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KĀPITI ADVICE
Kapiti Financial Advice Limited

Monthly View – November 2024

Market volatile in run up to US Presidential Election

A dominant market feature of October was a dramatic rise in longer-term US interest rates. Higher interest rates provided a headwind for global share markets over the month. Weakness in global markets over October comes after a period of strong gains from both share markets and fixed income, which have resulted in healthy returns over the last year for those investing in a diversified balanced fund.

Global Share Markets

Global share markets [1] fell -1.1% in October and are up 10.3% and 32.0% over the last six and twelve months respectively.

Stronger than forecast US economic data was one of the reasons why US longer-term interest rates rose in October. Although the better-than-expected economic data is positive for corporate earnings, the commencement of the US corporate earnings season provided mixed results and only added to market uncertainty in the lead up to the US Presidential election.

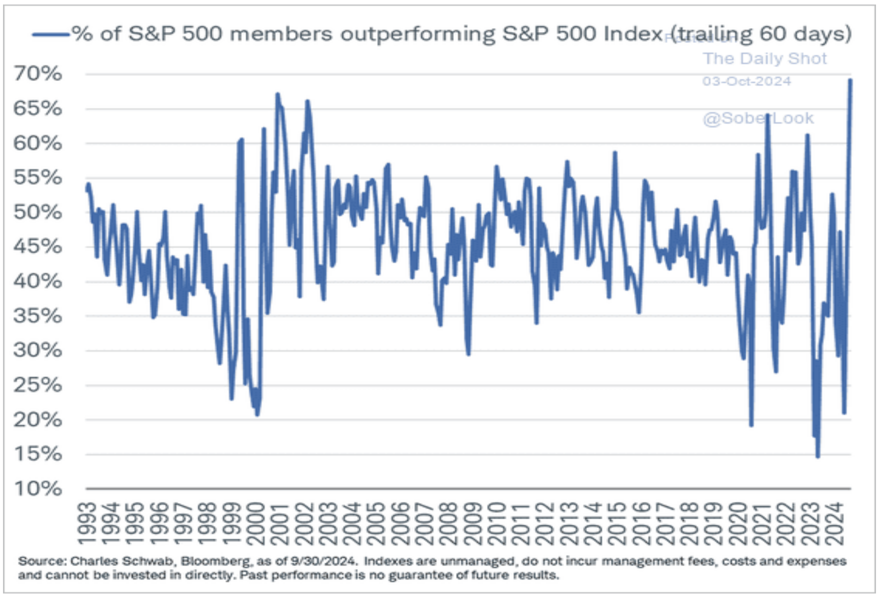
At the end of October 70% of companies in the US S&P 500 index had reported September quarter earnings. Of those companies, 75.5% of them had beaten analysts' forecasts, this compares to the historical average of 76%. Year-on-Year US corporate earnings growth to the end of September is forecast to be 7.0%, this is down on 11.6% year-on-year earnings growth recorded in the June quarter.

Mega Cap US technology companies, which have led global markets higher over the last year, delivered mixed profit results. For example, although Microsoft and Meta Platforms beat analysts' earnings forecasts, the firms' guidance for more AI spending has investors worried over the outcomes of these large investments in the short term. Meanwhile, Alphabet and Amazon beat analyst expectations, and their results were well received by the market. Tesla shares soared 22% immediately after its profit announcement. The market reaction was likely one of relief as Tesla's share price had fallen over 18% in the lead up to the profit announcement.

Companies outside the large US technology universe reporting better than anticipated profit results included McDonalds, JP Morgan, Wells Fargo, and Visa. Amongst those companies to disappoint included Caterpillar, who reduced their outlook on a slowdown in global construction activity.

Encouragingly, as the year has progressed more companies are performing well relative to the market, as highlighted in the graph below. At the beginning of the year a narrow set of companies dubbed the Magnificent (Mag) Seven (Apple, Microsoft, Google parent Alphabet, Amazon, Nvidia, Meta Platforms and Tesla) drove the US share market higher. More recently, a broader set of companies are outperforming, this has coincided with the US Federal Reserve commencing interest rate reductions and more companies outside the Mag Seven recording year-on-year profit growth.

The percentage of companies outperforming has increased



In New Zealand dollar terms, global equities rose 4.5%, which reflects weakness in the New Zealand dollar boosting returns from offshore assets. The New Zealand dollar weakened nearly 6.0% against the US dollar on better-than-expected economic data in the US, increasing odds that Trump will win the election, and more attractive local interest rates relative to those in NZ.

New Zealand & Australian Share Markets

New Zealand's share market [2] gained 1.7% in October, outperforming the rest of the world. Positive sentiment was maintained domestically on the prospect of further interest rate reductions by the Reserve Bank of New Zealand (RBNZ) and on company specific announcements. Serko (17.9%), Hallenstein Glasson (17.7%), and Ryman Healthcare (15.6%) were amongst the top performing companies over the month.

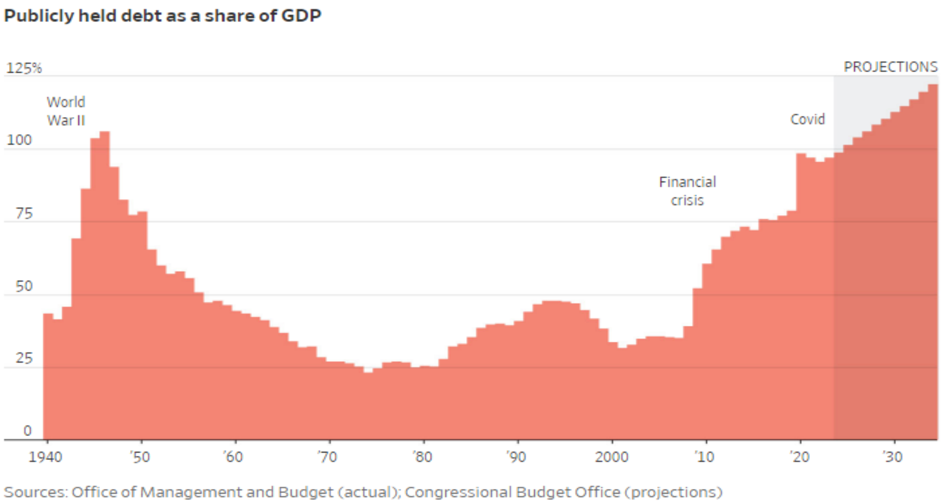
In October several local companies provided trading updates. Spark downgraded earnings and lowered dividend forecasts. Spark is seeking to maintain a balance between offering an attractive dividend and invest for future growth without materially raising debt levels. As a result, Spark signalled the prospect of selling non-core assets. Several cyclical companies, those more closely tied to the domestic economy, also provided profit updates. The results were mixed. Freightways provided a trading update that was well received. In contrast, Vulcan Steel provided a downbeat trading update reflecting the ongoing headwinds within the domestic construction industry.

Australian equities fell 1.3% [3] in October, driven mainly by offshore events, including an unwinding of positive market euphoria towards the outlook for the Chinese economy that had boosted Australian resource and mining companies in September. The Australia market also fell following the release of local inflation data, which dashed any hopes of interest rates cuts by the Reserve Bank of Australia (RBA) pre-Christmas. Although Australian inflation is moderating, it remains too high for the RBA to commence interest rate cuts. In a reversal of market performance last month, financial companies outperformed (CBA and National Australia Bank returned 5.4% and 3.8% respectively) and resource companies lagged the market. BHP fell -7.2%, only partially reversing its 16.0% gain in September, and Woodside Energy fell 5.7%.

Fixed income and cash markets

Global bond yields moved higher in October on better-than-expected US economic data and a focus on the growing size of America's national debt.

In the lead up to the US Presidential election the size of the US government's deficit and projected debt levels have gained greater market attention. This year's US budget deficit is on track to top $1.9 trillion, or more than 6% of economic output, a threshold reached only around World War II, the 2008 financial crisis and the Covid-19 pandemic. Publicly held federal debt—the sum of all deficits—just passed $28 trillion or almost 100% of US economic output. The total debt is forecasted to climb by another $22 trillion through 2034. Interest payments by the US government are poised to exceed annual defence spending.



Source: WSJ

This is a looming issue for America, with neither Presidential candidate offering a credible plan to address the mounting debt levels. The concern for fixed income markets is that a growing deficit will require the US government to issue more bonds. All else being equal, higher interest rates would be required to attract investors to buy these bonds given increased supply.

Over the month the US 10-year government bond yield rose 51 basis points (0.51%) to 4.29%. The Bloomberg Global Aggregate Bond Index (New Zealand dollar hedged) fell -1.5% in October.

New Zealand's long-term interest rates also drifted higher on global events and despite the Reserve Bank of New Zealand's (RBNZ) accelerated pace of short-term interest rates reductions. In October the RBNZ cut the Official Cash Rate (OCR) by 50 basis points to 4.75%. The RBNZ acknowledged policy settings remain restrictive and that an increase in spare capacity within the economy is leading to lower inflation pressures. New Zealand's headline inflation for the September quarter fell to 2.2% year-on-year, in line with expectations and taking it back into the RBNZ's 1.0 – 3.0% target range for the first time since the March quarter of 2021. Additional cuts to the OCR are forecast over the months ahead.

The local fixed income market [4] fell 0.5% for the month and is up 10.9% over the last twelve months.

Conclusion

The RBNZ is expected to continue to cut interest rates aggressively over the months ahead. Further reductions in short-term interest rates and the likelihood that domestic corporate earnings are at cyclical lows provides the opportunity for the local share market to perform solidly in the year ahead.

The relative attractiveness of domestic bonds has declined given the dramatic decline in longer-term interest rates over the last twelve months. The anticipated sharp decline in shorter term domestic interest rates in the months ahead is negative for people looking at term deposits to provide them with income.

Global bonds continue to offer stability of income and the potential for capital gains from further reductions in interest rates as inflation continues to decline and central banks progress interest rate cuts.

Market volatility around the US election outcome is likely, no matter the winner or loser. However, on a longer-term view, and looking through short-term volatility, further reductions in interest rates by central banks and continued US economic growth will be positive for global share markets.

The current environment remains constructive for both fixed income and equity markets. This provides a favourable backdrop for a well-diversified balanced portfolio. In this environment, we recommend investors continue to focus on their long-term goals while acknowledging that in the short-term returns may be volatile. In time, this approach should reward investors.

1 MSCI ACWI Index in local currencies
2 S&P NZX 50 gross index
3 S&P ASX 200 total return Index
4 Bloomberg NZ Bond Composite 0+ Yr Index

Indices for Key Markets

As at 31 October 2024	1 Month	3 Months	6 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	1.7%	2.2%	6.1%	18.4%	-0.4%	4.0%
S&P/ASX 200 Index (AUD)	-1.3%	2.1%	8.4%	24.9%	8.0%	8.2%
MSCI ACWI Index (Local Currency)	-1.1%	2.5%	10.3%	32.0%	6.9%	11.8%
MSCI ACWI Index (NZD)	4.5%	2.3%	9.8%	29.6%	12.1%	12.7%
S&P/NZX 90 Day bank bill Total Return	0.4%	1.4%	2.8%	5.8%	4.2%	2.7%