April 2024

Virtuous Wealth Monthly Market Update

It’s all about inflation

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 20 MAY 2024

The ASX300 Accumulation Index returned -2.9% over the month of April, to be 9.0% higher over the year. The share market’s weakness was in response to inflation data in the US being higher than expected, which caused bond yields to rise and led investors to revise their expectations for the timing of a reduction in the official interest rate. The Australian share market followed the US, where the S&P 500 returned -4.1%, the technology-heavy NASDAQ -4.4% and small companies as represented by the Russell 2000 Index -7.0%. The latter is reflective of the generally higher debt ratios across small companies.

It was a volatile month for financial markets as interest rate expectations ebbed and flowed in line with the release of economic data -in particular inflation. It's all about inflation. We have understood that inflation is on the decline, however, it’s the pace of decline in the short term and the terminal level over the next 1 to 2 years that is causing the volatility across financial markets. After three US inflation releases in a row had come in hotter than expected, the fear was that a fourth upside surprise in April could put a rate increase back on the table. Instead, headline (CPI) inflation decelerated to 0.3% over the month to bring the annual rate to 3.4% in April from 3.5% in March. The core CPI which excludes food and energy, eased from 0.4% over the month to 0.3% which took the yearly rate to 3.6%. This was enough to appease markets that US interest rates were unlikely to increase.

The next piece of economic data that reconfirmed that interest rates were unlikely to increase was the retail sales report. Retail sales in the US were unexpectedly flat (0%) in April as higher petrol prices pulled spending away from other goods, indicating that consumer spending was losing momentum. The retail sales report highlighted that households are tightening their belts on discretionary items and spending on necessities instead.

Then when the US unemployment rate increased from 3.8% in March to 3.9% in April markets once again brought forward their expectation for a 0.25% interest rate reduction in September and a further reduction in December. Not only did the unemployment rate increase but wage growth was softer than expected at 0.2% month-on-month. The average workweek dropped to 34.3 hours from 34.4. This is the first time we have seen every component of the labour market report come in weaker than expected for some time. Prior to the release of the data, investors had priced out the chances of an interest rate increase in September.

In Australia, the Reserve Bank of Australia (RBA) left monetary policy settings unchanged at 4.35% in line with expectations. The Statement on Monetary Policy highlighted that inflation continues to moderate, though at

Emmanuel Calligeris
Chairman of the Investment Committee

a slow pace. Underlying inflation is now higher than headline inflation, mainly due to stubbornly high prices in the services sector. The RBA projects inflation to fall back to target in December 2025 and forecasts economic growth to remain subdued for the rest of 2024. This projection has been revised down from three months ago, as household spending has been weaker and the savings rate higher than anticipated. The central bank highlighted that households are feeling the burden of high interest rates. The labour market is showing signs of easing with the unemployment rate rising to 4.1%. Seek data corroborates the employment data showing job advertisements falling and the number of applicants per job lifting. Furthermore, wage data indicated a step down in the pace of wage growth.

The Federal Budget will ease inflation in the short term. The $300 energy bill relief for homes and $325 for each small business, will mechanically reduce the headline inflation rate to within the Reserve Bank's 2-3% target band by the end of the year. However, the government has embarked on fiscal largess that will drive the structural deficit higher in the medium term. New spending on housing, infrastructure and the care sector of close to $20bn, is front-loaded into 2024–25 and 2025–26. The deficit for next year is forecast to be $28.3 billion, $10 billion more than forecast in December, with cumulative deficits over the next four years forecast to be $112 billion.

Chinese economic data continues to disappoint. Retail sales decelerated again, fixed asset investment growth slowed and although industrial production surprised to the upside, it was largely supported by exports and the stabilisation in global trade. This is likely to be short-lived. Meanwhile, new and used home prices contracted at an accelerated pace. The government announced a new property market rescue package which includes funding by the Peoples Bank of China (PBoC) to help government-backed firms absorb excess housing inventories. The plans will also relax mortgage rules and lower downpayment requirements for homebuyers to restore demand. China's housing demand is on a secular downshift due to structural factors such as a shrinking population, higher saturation in home ownership and mounting household leverage ratios. Housing affordability remains among the lowest globally. To restore demand, policymakers will need to either allow home prices to decrease or unleash speculative buying by investors. The latter would require initial purchases by government-related entities financed via very sizable quantitative easing. There are no indications thus far that policymakers are willing to pursue either approach. Without large financial intervention on the part of central authorities in Beijing, the property market will likely continue to struggle, and local government revenues and spending likely underwhelm. Consumption growth is likely to remain moderate through most of 2024, as consumer confidence remains downbeat amid tepid wage growth and the lingering negative wealth effects from the past several years of declining asset prices.

Lastly, there has been some positive news in Europe with industrial production tentatively bottoming out and a modest recovery expected in the second half of the year. The eurozone unemployment rate remained at an historic low of 6.5% in March and the number of unemployed decreased. While recent indicators point to some softening in labour demand, demographics preclude a significant increase in the unemployment rate in the coming quarters. Inflation is on a downtrend - albeit a bumpy one. Notwithstanding that, the just-released minutes of last month's ECB meeting confirm an increased confidence that inflation is on track back to 2% including a clear acknowledgement of the potential risks. Consequently, the rate-cutting cycle will be slow.

The market environment remains complicated with different countries and regions exhibiting different rates of economic growth, different inflation levels and different labour market dynamics. To cap it off, geopolitical conflict in the Middle East and Russia/Ukraine is not only impacting commodity prices but US fiscal policy too. We maintain the view that interest rates globally have peaked but the path of reductions will be slow and measured. Pressure on Australian households from higher mortgage rates, electricity prices and other cost of living pressures have impacted consumer spending in the first half. Increased wages, modest interest rate relief later this year, Stage 3 tax cuts and the "cost of living" relief in the Federal Budget, suggest the consumer will be in a better place in the second half. Stimulus in China should be good for Australia too.

Returns

30th April 2024

ASSET CLASS RETURNS ARE BASED ON

Australian Cash
RBA Bank accepted Bills 90 Days

Australian Bonds
Bloomberg AusBond Composite 0+ Yr TR AUD

International Bonds Hedged
BarCap Global Aggregate TR Hdg AUD

Australian Listed Property
S&P/ASX 200 A-REIT TR

International Property Hedged
FTSE EPRA/NAREIT Dv REITS TR Hdg AUD

Australian Shares
S&P/ASX 200 TR

International Shares
MSCI World Ex Australia NR AUD

Emerging Market Shares
MSCI EM GR AUD

RETURNS TO THE 30TH APRIL 2024

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Australian Cash	0.35	1.06	2.15	4.26	2.35	1.60	1.84
Australian Bonds	-1.98	-1.18	4.71	-0.73	-2.13	-0.29	2.29
International Bonds Hedged	-1.70	-1.70	4.18	0.38	-3.01	-0.47	2.06
Australian Listed Property	-7.78	6.27	33.26	19.61	7.44	5.28	9.02
International Property Hedged	-5.95	-3.16	10.80	-1.24	-3.56	-0.75	4.20
Australian Shares	-2.94	1.04	15.17	9.07	7.30	8.00	7.76
International Shares	-3.26	5.56	17.34	20.71	12.00	12.33	12.94
Emerging Market Shares	0.92	9.78	12.52	11.83	-0.07	3.54	6.68

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