WEEKLY MARKET UPDATE

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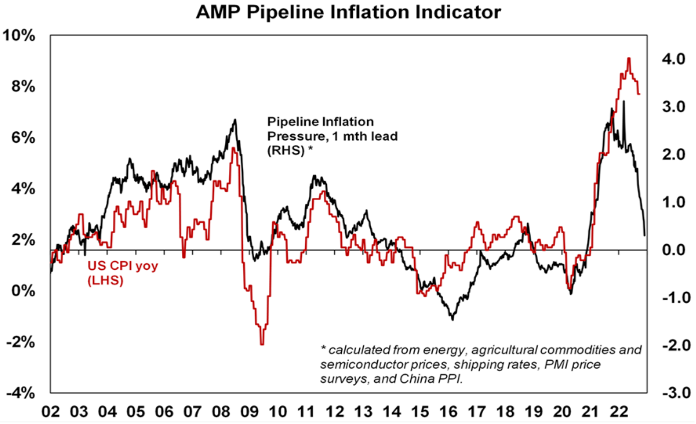
Investment markets and key developments

Share markets resumed their rally over the last week helped by further signs of a slowing in rate hikes from the Fed and a decline in bond yields. While the latter may partly reflect recession fears, lower bond yields also make shares more attractive from a valuation perspective. Reflecting this, US, Eurozone and Japanese shares rose for the week, but Chinese shares fell on Covid lockdown worries. The positive global lead saw Australian shares rise around 1.6% to their highest since May & they are now down by only around 2.4% for the year to date. The gains in Australian shares were led by utilities, industrials, health and consumer discretionary stocks. Bond yields fell further. Oil and iron ore prices fell but copper prices were little changed. The $A rose to its highest since September as the $US fell.

Slower growth and easing inflation pressures are enabling some slowing in rate hikes from central banks. The past week saw more positive news:

- The minutes from the Fed's last meeting leaned dovish with most Fed officials supporting a slowing in rate hikes and only a small number supporting an increase in the expected terminal (or peak) rate. This suggests recent somewhat hawkish Fed speeches have been aimed at stopping financial markets from rallying too quickly and easing financial conditions prematurely post the lower-than-expected October CPI. But the minutes support the view the Fed will slow to a 0.5% hike next month.
- Business conditions PMIs for major advanced counties for November showed a further easing in price pressures.
- German producer prices saw their first fall since 2020.
- This is all consistent with our Pipeline Inflation Indicator which is still trending down and points to further falls in US inflation.

AMP Pipeline Inflation Indicator



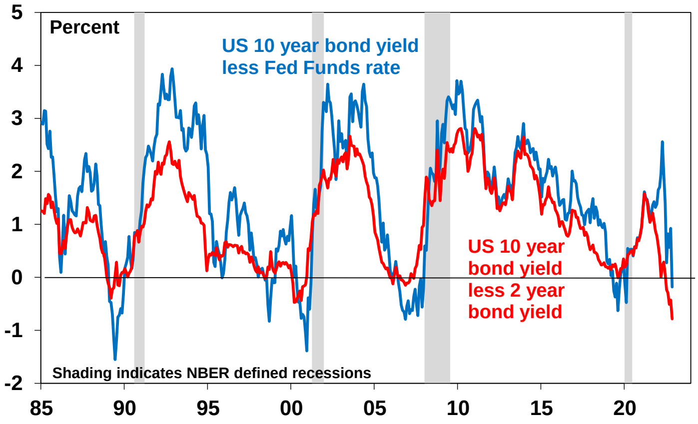
Source: Bloomberg, AMP

- In Australia, a speech by RBA Governor Lowe reiterated the Bank's determination to get inflation back down and its expectation to raise interest rates further but also repeated that it's not on a pre-set path and could step back up to 0.5% hikes or pause depending on what's warranted. Given stronger than expected wages and jobs data lately, the risks around a prices-wage spiral and the absence of a meeting in January we remain of the view that another 0.25% hike is likely next month. But a pause remains likely from early next year with the cash rate peaking in the low 3's - our base case is 3.1% but the risk is 3.35% - as by early next year there will be enough evidence indicating growth is slowing sharply and inflation is peaking.
- China's State Council indicated a cut in bank Required Reserve Ratios is imminent, which would enable banks to lend out more.
- The Bank of Korea also slowed down its rate hikes to 0.25% taking its policy rate to 3.25% and indicated it may be getting close to the peak of 3.5-3.75%. It revised down its growth and inflation forecasts.
- The Swedish Riksbank hiked by another 0.75% taking its policy rate to 2.5%, but its forward guidance suggests 0.5% or less in further rate hikes to come.

Of course, some central banks – notably the ECB – are still lagging the Fed having started rate hikes later, but just as US inflation led on the way up it will likely lead on the way down.

The main concern is the rising risk of recession in the US as this would drag down global and Australian growth and profits. The US yield curve has continued to invert and its business conditions PMIs are weaker than in other major countries and pushing near recessionary levels, as is its leading indicator.

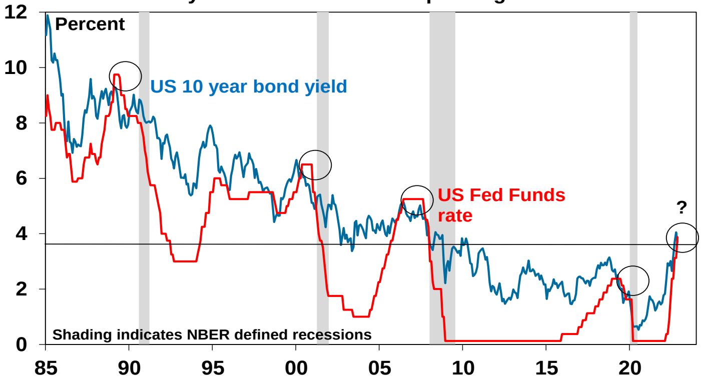
US yield curve inversions and recessions



Source: Bloomberg, AMP

In fact, with recession risk in the US now high – we think its probably now up around 55% - and forward-looking price indicators easing there is now a strong argument for the Fed to pause on the grounds that a recession or significant slowdown will lead to much lower inflation ahead. On previous occasions when the Fed Funds rate rose above the 10-year bond yield in 1989, 2000, 2006 and 2019 the Fed paused rate hikes knowing that yield curve inversions often precede recessions. To continue hiking too far from here could risk a deep recession which invariably suppress inflation. So even if the Fed goes a bit further its looking likely we may be nearer the top than market expectations and the Fed's dot plot for a rise to 5% indicate.

With the Fed Funds rate now above the US 10 year yield the Fed should be pausing!

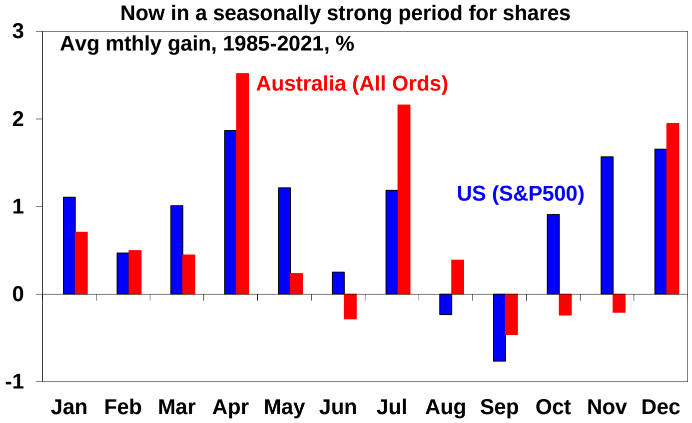


Source: Bloomberg, AMP

But what about the Reserve Bank of New Zealand's 0.75% hike? The RBNZ not only undertook another supersized hike taking the cash rate to 4.25% but also raised its guidance to a peak of 5.5%. All at the same time as forecasting a recession next year. However, I wouldn't read too much of this through to other central banks: NZ faces a higher risk of a wage-price spiral than other countries with a tighter for longer labour market; the RBNZ has a history of being a bit erratic; it appears to be giving little weight to the lags with which monetary policy impacts the economy whereas other central banks are now paying pay more attention to lags; and don't forget it only reviews rates seven times a year versus 11 for the RBA. And if NZ consumers "cool their jets" as Governor Orr wants, and as seems likely, 5.5% won't be reached.

The bottom line for investment markets is that short term risks remain high and could keep share markets erratic – with the main risk being a US/global recession – but providing any recession is mild we remain of the view that the combination of improved valuations, central banks easing up on the brakes and anticipation of stronger growth in 2024 will enable share markets to rise on a 12-month view. We are now entering a seasonally strong time of the year for shares – so a playout to watch would be for shares to rally into January, pull back into around February but remain above recent lows and then for the rally to resume. Failure to rally through the seasonally strong period ahead would be a bad sign.

Now in a seasonally strong period for shares



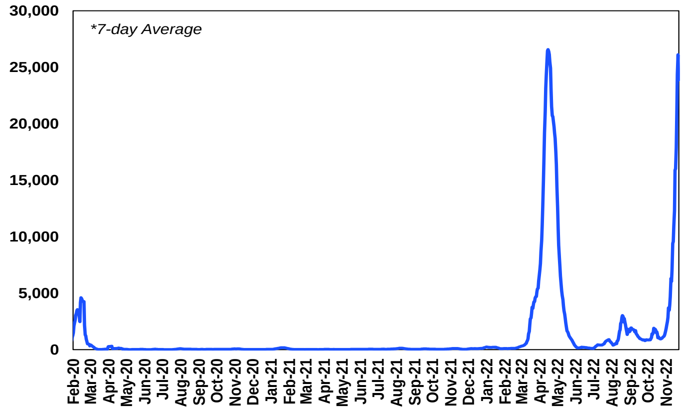
Source: Bloomberg, AMP

Recording and releasing covers of other artists songs after a long period of performing their own songs is often a sign that a group has really made it. The Pet Shop Boys have done this with great effect over the years. Their version of [Viva La Vida](#) - combined with their own Se A Vide, Domino Dancing and Discoteca - was a huge improvement on Cold Play's original! Of course their [Always on Mind](#) could never beat Elvis'.

Coronavirus update

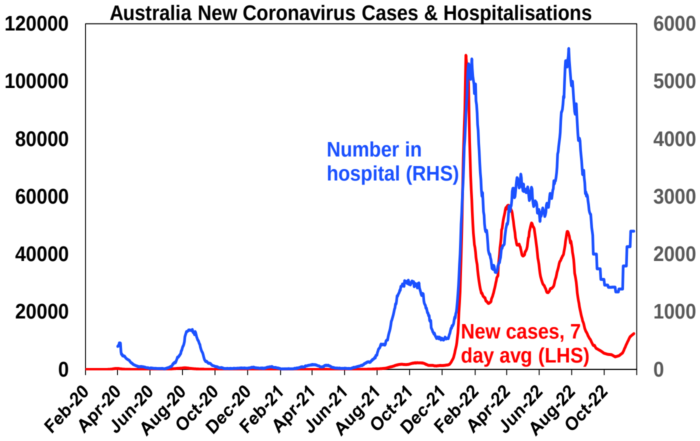
New global Covid cases and deaths rose further over the last week reflecting an ongoing rise in Asia, including Japan, albeit both remain low. New cases in China are above levels seen earlier this year and its lockdowns are tightening. We still expect China to exit its zero covid policy around March next year.

China: Coronavirus daily change (new cases)



Source: ourworldindata.org, AMP

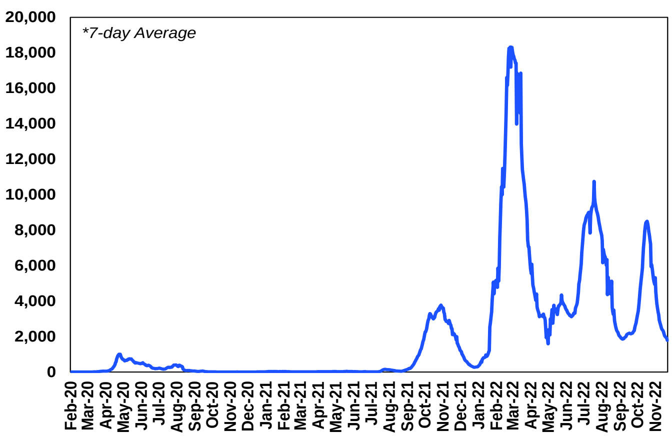
New cases and hospitalisations are continuing to rise in Australia, but the new Omicron variants do not appear to be more harmful. Note - hospitalisations appear to be rising relative to new cases but this likely reflects the underreporting of new cases now.



Source: covidlive.com.au, AMP

Singapore saw a similar wave recently that has already rolled over.

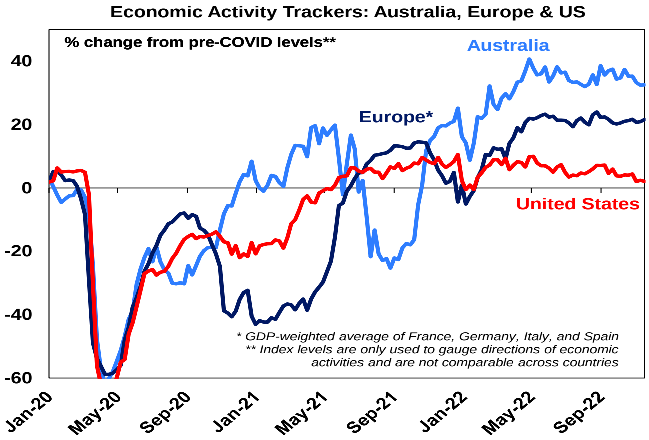
Singapore: Coronavirus daily change (new cases)



Source: ourworldindata.org, AMP

Economic activity trackers

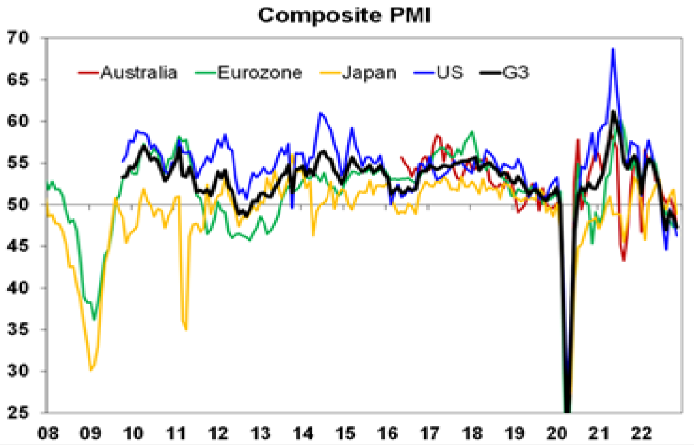
Our Australian Economic Activity Tracker was little changed over the last week with a slight lift in consumer confidence but a further fall in restaurant bookings. It remains down from recent highs. Our US Tracker was little changed, but our European Tracker rose remaining surprisingly resilient.



Based on weekly data for eg job ads, restaurant bookings, confidence, credit & debit card transactions, retail foot traffic hotel bookings. Source: AMP

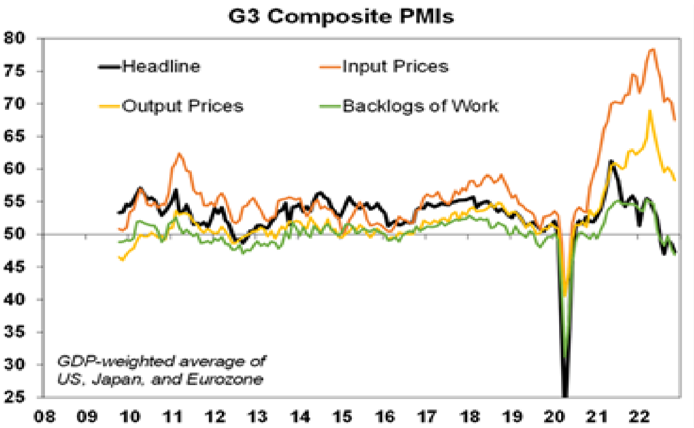
Major global economic events and implications

November composite business conditions PMIs mostly softened with sharp falls in the US, Japan and Australia, the UK flat and a surprise small rise in Europe. Overall new orders look very weak with employment still positive but slowing too. While still well above GFC and pandemic levels they are providing a clear warning of slowing growth and rising recession risks, particularly if central banks continue with aggressive rate hikes.



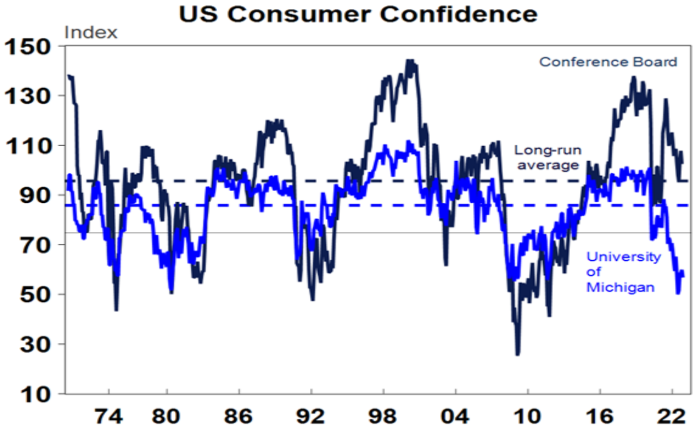
Source: Bloomberg, AMP

The good news is that price and cost pressures have continued to ease with work backlogs way down, delivery times up to around normal and input and output prices continuing to fall albeit they remain high.



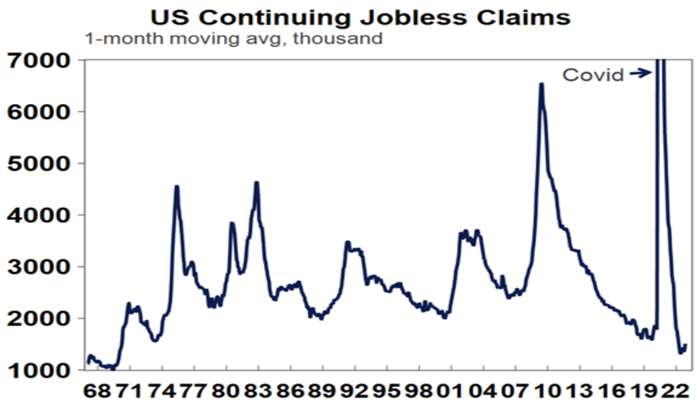
Source: Bloomberg, AMP

US data was a mixed bag, but leading indicators are all pointing down. October durable goods orders rose solidly suggesting that business investment growth remains solid and along with a solid start to retail sales this month the Atlanta Fed's GDPNow is tracking at 4.3% annualised GDP growth for this quarter. Consumer sentiment as measured by the University of Michigan rose slightly but remains very weak. New home sales also surprised with a 7.5% rise in October, but the trend is likely to remain down.



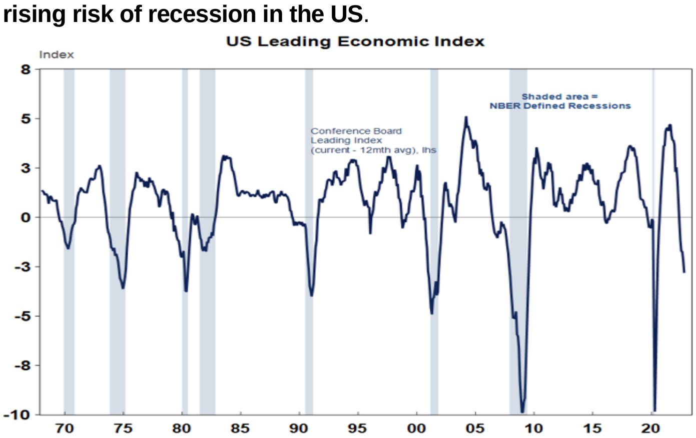
Source: Macrobond, AMP

US jobless claims remain low but they rose more than expected adding to signs (including a surge in company layoff reports) that the jobs market is finally turning.



Source: Bloomberg, AMP

And the continuing plunge in business conditions PMIs in the US along with the US leading index are pointing to a high and rising risk of recession in the US.



Source: Macrobond, AMP

The good news for the Fed is that long term consumer inflation expectations in the US remain low at 3%, well down from 10% in 1980 indicating that inflationary psychology is far less entrenched today than in the early 1980s so it should be possible for the Fed to get inflation back down without a deep recession.

Along with the surprise upswing in Eurozone business conditions PMIs for November, the German IFO business index rose and Eurozone consumer confidence improved slightly with all likely helped by the rebuilding of gas reserves in Europe. All are still weak though. Softer energy prices saw German producer prices fall in October, but they are still up 34.5%yoy.

Australian economic events and implications

Australia's business conditions PMIs weakened further in November suggesting economic activity is slowing more than the NAB business survey is indicating. Input and output price pressures rose a bit but remain well down from recent highs.

What to watch over the next week?

In the US, the focus is likely to be on a speech by Fed Chair Powell (Wednesday) and jobs data for November (Friday). Powell is likely to reiterate recent Fed commentary expressing an openness to slowing the pace of rate hikes but indicating that more rate hikes are required as part of an effort to keep financial conditions relatively tight (and hence shares from rallying too quickly). Friday's jobs data is expected to show a further slowing in payroll growth to 200,000, flat unemployment at 3.7% and a further slowing in wages growth to 4.6%yoy. In other data, expect falls in home prices and consumer confidence (both Tuesday), pending home sales and job openings (Wednesday) and the November ISM manufacturing conditions index (Thursday). Against, this retail sales data points to a pick up in personal spending growth for November (also due Thursday). October core private consumption deflator inflation is likely to have slowed to 5%yoy.

Eurozone confidence data for November (Tuesday) is likely to improve slightly, inflation (Wednesday) is likely to remain around 10.7%yoy but core inflation is likely to have risen to 5.5%yoy and unemployment (Thursday) is likely to be unchanged at 6.6%yoy.

Japanese jobs data for October will be released Tuesday with industrial production data on Wednesday, where a further fall is expected.

Chinese business conditions PMIs for November (Wednesday) are likely to have weakened further given rising Covid cases.

In Australia, monthly inflation data for October (Wednesday) will likely show a further lift in inflation to 7.4%yoy, but the monthly CPI misses out on about 30% of CPI components including for gas and electricity prices so it may understate actual inflation. RBA Governor Lowe's participation in a panel discussion in Thailand (Friday) will be watched for any further clues on the interest rate outlook although its hard to see him saying anything new. On the economic activity front: retail sales for October (Monday) are expected to rise 0.4%mom (mostly due to inflation); building approvals are expected to be flat, credit growth is expected to show a further slowing in housing credit growth and September quarter construction data is likely to rise by 1.4%qoq (Wednesday); September quarter business investment data (Thursday) is likely to rise by around 0.7% with capex plans remaining solid; and housing finance (Friday) is expected to bounce 3% after a sharp fall in September. Core Logic home price data for November (Thursday) is expected to show further 1% fall in national dwelling prices.

Outlook for investment markets

Shares are not completely out of the woods yet as central banks continue to tighten, uncertainty about recession remains high and geopolitical risks continue. However, we are now in a favourable part of the year for shares from a seasonal perspective and we see shares providing reasonable returns on a 12-month horizon as valuations have improved, global growth ultimately picks up again and inflationary pressures ease through next year allowing central banks to ease up on the monetary brakes.

With bond yields likely at or close to peaking for now, short-term bond returns should improve.

Unlisted commercial property may see some weakness in retail & office returns & the lagged impact of higher bond yields is likely to drag down unlisted property and infrastructure returns.

Australian home prices are expected to fall 15 to 20% top to bottom into the September quarter next year as poor affordability & rising mortgage rates impact. This assumes the cash rate tops out in the low 3's but if it rises to around 4% as the money market is assuming then home prices will likely fall 30%.

Cash and bank deposit returns remain low but are improving as RBA cash rate increases flow through.

The $A remains at risk of a pull back in the short term as global uncertainties persist and as the RBA remains a bit less hawkish than the Fed. However, a rising trend is likely over the medium term as commodity prices ultimately remain in a super cycle bull market.

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