RIPPL Investment Commentary

JUNE QUARTER 2024

Australia's monetary policy tightening has affected individuals, companies, and the country's overall economy. Our perspective for 2024 is shaped by the interaction between domestic financial circumstances and international economic trends. This commentary examines the effects on different Australian industries, offers perceptions into the geopolitical and economic environment worldwide, and evaluates regional economic outcomes and market patterns. Comprehending these dynamics is essential to developing well-informed investment strategies in the face of persistent uncertainty.

CENTRAL BANK ACTIONS

Australia's Monetary Policy Impacts

The tightening of monetary policy in Australia has had diverse effects across various sectors. Households, especially those with mortgages, are significantly impacted by higher interest rates, leading to reduced purchasing power and increased debt servicing costs. This financial strain has resulted in declining consumption growth, notably among low-income households. Despite these challenges, the labour market's resilience has helped many households maintain timely debt payments. Larger businesses benefit from favourable wholesale funding conditions, while smaller businesses face increased financial pressure due to higher leverage. Business investment is expected to slow down, with borrowing costs rising and business debt growth remaining above average.

Restrictive financial conditions have led to higher savings and reduced borrowing among households, resulting in a decline in household credit growth. Indicators such as loan-to-value ratios and loan commitments reflect this trend. Businesses face higher debt costs, but strong nominal earnings and low leverage provide some relief. However, financial stress indicators show rising insolvencies, particularly among small businesses in construction and hospitality. These conditions help balance demand with supply, contributing to declining inflation, which is essential for economic stability. The Reserve Bank of Australia (RBA) continues to monitor and adjust policies to maintain economic stability.

Global Geopolitical and Economic Landscape

2024 is marked by significant elections worldwide, with Vladimir Putin's re-election intensifying the Ukrainian conflict and raising fears among former Soviet nations. Upcoming elections in the European Parliament, UK, and US are potential targets for Russian propaganda. The US faces a presidential race between two elderly candidates, presenting a challenging choice for voters. Geopolitical tensions in the Middle East further contribute to global uncertainty. The sharp rise in gold prices indicates underlying concerns about geopolitical risks and fiscal policies. High global debt is a drag on growth, highlighting the importance of diversified investment strategies across global markets and asset classes.

Initially, 2024 was expected to experience a cyclical recession with moderate economic contraction followed by growth. However, improved market outlooks in the first quarter have led to a more positive stance. Leading economic indicators and insights from analysts suggest that economies are holding up well, prompting increased risk-taking. Despite this optimism, there is still uncertainty about central banks' ability to control inflation, necessitating a cautious approach to future scenarios and investment implications.

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Regional Economic Insights

Europe: The euro area's economic recovery is driven by strong domestic demand and resilient labour markets, which support household incomes and sentiment. Disinflation trends may lead to interest rate reductions by the ECB, although some regions still experience elevated inflation. Structural challenges like aging populations, climate change, and low productivity require advancing the Single Market, improving infrastructure, and integrating capital and labour markets to boost resilience and counter global fragmentation risks.

China: The focus is on controlled stabilization amidst a property downturn, with growth shifting towards consumption and high-end manufacturing. Significant rate cuts from the People's Bank of China are unlikely until the US Federal Reserve signals a clear pivot. China's growth rate forecast remains slightly below the official target due to insufficient policy commitment. Geopolitical concerns and the 'China plus one' trend are diversifying supply chains, benefiting countries like Vietnam, Indonesia, and Mexico.

Market Performance and Outlook

Equity Markets: Over the half-year to 30 June, the broad US market (S&P500) rose by 15%, the technology-focused Nasdaq by 18%, Germany by 9%, the UK by 6%, Japan by 18%, and Australia by 2%, while the French and Chinese markets slightly declined. The US market appears fully valued, but most others remain attractively priced, particularly small caps, if interest rates decline soon.

USA: Wall Street's performance relies heavily on the "Magnificent Seven" tech giants, which have achieved significant market-cap milestones. Despite cooling inflation, economic indicators like retail sales and manufacturing remain weak, impacting Treasury yields. The market-cap-weighted S&P 500 gained 3.9% over the quarter, driven by advancements in artificial intelligence and strong performance in tech sectors.

Europe: Eurozone shares declined in Q2, influenced by political uncertainty and tempered expectations for significant interest rate cuts. The ECB's 25 basis point rate cut in June and mixed economic data contribute to cautious outlooks.

Japan: Positive returns were noted in yen terms, but foreign currency returns turned negative due to yen depreciation. The Bank of Japan's actions and strong foreign investor optimism about Japan's economic cycle drove the Nikkei above 40,000 yen.

Emerging Markets: Emerging market equities outperformed developed peers in Q2, driven by a rebound in China and positive developments in countries like Turkey, Taiwan, and South Africa. However, some markets, like Korea and energy-related sectors, underperformed.

Australia: The Australian market benefitted from declining global bond yields, with positive returns in June. Corporate balance sheets in the ASX 200 remain strong, providing stability amid economic challenges.

In conclusion, the remainder of 2024 is expected to bring slower price increases and greater return divergence, necessitating cautious investment strategies amidst ongoing geopolitical and economic uncertainties.

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