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Fiducian Monthly Economic Commentary Report

30 June 2024 Conrad Burge, Investment Manager, Fiducian Investment Management Services Limited

ECONOMIC OUTLOOK

GLOBAL ECONOMY

The global economy has been expanding at a moderate rate and, in the IMF's words, 'remains remarkably resilient', despite the implementation of tight monetary policy by most of the world's major central banks in an attempt to contain inflation. Nevertheless, the IMF notes that 'challenges remain' and 'while inflation trends are encouraging, we are not there yet'. Nevertheless, some European central banks have already begun to lower interest rates.

In the case of the US, inflation readings have come down over the past 2 years but remain above target. As such, it is unlikely that interest rates can be lowered until at least later in the year. Across the developed world, economic activity is mostly weak, with the outlook for the rest of this year 'broadly balanced'.

The global economy has continued to grow at close to its longer-term trend rate, despite ongoing tight monetary policy being implemented by most of the world's major central banks in an effort to push inflation lower and back into target ranges. As the International Monetary Fund (IMF) noted in its most recent report (April), 'the global economy remains remarkably resilient, with growth holding steady as inflation returns to target'. It added though that 'numerous challenges remain' and 'while inflation trends are encouraging, we are not there yet'. Nevertheless, several central banks have already begun to lower official interest rates, including the European Central Bank (by 0.25% in June), as well as the Swiss and the Swedes. Looking ahead, the IMF is still expecting inflation to steadily decline over the rest of this year and through 2025, with the challenge for the major central banks being 'to ensure that inflation touches down smoothly, by neither easing policies prematurely nor delaying too long and causing target undershoots'.

In the case of the US, the central bank (the 'Fed') last raised rates on 25 July 2023 to the range of 5.25% to 5.5%. 'Fed' Chairman, Jerome Powell, stated on 3 April that 'we continue to believe that the policy rate is likely at its peak for this tightening cycle'. On 12 June he noted that 'we do not expect it will be appropriate to reduce the target range until we have gained greater confidence that inflation is moving sustainably toward 2 percent'. More broadly, tight monetary policy has been effective in slowing activity and the IMF is forecasting global growth of 3.2% this year and again in 2025 but only 1.7% and 1.8% for the advanced economies, noting that 'with the likelihood of a hard landing receding, risks to the global outlook are broadly balanced'.

AUSTRALIAN ECONOMY

The Australian economy entered a per capita recession last year and remains weak, with households under cost-of-living pressure. Discretionary spending has fallen but tight monetary policy is likely to remain in place for some time.

The Australian economy weakened further in the March quarter, growing by only 0.1%. On a per capita basis, it remained in recession, contracting for the fourth quarter in a row (by 0.4%), with output also likely to have been weak in more recent months. The key factor driving this slowdown has been rate rises by the Reserve Bank. These have weighed on household spending, with discretionary spending up only 0.1% for the year. In May, the annual inflation rate came in above expectations at 4.0% (and 1.0% for the quarter).

MARKETS

Major share markets experienced high volatility last year until a strong upwards surge began in October, which continued through June. Some markets look cheaper than others, including European markets and global small cap markets, while the US market appears more fully valued, although narrowly based.

Most share markets have been on a broadly upwards trend since last October on the assumption that interest rates had peaked and would soon begin to be reduced. This has been particularly supportive of the more interest rate sensitive sectors of the market, including the technology and property sectors. This year, over the half year to 30 June, market movements have included rises of 15% for the broad US market (S&P500), 18% for the technology-focused Nasdaq, 9% for Germany, the UK 6%, Japan 18% and Australia 2%, while the French and Chinese markets declined slightly. The US market appears fully valued but most others still appear attractively priced, especially small caps, assuming that interest rates soon begin to decline.

Major sovereign bond markets saw yields rise after the end of 'quantitative easing' in 2022. However, subsequently, slow growth in key economies encouraged investors back into this 'safe haven' before concerns about stubborn inflation data have seen yields rise more recently.

Major sovereign bond markets have seen yields (interest rates) rise after indications that inflation might not be falling as fast as expected. The US 10-year Treasury bond yield fell to a record low of 0.54% on 9 March 2020 during the pandemic but touched 5.0% in October last year before sliding down and then rising again to 4.34% on 28 June this year. Similarly, the Australian 10-year bond yield was 0.57% on 8 March 2020 but was also 4.34% on 28 June 2024. Some bond markets could see yields fall again (and prices rise) over coming months if growth remains soft and if inflation continues to fall back towards targets.

FIDUCIAN FUNDS

Fiducian's diversified funds are slightly above benchmark for growth assets (shares and property). Bond holdings have been increased and cash reduced.

Fiducian's diversified funds are currently slightly above benchmark for international shares, domestic shares and listed property. Exposure to bond markets was lifted last year to around benchmark, while cash holdings have been lowered.

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