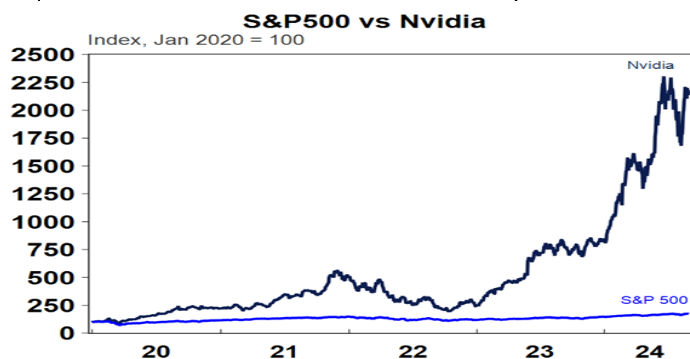
WEEKLY MARKET UPDATE

30 AUGUST 2024

Investment markets and key developments

Share markets were mixed over the last week. The US S&P 500 fell on the back of weaker tech stocks as Nvidia's earnings results beat but not by as much as had been priced into its share price, but most shares still rose in the US boosted by okay economic data and ongoing expectations for Fed rate cuts. Eurozone and Japanese shares also rose but Chinese shares fell. Australian shares rose around 0.7% as investors looked through softish earnings results to help from lower interest rates eventually ahead with gains in property, finance and resources shares offsetting falls in IT and retail stocks. Bond yields rose slightly. Oil prices rose on the back of concerns about a political disruption to Libyan oil exports which accounts for just over 1% of global liquid fuel production. Metal prices fell but iron ore prices rose. The $A rose making it to around $US0.68 despite a slight rise in the $US.

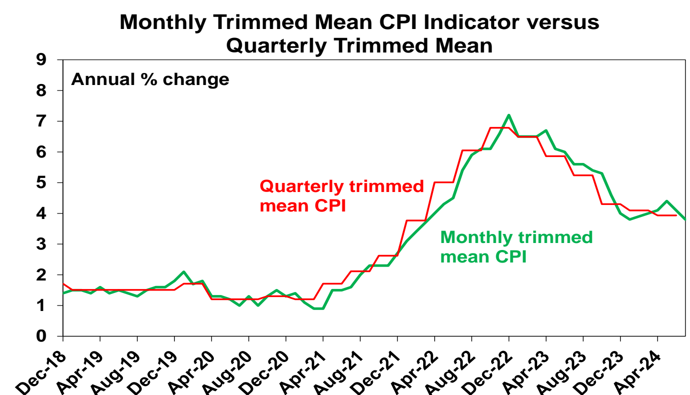
August saw shares put in a strong recovery from the slump at the start of the month. For the month US shares are up around 1.3% and global shares are up 0.9%. Australian shares fell around 0.2%, which is still not bad considering their 5.7% fall early in the month. However, shares remain at high risk of further falls and volatility over the next few months as: valuations remain stretched; investment sentiment is still relatively upbeat which is negative from a contrarian perspective; the AI boom in tech stocks is looking shaky with Nvidia down despite beating expectations; recession risk remains high in the US and Australia; and geopolitical risk is high particularly around the US election and the Middle East; and September tends to be the weakest month of the year for shares.



Source: Macrobond, AMP

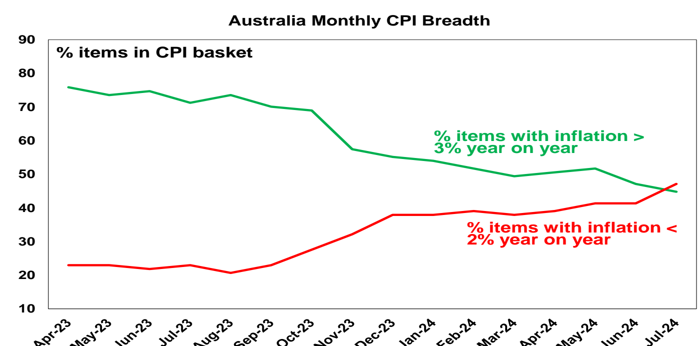
The good news remains that global rate cuts are continuing as central banks like the Fed and ECB are shifting their focus from inflation to preventing a significant deterioration in jobs. Two aspects of Fed Chair Powell's Jackson Hole comments are of particular relevance to Australia. First, he noted that "we do not seek or welcome a further cooling in labour market conditions". This is relevant for Australia because the rise and level of US unemployment at 4.3% is not that different to the rise and level of unemployment here at 4.2%. Second, he noted that "an important takeaway from recent experience is that anchored inflation expectations, reinforced by vigorous central bank actions, can facilitate disinflation without the need for slack." If the US experience is any guide the RBA's concerns about continuing excess demand may be overstated. Time will tell.

Australian inflation for July provided no justification for another rate hike, but it won't rush the RBA into a cut either. The July Monthly CPI indicator fell to 3.5%yoy with trimmed mean inflation dropping to 3.8%yoy. Both were a bit higher than expected, inflation is still too high particularly for services which is at 4.4%yoy, and the monthly CPI needs to be treated with caution as for July it only includes 60% of components.



Source: ABS, AMP.

But the good news is that: inflation looks to be falling again in Australia; there is still more to come from electricity rebates with the Federal $300 household rebate to be spread across four months and it only started in Queensland and WA in July; annual inflation is still above 3% for lots of essentials but its fallen below 2% for clothing, furnishing and household services, communication and recreation; in fact for what its worth given the gaps in the July monthly CPI there are now more CPI basket items with inflation less than 2%yoy than there are with inflation above 3%yoy; and slowing wages growth will slow services inflation.

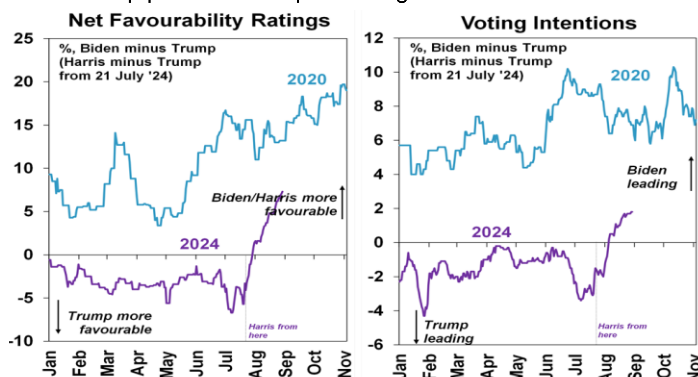


Source: CBA, ABS, AMP

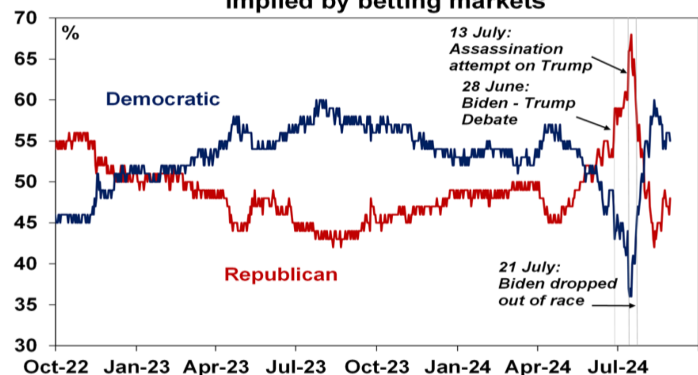
The July CPI is unlikely to change the RBA's thinking. The monthly CPI should be treated cautiously, but for what it's worth it suggests that inflation is roughly on track for RBA forecasts for the September quarter for a fall to 2.9%yoy and trimmed mean to slow to 3.6%yoy. So, it's not going to drive another rate hike. But nor is it going to bring forward a rate cut. Our base case remains for the first rate cut starting in February as the RBA is unlikely to be confident enough, about inflation falling to target, until then to start cutting.

What would bring forward an RBA rate cut? RBA guidance that "it was unlikely that the cash rate target would be reduced in the short term", taken to mean by the end of the year and the next six months, does not mean that the RBA has ruled out a near term cut. As we saw in 2021-22 with the "no rate hike before 2024" guidance if the facts change the RBA will change as their current guidance is predicated on "what the Board knows at present". And we have seen that this year with other central banks globally that have pivoted to rate cuts. The same could easily happen in Australia if we saw a faster than expected fall in inflation, a sharp rise in unemployment or a financial shock. None of these are our base case but they are a high risk so a pre-Christmas cut is possible.

The Democrat bounce after Harris replaced Biden has largely been sustained helped by the Democrat National Congress, but the honeymoon could wear off. Harris continues to lead in the average polls and favourability, is slightly ahead in the top battleground states and a Harris/Democrat victory is seen as around 55% probable by betting markets. However, Trump still leads in 3 of the 7 battleground states and Harris is still well behind where Biden was in 2020. So it still looks like being a close election and as such there is a high risk that at some point in the next month or so financial markets will start to become more concerned again about Trump policies which point to higher inflation and a trade war.



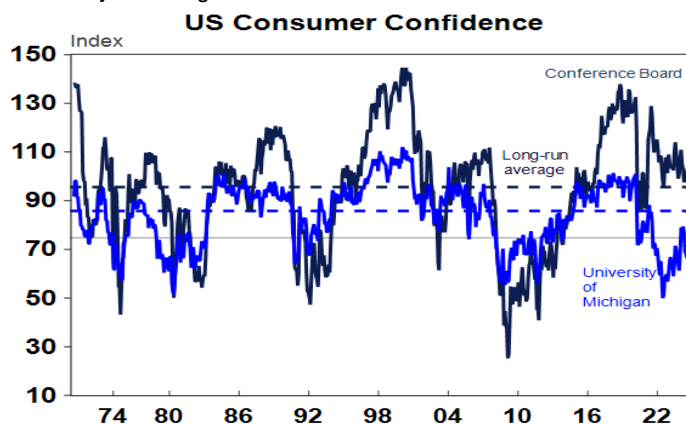
Source: RealClear Politics, AMP



Source: PredictIt, AMP

Major global economic events and implications

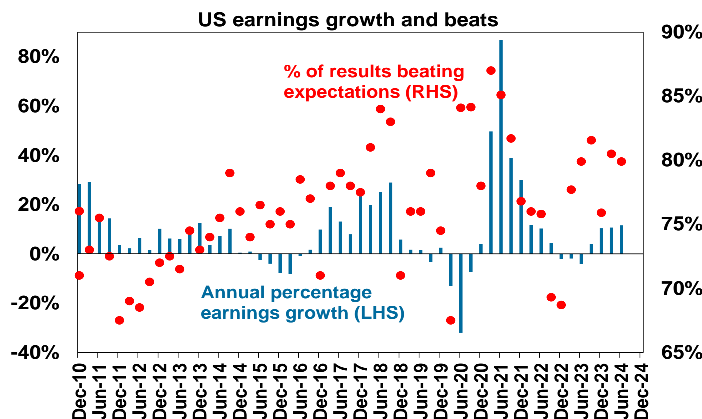
US economic data released over the last week was mixed. June quarter GDP was revised up slightly to 3% annualised with stronger consumer spending, initial jobless claims fell slightly, and consumer confidence rose in August but across the Conference Board and University of Michigan measures remains subdued.



Source: Macrobond, AMP

Against this, US durable goods orders data for July showed core capital goods orders trending sideways and shipments trending down with both down in real terms pointing to weak business investment. And pending home sales fell, with annual home price growth still solid but slowing.

Strong US earnings growth. The US June half earnings reporting season is now complete with earnings up 11.6%yoy and 79% beating against a norm of 76%. The problem has been that the beats particuarly for tech stocks like Nvidia were less than many had hoped for and had been priced in to share prices.



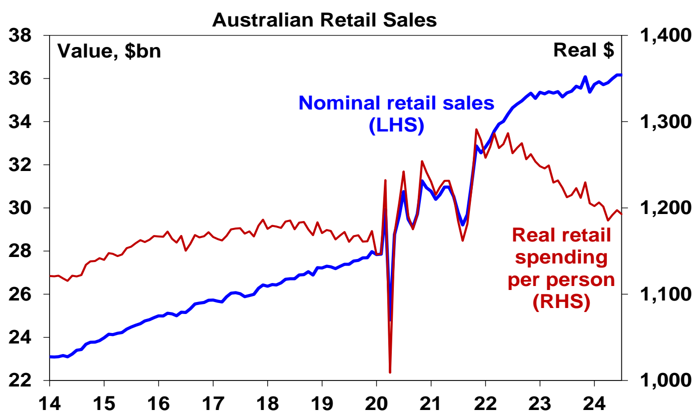
Source: Bloomberg, AMP

The German IFO business climate index fell again in August. And the minutes from the last Swedish central bank meeting indicated they actually considered a 0.5% cut before settling on another 0.25% cut at their last meeting.

Japanese data for July was mixed with unemployment up slightly to 2.7% and industrial production up less than expected but solid growth in retail sales and a rise in job vacancies relative to applicants. Hotter than expected Tokyo inflation of 2.6%yoy with core (ex food & energy) inflation rising to 1.3%yoy keeps alive the possibility of another BoJ rate hike this year.

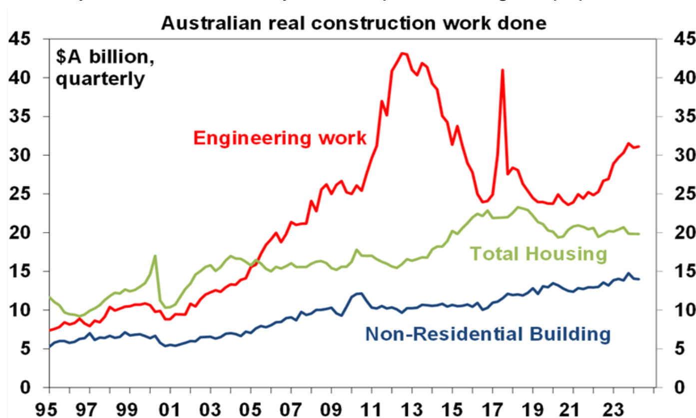
Australian economic events and implications

Australian economic data releases over the last week were mostly soft. After two months of support from end of financial year sales retail sales were flat in July, defying expectations for a 0.3% gain and suggesting the tax cuts have not provided a boost as cash strapped Australians use them to boost their savings. We are still growing our spending on food (as there are more of us), but spending in discretionary areas like clothing, department stores, cafes and restaurants and household goods is flatlining and down in real terms. Real retail spending per person is in a clear down trend.



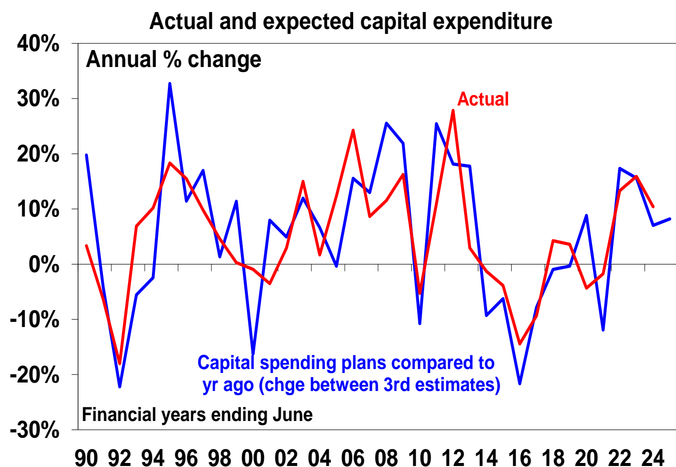
Source: ABS, AMP

June quarter construction was weak again. Total construction rose just 0.1%qoq which was less than expected and followed a 2% fall in the March quarter with falls in residential and non-residential building offset by a rise in public infrastructure spending. As can be seen in the chart below housing investment has been tracking sideways over the last few years despite the surge in population.



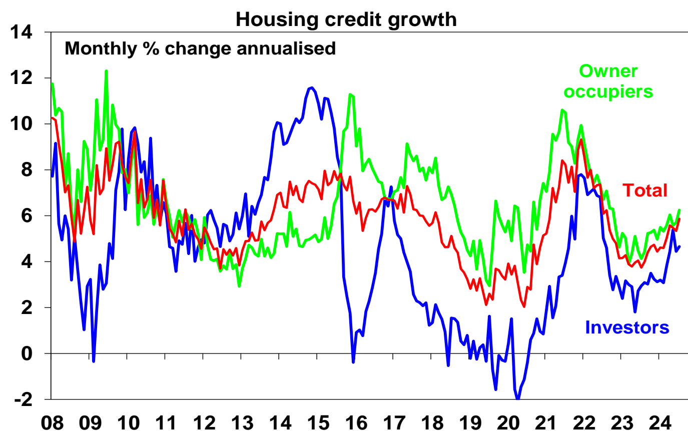
Source: ABS, AMP

Business investment was also far weaker than expected. Capex fell 2.2%qoq in the June quarter against expectations for a 1% rise. The fall was led by a 3.8%qoq fall in building and structures investment but equipment investment also fell 0.5%qoq, with mining investment up but non-mining down sharply. Business investment plans for this financial year compared to those made a year ago imply nominal capex growth of around 8.2%yoy which is still resilient, but this is down from an expectation of 12.3%yoy in the March quarter and the pace looks to be slowing.



Source: Bloomberg, AMP

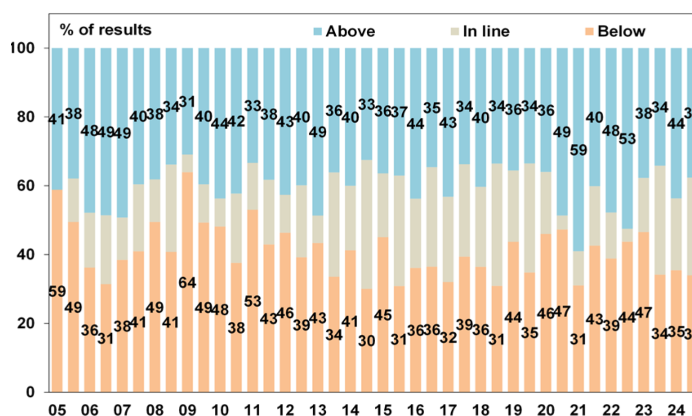
Private credit growth remained moderate in July at 0.5%mom or 5.7%yoy. Housing credit growth continues to edge up but is soft compared to prior cycles.



Source: RBA, AMP

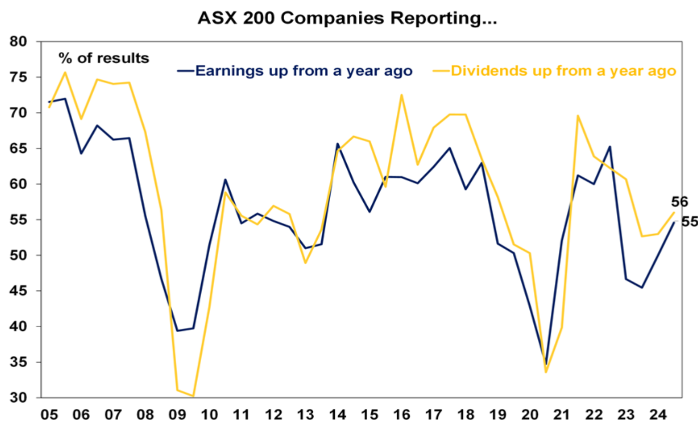
The Australian June half earnings reporting season is now complete. Results have been okay with slightly less than normal upside surprise, but also less than normal downside surprise and an increase in the number of companies reporting profits or dividends up on a year ago compared to the December half reporting season but with both slightly weaker than normal. However, in aggregate results were softer than expected with earnings down 4.4% in the last financial year which was worse than consensus expectations for a 3.5% fall at the start of August. Energy shares saw the biggest fall in earnings, but this was as expected with the downside surprise mainly concentrated in industrials, telcos and utilities. The signal from consumer stocks was mixed but not as bad as feared. The rise in the proportion of companies raising dividends is positive but outlook comments were more cautious and this along with the weaker than expected overall results for 2023-24 led to a downgrade in consensus earnings expectations for this financial year to a 4.6% rise from a 5.4% rise at the start of August. Despite the downgrade to aggregate earnings expectations, investors appear to be looking through it with hopes for relief ahead from eventually lower interest rates.

- 38% of results have surprised consensus earnings expectations on the upside, which is less than the norm of 40%, but on the other hand 34% have surprised on the downside which is also less than the norm of 41%. So not great, but okay.



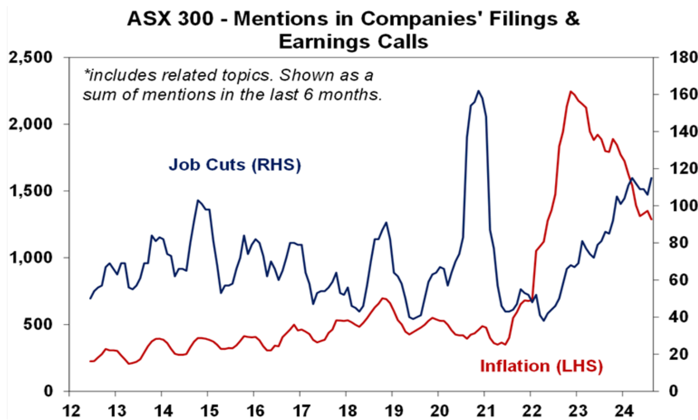
Source: Bloomberg, AMP

- 55% of companies saw earnings rise on a year ago, and this is below the norm of 56%. But don't forget that falls in the level of profits in 2023-24 were concentrated in energy stocks, which explains why more companies report profits up than down.
- 56% of companies have increased their dividends on a year ago, but this is also below the norm of 59%, suggesting caution.



Source: Bloomberg, AMP

- **The good news is that less companies are talking about inflation, but unfortunately there has been a rise in talk of job cuts**, albeit from a low base – note the different scales in the chart below.



Source: Bloomberg, AMP

What to watch over the next week?

In the US, the focus will be back on jobs data (Friday) with August payroll growth likely to tick up slightly to 165,000 after Hurricane Beryl depressed the rise in July and unemployment likely falling back to 4.2% from 4.3%. The latter would reverse the recession trigger from the Sahm rule. But I wouldn't read too much into this as the trend is still towards slower jobs growth and higher unemployment, with job openings, quits and hiring data for July (Wednesday) likely to show a further softening. Meanwhile average hourly wages growth is likely to tick up slightly to 3.7%yoy. In terms of other data expect a slight improvement in the manufacturing conditions ISM for August (Tuesday) to a still soft 48 and services conditions ISM (Thursday) to remain around a subdued but okay 51.

The Bank of Canada (Wednesday) is likely to cut its key policy rate for the third time by 0.25% taking it to 4.25%.

China's Caixin business conditions PMIs for August will be released on Monday and Wednesday and are likely to remain soft.

In Australia, June quarter GDP data (Wednesday) is likely to show growth remains weak at around 0.2%qoq, resulting in annual growth dropping further to 0.9%yoy. We expect only weak growth in consumer spending, flattish dwelling construction and business investment and a detraction from inventories offset by solid public spending and a strong contribution to growth from net exports. This will mean that the per capita recession continues with per capita GDP down in seven of the last eight quarters with a fall of around 2% from its June quarter 2022 high. A 0.9%yoy rise in June quarter GDP is in line with the RBA's forecasts, but we expect growth will be well below RBA forecasts for a pickup to 2.6%yoy over the year to the June quarter next year. Meanwhile, CoreLogic data is likely to show continuing moderate home price growth of around 0.5% in August (Monday), home building approvals for July (Monday) are likely to rise 3% after a sharp fall in June, the trade surplus for July (Thursday) is likely to fall slightly to around $5.3bn and housing finance data for July (Friday) is likely to show a 1% gain. A speech and a fireside chat by RBA Governor Bullock on Thursday will be watched for any change in the RBA's thinking post the July CPI and June quarter GDP data, but the Governor is likely to retain a relatively hawkish stance continuing to signal that the Board does not expect to cut rates by year end.

Outlook for investment markets

Easing inflation pressures, central banks moving to cut rates and prospects for stronger growth in 2025-26 should make for reasonable investment returns over 2024-25. However, with a high risk of recession, poor valuations and significant geopolitical risks particularly around the US election, the next 12 months are likely to be more constrained and rougher compared to 2023-24 and there is a very high risk of a further correction in the near term.

A recession is the main threat for shares and there is a risk that we may have already seen the high for the year in the Australian share market after it reached our year-end target of 8100 in early August.

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 remain negative due to the lagged impact of high bond yields and working from home reducing office space demand.

Australian home prices are likely to see more constrained gains over the next 12 months as the supply shortfall remains, but still high interest rates constrain demand and unemployment rises. The delay in rate cuts and talk of rate hikes risks renewed falls in property prices as its likely to cause buyers to hold back and distressed listings to rise.

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 is the main downside risk.

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