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Fiducian Monthly Economic Commentary Report

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ECONOMIC OUTLOOK

GLOBAL ECONOMY

The global economy has sustained solid growth this year despite the continued implementation of tight monetary policy by most major central banks. However, most major central banks have begun to lower their official interest rates as they seek to engineer 'soft landings' for their economies. In the IMF's view, 'risks to the outlook remain balanced', but 'a lack of progress on services disinflation' means that rates may need to stay 'higher-for-even-longer'.

The global economy has continued to sustain solid growth despite the persistence until now of 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. However, monetary policy is now in the process of being loosened, with interest rates having been cut twice since June by the European Central Bank and once in September by the US central bank (the 'Fed'). As the International Monetary Fund (IMF) noted in its most recent report (July), 'monetary policy rates of major central banks are still expected to decline in the second half of 2024', adding that 'the gradual cooling of labour markets, together with an expected decline in energy prices, should bring headline inflation back to target by the end of 2025'. This view about an imminent softening in labour markets underpins the forecast of further falls in inflation and thus in interest rates, although the IMF tempers its own view of the near-term outlook by stating that 'risks to the outlook remain balanced', with the potential of 'higher-for-even-longer interest rates'.

In the case of the US, while inflation remains above target, in the words of the 'Fed' Chairman, Jerome Powell, 'the time has come for policy to adjust' and on 18 September, the 'Fed' reduced rates by a hefty 0.5%. Despite a soft economic environment, the IMF is still forecasting global growth to remain relatively robust.

In the case of the US, on 18 September, the 'Fed' implemented its first rate reduction since early 2020 with a 0.5% cut, taking the range to 4.75% to 5.0%. 'Fed' Chairman, Jerome Powell, stated that the 'Fed' had 'gained greater confidence that inflation is moving sustainably toward 2 percent, and judges that the risks to achieving its employment and inflation goals are roughly in balance'. Earlier, Powell had noted that 'it seems unlikely that the labor market will be a source of elevated inflationary pressures anytime soon'. More broadly, the IMF is forecasting global growth of 3.2% this year and 3.3% in 2025 but only 1.7% and 1.8% for the advanced economies. Growth in the developing world is forecast to be stronger (4.3% this year and in 2025).

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 remains weak, growing by only 0.2% in the June quarter. On a per capita basis, it remained in recession, contracting for the fifth quarter in a row (by 0.4%), with the economy also likely to have been very weak in the September quarter. The key factor driving this slowdown has been tight interest rate policy by the Reserve Bank. This has weighed on household spending, with discretionary spending contracting. In August, the Reserve Bank's preferred measure of annual inflation remained elevated at 3.4%.

MARKETS

Major share markets experienced high volatility last year until a strong upwards surge began in October. This year has seen most markets appreciate, with some rising strongly. However, a number of market sectors still appear attractively priced, including European markets and global small cap markets, while the US market appears more fully valued.

Most share markets have been on a broadly upwards trend since October 2023 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, up to 24 September, market movements have included rises of 20% for the broad US market (S&P500) and for the technology-focused Nasdaq, 13% for Germany, the UK 7%, France 1%, Japan 13% and Australia 7%, while the Chinese market declined by 4%. The US market appears fully valued but most others still appear attractively priced, especially small caps, assuming that recession can be avoided.

Major sovereign bond markets saw yields rise after the end of 'quantitative easing' in 2022. However, since then slow growth in key economies has encouraged investors back into these 'safe havens' and strong inflows have seen yields slip back recently.

Major sovereign bond markets have been volatile this year, with yields (interest rates) rising and falling in line with the outlook for inflation. 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, then rising again and then sliding to 3.75% on 23 September this year. Similarly, the Australian 10-year bond yield was 0.57% on 8 March 2020 but was 3.96% on 23 September 2024. Some bond markets could see yields fall further (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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