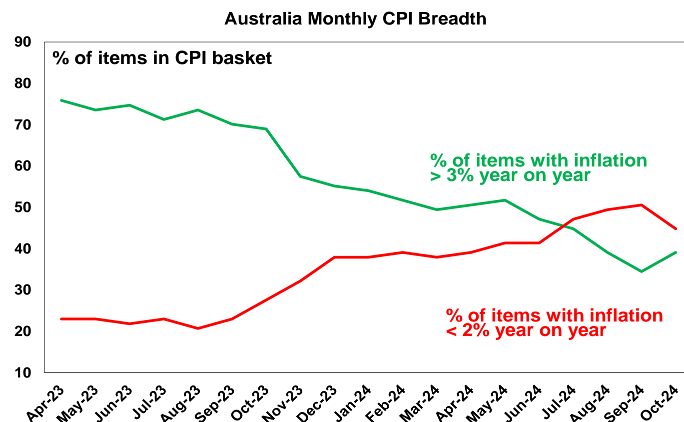
Source: Bloomberg, AMP

Australian inflation data leaves the RBA on hold for now, but remains consistent with a falling trend. The RBA will look through the lower-than-expected headline reading of 2.1%yoy on the grounds that's it fall has been exaggerated by electricity rebates the effect of which will start to reverse this month. Governor Bullock's speech to CEDA reiterated that it will focus on underlying inflation and not the headline CPI. And here the news was not so positive with trimmed mean inflation, the RBA's preferred measure of underlying inflation, rising to 3.5% which the RBA sees as still too high. Services inflation also edged up to 4.8%yoy. This will keep the RBA on hold and cautious for now.



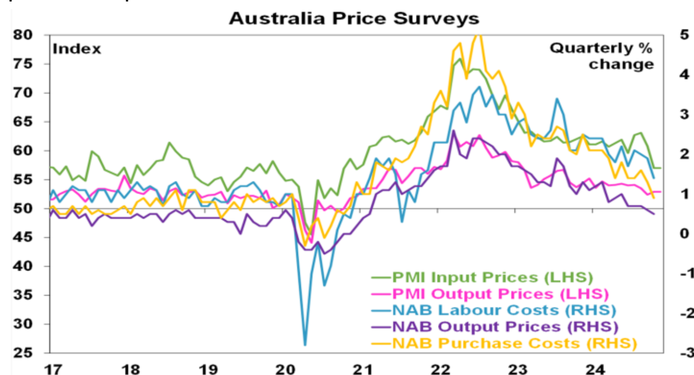
Source: ABS, AMP

However, the trend in trimmed mean inflation remains down, nearly half of the CPI subgroups saw price falls in October & more items are seeing annual inflation below 2%yoy than above 3%yoy.



Source: ABS, AMP

The evidence of an ongoing downtrend in inflation in the CPI is consistent with business surveys with both the NAB and PMI surveys showing output price increases running around levels seen prior to the pandemic.



Source: NAB, Bloomberg, AMP

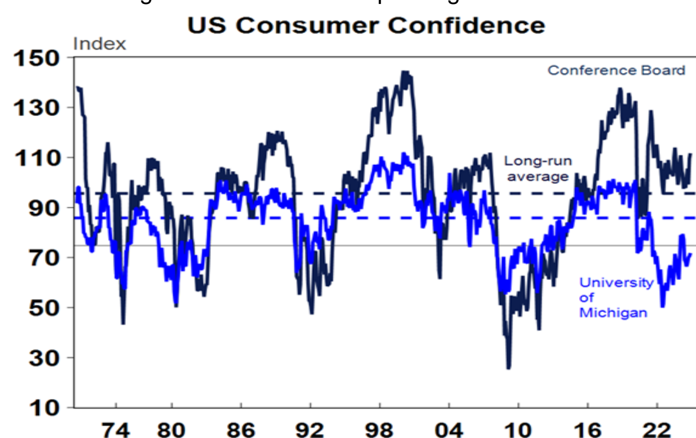
However, the RBA appears to be in no hurry to ease so we have shifted our expectation for the first rate cut from February to May. The minutes from the last RBA board meeting provided mixed signals referring to the need to see two good quarterly underlying inflation readings in a row before cutting (pointing to a cut in May at the earliest) but also noting the importance of being forward looking and not too reliant on backward looking information (which inflation is) (arguably pointing to an earlier cut). Since then, Governor Bullock has noted that "underlying inflation is still too high to be considering lowering the cash rate target in the near term", but she also noted that the RBA wasn't just focussed on CPI data and would look at forward looking indicators, including the NAB survey referred to above. Ultimately, we think the RBA will remain flexible and so a February easing is still possible but the hurdle to cut then looks high and would require some combination of a very good December trimmed mean inflation reading (say 0.5%qoq versus the RBA's forecast of 0.7%qoq) and a sharp rise in unemployment in the next three monthly releases. This is possible but not probable and so we have pushed out our expectation for the first rate cut from February to May. The prospect of a new interest rate setting board at the RBA by March also adds to uncertainty around RBA rate decisions as new board members will potentially alter how the RBA reacts to data. The money market has only a 30% probability of a February cut but has one fully priced in by May.

RBA reforms to set up separate interest rate setting and governance boards passed into law - unfortunately! After being ditched two months ago the proposal to split the RBA Board has now passed into law with Greens and cross bench support. This is

unfortunate as there is no evidence that the RBA Review's proposal to set up a separate interest rate setting board would lead to better outcomes or that its world's best practice. But it could reduce RBA accountability and authority (as egotistical external economists could outvote the RBA by 6 to 2) and create confusion - with those economists on the Board delivering regular speeches which may differ from the RBA's view and the RBA potentially having to defend decisions it did not support. The lack of bi-partisan support for the reform also leaves the it weakened and the Coalition is right to be concerned that the Government could stack the interest rate setting board with soft-on-inflation economists which would undermine the RBA's inflation fighting credibility and lead to higher than otherwise interest rates in Australia over the long term. If the new rate setting board with Government appointed members is set up by 1 March next year as indicated in the legislation and then the RBA delivers a pre-election rate cut in April after having left rates on hold in February it could lead to questions about the independence of the new board and dent the RBA's credibility.

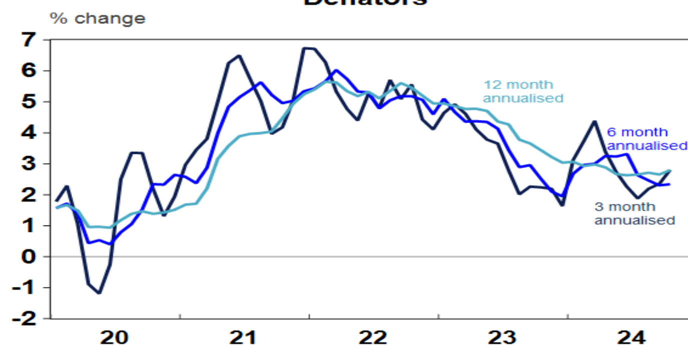
Major global economic events and implications

US economic data was mixed. September quarter GDP growth was confirmed at a 2.8% annualised pace and reflecting solid data to date the Atlanta Fed's GDPNow estimate of December quarter growth is running at 2.7% annualised. Personal income and spending rose solidly in October, consumer confidence as measured by the Conference Board rose and is above average levels and initial jobless claims remain low. However, against this underlying capital goods orders and shipments are trending sideways, continuing unemployment claims rose further indicating that once a job is lost its harder to find a new one, new home sales plunged as the rebound in mortgage rates impacted, home price gains slowed further and the personal saving rate remains weak indicating that pandemic era saving buffers are continuing to run down warning of slower consumer spending ahead.



Source: Macrobond, AMP

Another elevated US inflation reading. Consistent with the October CPI, core private final consumption inflation showed a further tick up to 2.8%yoy from 2.7%yoy, with 3-month and 6-month annualised inflation showing that progress in getting inflation down may have stalled again. We still see the Fed easing again next month, but its a very close call particularly with Trump's policies potentially adding to inflation next year, and November jobs and CPI data ahead of the December Fed meeting may now be key.



Source: Macrobond, AMP

Eurozone CPI inflation edged up to 2.3%yoy in November, due to energy base effects with core inflation unchanged at 2.7%yoy. This won't alter the ECB's easing profile with another cut expected in December (probably -0.25% but it could be -0.5%) and the money market is pricing in around seven cuts out to October next year. Eurozone economic confidence rose slightly but remained weak in November consistent with weak PMIs with a further fall in the German IFO business conditions index highlighting the weakness in the German economy.

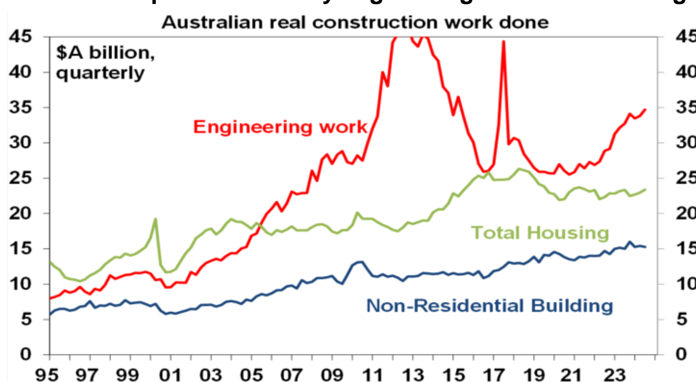
Meanwhile, political uncertainty is up again in France with the Barnier minority government struggling to pass a budget to reduce the deficit. It may still pass but failure to do so could lead to the collapse of the government and an ongoing impasse in terms of getting the deficit down threatening even higher French bond yields.

Japanese economic data was messy with a slight rise in unemployment to 2.5% but stronger industrial production and retail sales. Tokyo core inflation for November rose but only to 1.2%yoy.

The Reserve Bank of New Zealand cut its cash rate by another 0.5% taking it to 4.25% noting "considerable spare capacity" and "core inflation…converging to target". It expects to cut further if "economic conditions continue to evolve as projected". Its cash rate projections now show a steeper fall than in August.

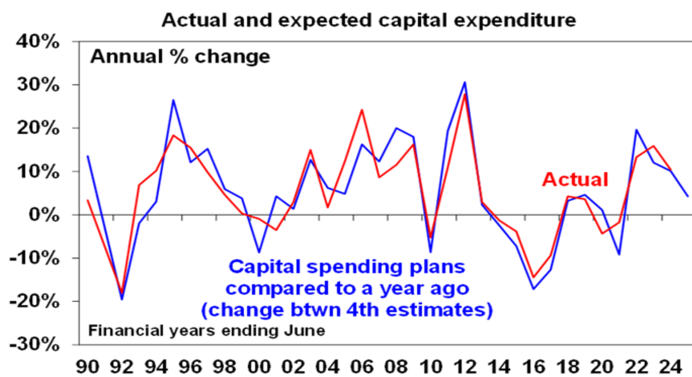
Australian economic events and implications

In Australia, September quarter construction activity rose more than expected driven by engineering and home building.



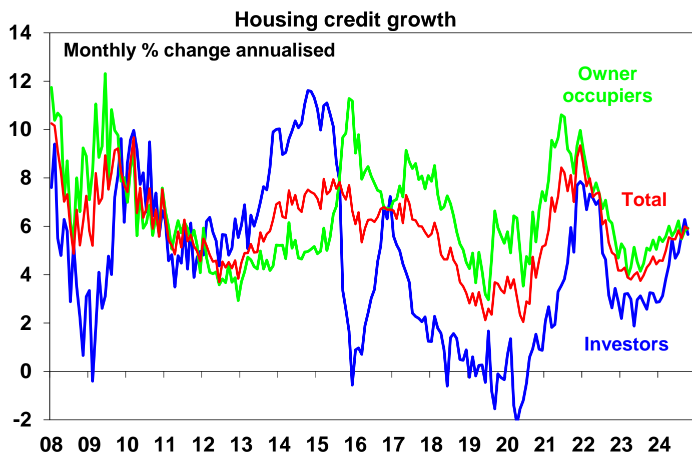
Source: ABS, AMP

Business investment rose in line with expectations. Capex rose 1.1%qoq in the September quarter, with mining investment down and non-mining up. Business investment plans for this financial year compared to those made a year ago imply nominal capex growth of just 4.3%, which is down from an expectation of 7.5%yoy in the June quarter and 12.3%yoy in the March quarter and implies weak growth after inflation.



Source: Bloomberg, AMP

Private credit growth ticked up slightly in October to 0.6%mom or 6.1%yoy driven by business credit. Growth in housing credit was unchanged and looks like it may be peaking at a lower level than seen in past cycles.



Source: RBA, AMP

What to watch over the next week?

In the US, the focus will be back on jobs data with payrolls for November (Friday) likely to show a rebound to a rise of 200,000 after the weather depressed 12,000 gain in October, but the trend remaining down. Unemployment is likely to have ticked up slightly to 4.2% with wages growth slowing a notch to 3.9%yoy. Meanwhile, the trend is likely to remain down in job openings and quits data for October (Tuesday), warning that the jobs market is likely to cool further. In other data, the manufacturing conditions ISM for November (Monday) is likely to improve slightly but remain weak at around 48, but the services conditions ISM (Wednesday) is likely to have slowed a bit but remain strong at around 55.

Eurozone unemployment for October (Monday) is likely to have remained unchanged at 6.3%.

In Australia, September quarter GDP growth (Wednesday) is likely to show a slight pick up to 0.4%qoq after 0.2%qoq in the June quarter with a small rise in consumer spending, stronger business investment and another positive contribution to growth from net exports but a drag from inventories. However, annual growth will remain weak at 1%yoy and Australia will have remained in a per capita recession, with per capita GDP having fallen in 8 of the last 9 quarters resulting in a total fall of around 2.2% from its June quarter 2022 high, its biggest fall outside of the pandemic since the early 1990s recession. This is one indicator of slumping living standards in Australia on the back of the “cost of living” crisis.

In other Australian data, CoreLogic data is likely to show that home price growth slowed to just 0.1%mom in November with Sydney and Melbourne prices falling further and Brisbane, Adelaide and Perth showing a further slowing, retail sales for October are likely to show a 0.3% and building approvals are likely to be flat (all Monday), household spending for October is likely to have remained soft and the trade surplus (both Thursday) is likely to have improved to around $5.5bn.

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 than the last year has been.

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.

The $A is likely to be buffeted between the positive of a narrowing in the interest rate differential between the Fed and the RBA and the negative of US tariffs and a potential global trade war. This could leave it stuck between $US0.60 and $US0.70.

Important note: While every care has been taken in the preparation of this document, neither National Mutual Funds Management Ltd (ABN 32 006 787 720, AFSL 234652) (NMFM), AMP Limited ABN 49 079 354 519 nor any other member of the AMP Group (AMP) makes any representations or warranties as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor’s objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor’s objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided. This document is not intended for distribution or use in any jurisdiction where it would be contrary to applicable laws, regulations or directives and does not constitute a recommendation, offer, solicitation or invitation to invest.