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Fiducian Monthly Economic Commentary Report

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ECONOMIC OUTLOOK

GLOBAL ECONOMY

The global economy has been weighed down for the past 2 years by a severe and rapid tightening in monetary policy, as well as by the outbreak of wars in Ukraine and the Middle East. Central banks raised interest rates to counter inflation, which itself was caused by stimulus measures implemented to sustain employment during the pandemic that began in 2020. However, it is now evident that inflation is subsiding, interest rates have peaked and 'soft landings' (no recessions) for most major economies are forecast by the IMF.

The global economy remains sluggish as a result of severe measures taken over the past 2 years by most of the world's major central banks to counter inflationary pressures. However, as the International Monetary Fund (IMF) noted in its 31 January 2024 report, 'amid favourable global supply developments, inflation has been falling faster than expected'. Furthermore, the IMF is expecting inflation to continue to steadily decline, especially in the advanced economies, where the average inflation rate is now forecast to drop to 2.3% by the end of this year and 2.0% in 2025. This implies that not only are further increases in interest rates unlikely, but that in the IMF's words, its 'projections are for policy rates to remain at current levels for the Federal Reserve (the US), the European Central Bank and the Bank of England until the second half of 2024, before gradually declining as inflation moves closer to targets'. This is a positive development that has been supporting key markets over recent months. However, the IMF also emphasises that 'fiscal consolidation (less government spending) is needed'. Nevertheless, 'the path to a soft landing' has been opened.

In the case of the US, inflation readings have come down significantly over the past 6 months, despite unemployment rates remaining low and growth being sustained. Across the developed world, however, economic activity is mostly weak and growth is forecast to be under the long-term trend rate for some time.

In the case of the US, the central bank (the 'Fed') last raised rates on 25 July 2023 to a minimum of 5.25% and it now appears that the next move in US interest rates will be down. 'Fed' Chairman, Jerome Powell, stated on 31 January that 'our policy rate is likely at its peak for this tightening cycle'. He added though that rate cuts would not be appropriate until there was 'greater confidence that inflation is moving' towards the 2% target. More broadly, tight monetary policy has been effective in slowing activity and the IMF is forecasting global growth of 3.1% this year and 3.2% for 2025 and only 1.5% and 1.8% for the advanced economies, noting that 'with the likelihood of a hard landing receding, risks to the global outlook are broadly balanced'.

AUSTRALIAN ECONOMY

The Australian economy in the September quarter remained in a per capita recession, which it entered in the first half of 2023. Household spending has been curtailed but tight monetary policy has also pushed inflation lower.

The Australian economy was weak again in the September quarter, growing by only 0.2%. On a per capita basis, it actually contracted (by 0.5%), indicating that the country remains in a per capita recession, with output also likely to have been weak in more recent months. The key factor driving this slowdown has been rate rises by the Reserve Bank. These have weighed on household spending (flat over the quarter) but have reduced inflation (up 3.6% over the year to the month of January and up 0.7% for the quarter).

MARKETS

Major share markets fell heavily in 2022 but then experienced heavy volatility before rising sharply in the December quarter 2023. Some markets look cheaper than others, including European markets and global small cap markets, while the US market appears more fully valued, although narrowly based.

Most share markets have been volatile over the past year, at first enjoying a strong upwards trend from October 2022 to late July last year before trending mildly downwards until rebounding again from last October. This year, over the period to 27 February, market movements have included rises of 6% for the broad US market (S&P500), 7% for the technology-focused Nasdaq, Germany 5%, France 5%, Japan 17%, China 1% and Australia 1%, while the UK fell by 1%. The US market appears fully valued but most others still appear attractively priced, especially small caps, assuming that interest rates soon begin to decline.

Major sovereign bond markets saw yields rise after the end of 'quantitative easing' in 2022. However, more recently, slow growth in key economies has encouraged investors back into this 'safe haven'.

Major sovereign bond markets saw yields reach record lows in March 2020 as central banks sought to push rates down due to the pandemic. However, sovereign bond yields trended up as economies re-opened. The US 10-year Treasury bond yield fell to an historic low of 0.54% on 9 March 2020 but touched 5.0% in October last year before sliding down again. On 27 February this year, it was 4.31%. Similarly, the Australian 10-year bond yield was 0.57% on 8 March 2020 but was 4.13% on 27 February 2024. Some bond markets could experience lower yields (and higher prices) over coming months if growth remains soft.

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.