Allianz Global Investors

08/2023

Market Snapshot

Equity Snapshot

United States

US equities lost ground over August as hopes that interest rates may soon be cut were dashed by hawkish statements from Federal Reserve (Fed) policymakers. The broad-based S&P 500 Index recorded its first monthly drop since February, while it was the worst month since December 2022 for the tech-heavy Nasdaq. In other news, President Joe Biden signed a presidential order restricting US investment in three sectors in China: semiconductors and microelectronics; quantum information technologies; and certain artificial intelligence systems.

US second-quarter GDP growth was revised downward to an annualised rate of 2.1%. The flash S&P Global US Composite Purchasing Managers Index (PMI) fell to 50.4 in August, compared to 52.0 in July, and was the lowest reading since February of this year. The services PMI dropped to a six-month low of 51.0, while manufacturing activity declined to 47.0 from 49.0 in July. Momentum in jobs also slowed, with non-farm payrolls rising by a weaker-than-expected 187,000 in July, with data for the previous two months also revised lower. Nevertheless, consumer spending remained robust, with retail sales rising 0.7% in July

Europe

Eurozone equities retreated over August. Sentiment was undermined by central banks' continued hawkish stance as well as further evidence highlighting that economic momentum was weakening. Energy was the only sector to deliver meaningfully positive returns, while consumer discretionary was the weakest. The Italian government's decision to impose a 40% windfall tax on banks caused Italian bank stocks to plummet, although it later backtracked by capping the tax at 0.1% of total bank assets. Spain has already imposed windfall taxes on banks.

Economic activity continued to deteriorate. The flash estimate of the HCOB Eurozone Composite Purchasing Manager's Index (PMI) declined to a 33-month low of 47.0 in August. Services activity dropped to 48.3 in August from 50.9 in July, marking the first contraction since the end of 2022, amid worsening demand conditions. Manufacturing PMI edged higher to 43.7 in August from a three-year low of 42.7 in July, but remained deep in contractionary territory. Preliminary estimates of euro-zone inflation for August indicated headline prices were holding steady at an annual rate of 5.3%, although core inflation eased slightly.

Asia

Asian equities lost ground over August, with almost all markets in the region posting negative returns. An underwhelming response from the Chinese authorities to China's slowing economic momentum weighed on sentiment, as did signals from the US Federal Reserve that US rates are likely to stay higher for longer. The tech-heavy markets of Taiwan and South Korea declined modestly, mainly due to profit-taking on AI-related stocks and continuous concerns over the Chinese economy. ASEAN markets also fell overall. While Malaysia, Indonesia and Thailand slid slightly, share prices fell sharply in the Philippines and Singapore. Indian shares also retreated from the record highs of recent weeks, dragged down by the energy, consumer staples and financials sectors. Australian shares held up relatively well, closing the month flat.

Bond

In August, US bonds declined as the Federal Reserve signalled that US rates would stay higher for longer and credit rating agency Fitch cut the US's AAA credit rating to AA+, citing the debt burden and recent debt-ceiling stand-off. The yield curve became less inverted as the US raised its debt issuance target for the coming quarter, putting upward pressure on long-dated bond yields. On the other hand, European bonds outperformed the US and rose modestly, while peripheral spread widened slightly in the month.

Outlook

August saw a continuation of recent trends as economic data continued to show signs of improvement in the US, Japan and a selection of emerging markets. Some analysts are increasing near-term GDP forecasts in anticipation of a soft landing, particularly in the US. There is, however, a widening regional disparity with Europe and China showing continuing weakness. The Eurozone Purchasing Managers Index (PMI) declined to a 33-month low in August, as services activity dropped to 48.3, the first contraction since late 2022. With manufacturing activity only slightly above a three-year low, this highlights the deteriorating demand conditions. China, the world's second-largest economy, is experiencing slowing growth, falling prices and rising unemployment. Further signs of distress in the real estate sector highlight some of the structural vulnerabilities that policymakers will seek to address.

Hawkish statements from the Fed, underscore that although US inflation has slowed considerably, they believe that the fight against inflation is yet to be won and a rate cut in the very near future is unlikely. The September inflation data in the euro zone and the UK will be watched closely as policymakers attempt to achieve the delicate balance of continuing to reduce inflation while avoiding further stunting sluggish growth.

Turning to the equity markets, the most important question is to what extent individual sectors and companies can protect or even increase their earnings in this environment. While valuation corrections are quite possible, there will be some areas where structural growth factors enable companies to achieve above-average returns. As the market becomes more granular, active investors may benefit from new entry opportunities and robust developments in individual market segments or selected companies.

As most companies have now reported, underlying earnings have been steady across most sectors (excluding energy). Companies within the portfolio have generally exceeded expectations, primarily driven by recovering margins. Guidance has been more positive than in the previous quarters and there are early signs, especially in the US, that EPS growth may be returning after 12 months of declines.

As always, our focus will remain on opportunities that best compound client wealth over the longer term. Valuation multiples are near long-term averages, but there is a wide divergence between different sectors and types of stocks. Hence, opportunities to add positions in quality companies with high earnings visibility and robust growth remain.