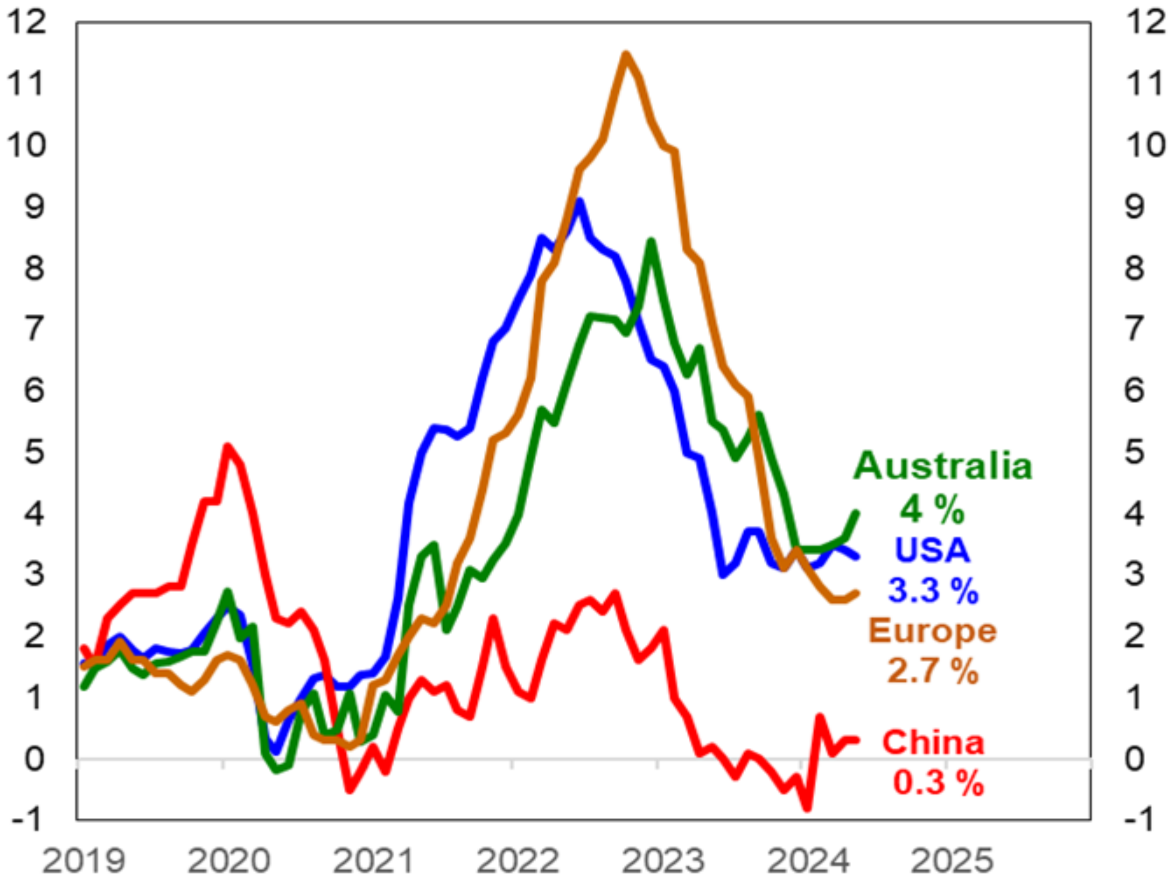
A look at the financial year that was, thoughts on the year ahead and commentary around current events and their impact on the economy. With so many moving parts in the global economy, identifying emerging investment themes is challenging. But while there are many unknowns in investment markets such as US policy direction, there are certain themes that are already coming to light.

Global inflation has fallen but the 'cost of living' remains worry for consumers

Global inflation has gradually cooled in the past year after the rapid increases recorded in 2021-2022 (see Chart 1). Lower prices for key commodities (such as natural gas and wheat) as well as improving production and transport supply chains have lowered the rate of inflation. However, consumer inflation has recently become sticky and stubborn around the 3% to 4% annual rate in both Australia and the US. This stickiness in inflation is a result of more persistent price pressures in food, health care, insurance, and rents. Thus for many households, the 'cost of living' crisis is continuing. Europe has made more progress on lowering inflation towards a 2% annual rate. China remains the exception to the global inflation challenge with inflation barely registering a pulse.

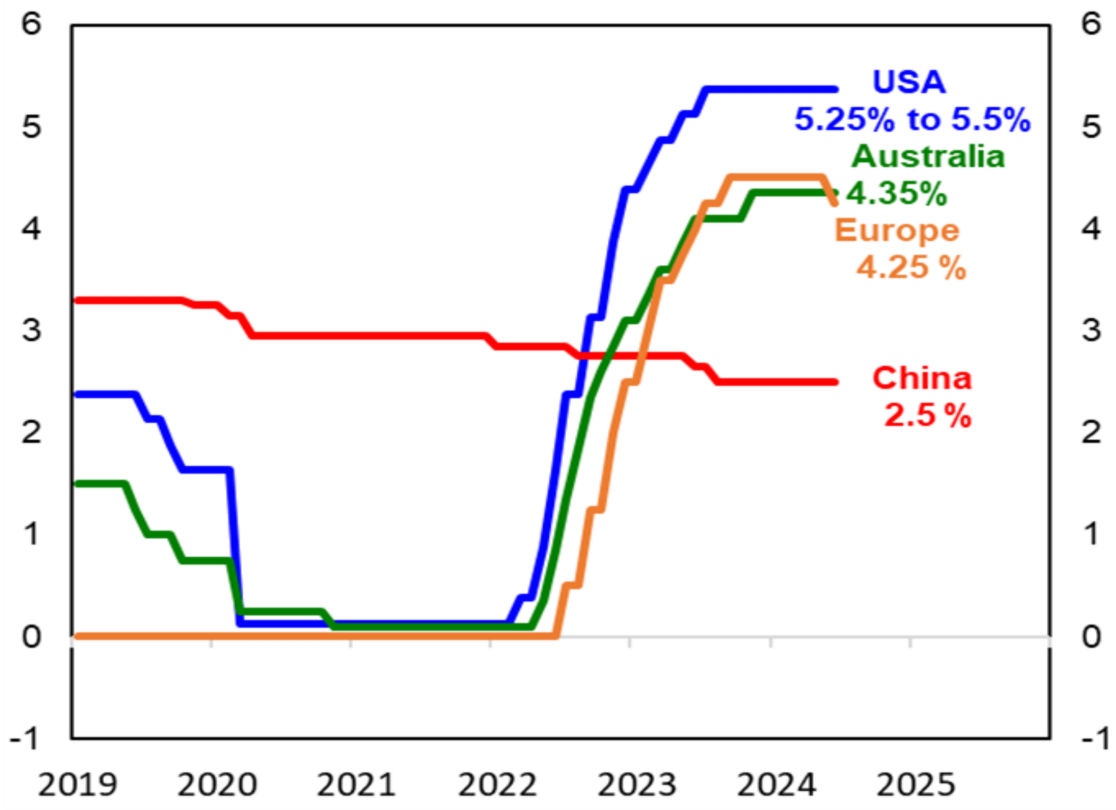
Chart 1: Global consumer inflation



Sources: Australian Bureau of Statistics, Eurostat, National Bureau of Statistics of China and US Bureau of Labor Statistics.

For Australian consumers, the painful squeeze from rising prices is most evident in the struggle to keep food on the table and a roof over our heads. Australian food products have risen by 3%, health care by 6%, rents by 7% and insurance by nearly 8% in the year to May 2024. Those with housing mortgages have also endured the squeeze with higher interest rates on their loans.

Chart 2: Central banks are now either holding or cutting interest rates



Sources: Reserve Bank of Australia statistical table International Official Interest Rates

A ray of sunshine is that global interest rates appear to have peaked (Chart 2). Most central banks around the world are holding cash interest rates steady. Some central banks have even cut interest rates given subdued economic activity and fading inflation (notably China and Europe). The Reserve Bank of Australia (RBA) is an exception by still signalling a more cautious tone on interest rate prospects given “persistent” inflation. Essentially the RBA is “not ruling anything in or out” on interest rates given the “uncertain” inflation path.

The past year has also provided dramatic and terrible political shocks. The October 2023 Hamas attack on Israel generated considerable tragedy and turmoil in the Middle East. Russia’s devastating invasion of Ukraine in 2022 is still casting a shadow over Europe and remains a threat to political stability. The assassination attempt on former President Donald Trump and the subsequent stepping down by President Joe Biden and the new Democrat nominee, Kamala Harris has seen a huge upheaval in US politics in the last few weeks.

The global economy has provided both positive and negative surprises

Global economic activity has been ‘multi-speed’ in the past year. The US economy has been a continuing source of strength. American businesses and consumers have kept spending despite the headwinds of higher interest rates and inflation. Strong jobs growth has allowed the unemployment rate to remain stable at around 4% and supported wages. Even the US housing market has been solid with house prices making gains.

European economic activity has stagnated over the past year with flat economic activity. Germany’s status as Europe’s ‘industrial powerhouse’ has lost steam given weaker export demand for luxury cars and chemicals. The UK has also struggled as consumers have trimmed their spending given inflation and higher interest rates.

China’s economic growth in the past year has been constrained by a cautious consumer and weak property market. Falling property prices and the financial troubles of key property developers have undermined confidence in China’s economy. Japan has also struggled with subdued consumer spending and weak exports. There has been a more positive performance from India in the past year with economic growth near 8% compared to China’s 5% pace.

Australia’s struggling economy with persistent inflation is troubling

Australia’s economy has been subdued in the past year. The negative impact of persistent inflation, rising mortgage interest rates and rents have generated a very ‘painful squeeze’ for Australian households. Notably the Australian economy is in a ‘per capita’ recession where population growth at circa 2.5% exceeds annual real economic growth at 1.1% for the March quarter.

Yet there has been some positive news. Australia’s labour market has recorded solid job gains and the unemployment rate remains low at 4%. Business investment and government infrastructure spending have made strong contributions to job gains as well as broader economic activity. There are some hopeful signs for a boost to Australian economic activity and lower inflation outcomes with the recent Federal and State Government Budget stimulus measures such as income tax cuts, electricity rebates and rent assistance.

A turbulent financial year for investment returns

Encouragingly, global share returns have been very strong for the past year. Optimism over the promise of ‘Artificial Intelligence’ (AI), modest progress towards lower global inflation and the encouraging resilience of the US economy have been the major drivers of global share markets.

Investor’s enthusiasm for technology has been the key positive driver of global share returns. The largest AI chipmaker in Nvidia led the charge with huge gains for the year. Notably, Nvidia briefly achieved the title of the “world’s most valuable company” in June 2024 before Microsoft regained the title to end the financial year. There were also very strong price gains from large technology companies such as Meta/Facebook, Alphabet/Google and Amazon.

European shares made solid returns for the year. A clear standout was Novo Nordisk which has become Europe's largest company on the back of the diabetes and weight loss drug Ozempic. The chipmaker ASML rode the technology wave also to become Europe's second most valuable firm.

Asian share markets were mixed. Chinese share prices continued to struggle with a -1.9% negative annual return, given subdued economic activity and a very weak property market. Notably property developer Evergrande entered bankruptcy proceedings on foreign borrowings in August 2023 while rival Country Garden is on shaky ground.

Australian shares recorded sharp annual gains in Information Technology, which accords with the global enthusiasm, while the Financial and Consumer Discretionary sectors delivered surprisingly strong gains despite the challenge of higher inflation and interest rates squeezing consumers.

However, Australia's Resources sector was a major disappointment with a negative return of -3.2% given concerns over China's growth prospects. Notably Australia's most valuable public company in BHP delivered a 0% return given lower iron ore prices. Lower lithium prices also played havoc and generated pain in the Resources sector total returns with Pilbara Metals (-33.5%) and Mineral Resources (-22.6%) both down for the year.

Global prospects

Global share prices have made very strong gains in the past financial year. The enthusiasm for AI and broader technology prospects have been the key drivers. There is also confidence that the global inflation threat has faded enough to allow interest rates to fall in the coming year.

However, these exuberant expectations may not be realised if inflation proves more persistent and central bankers are more stubborn in lowering interest rates. The continued tragic Russia-Ukraine War and Hamas-Israel conflicts and the potential for further escalation are key threats to global economic stability. Investors will also need to contend in the US Presidential and Congressional elections in November 2024 which could dramatically transform the global political landscape if Donald Trump takes the Oval Office.

Accordingly, there are significant inflation, interest rate and political risks that investors should be cautious of. Assessing these complex risks is challenging given the potential for shocks. Given there are multiple outcomes possible over the next year, we recommend investors maintain a disciplined and diversified strategy.

If you have any questions or wish to discuss anything, please call us on 03 9544 1004.

All the best,

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