Allianz Global Investors

06/2023

Market Snapshot

Equity Snapshot

United States

US equities delivered solid gains over June, with the rally broadening out from artificial intelligence-related and technology stocks. Stocks were initially boosted by news that policymakers had agreed to a last-minute deal to raise the debt ceiling, avoiding the threat of a US default. By mid-month, US equities had entered an official bull market, defined as a rise of at least 20% from a recent trough, and the rally continued with the S&P 500 Index and the Nasdaq Composite Index closing June at their highest levels since early 2022. Economic news was generally positive, with little sign that higher interest rates were severely denting growth. US first-quarter GDP growth was revised up to a 2.0% expansion on an annualized basis, with consumer spending rising at the strongest rate in two years. Job growth also picked up: May's addition of 339,000 positions is the strongest since January while data for April and March was also revised higher. Headline inflation continued to wane, falling to 4.0% in May, the lowest level since March 2021, and core inflation slid to a one-and-a-half-year low of 5.3%. On the other hand, the S&P Global US composite purchasing managers' index dropped to 50.3 in June, with manufacturing activity falling at the steepest rate since the start of the year, while services activity cooled from May's 13-month high.

Europe

Euro-zone equities advanced moderately over the month (in EUR terms), as investors balanced concerns over slowing economic growth and the European Central Bank's continued hawkish stance against signs that inflation may be easing. Consumer discretionary and financials stocks were among the strongest performers, while communication services was the only sector to record negative returns over the month. Economic data indicated that the euro-zone economy had stagnated in June, with the flash estimate of the HCOB eurozone composite purchasing manager's index (PMI) falling back to 50.3, as the contraction in manufacturing activity deepened and services activity also lost momentum. At a country level, France lagged noticeably, with June's composite PMI dropping to 47.3, indicating the economy was contracting at the fastest pace since February 2021, as the decline in manufacturing worsened and services also saw an unexpected fall.

Asia

Asian equity markets advanced moderately over the month, helped by a recovery in Chinese stocks but undermined by disappointment over stimulus measures in China and hawkish statements from central banks in developed markets. Chinese equities rebounded over the first half of the month, boosted by growing expectations of further fiscal and monetary support. However, shares later gave back some of these gains as data highlighted the extent of the slowdown and its effects on Chinese companies, with industrial profits in the first five months of 2023 dropping 18.8% from a year earlier. The tech-heavy markets of Taiwan and South Korea delivered more muted performance in June following their AI-driven surge during the previous month. Returns in ASEAN markets retreated slightly with overall economic activity easing and some signs of decelerating inflation. Indian equities advanced, with the S&P BSE Sensex Index hitting an all-time high as the country's robust economy attracted strong overseas inflows. Australian shares closed only modestly higher, with the Reserve Bank of Australia unexpectedly raising interest rates by 25 basis points.

Bond

In June, government bond yield curves continued to flatten on the back of resilient economic activity and sticky core inflation data, with the major central banks also reiterating their hawkish rhetoric. The US Federal Reserve paused its hiking cycle at its latest meeting, maintaining the Fed funds rate within the 5.00–5.25% range, but the committee's median projection for the Fed funds rate rose by 50 bps to 5.50–5.75% for end-2023. The European Central Bank raised its key interest rates by 25 bps, with the deposit rate rising to 3.5%, and signalled that it expects to raise rates by another 25 bps in July. Meanwhile, in the UK, headline CPI inflation exceeded expectations for a fourth consecutive month, resulting in the Bank of England hiking rates by 50 bps to 5%. The message from central bankers was clear—there is more work to do to bring inflation under control—leaving markets to digest the implications of the "higher for longer" rates theme.

Outlook

With the US Federal Reserve taking a "hawkish pause" on interest rate hikes, and the European Central Bank (ECB) flagging that there is no pause in sight—despite an economy technically in recession—investors will likely contend with further macro uncertainty in the second half of 2023.

It normally takes 12–18 months for the lagged effect of monetary policy tightening to bite. However, it is fair to expect that the impact may be delayed by the excessive liquidity central banks injected during the Covid-19 pandemic. The demonstrable resilience of the US economy is another factor.

With core inflation proving sticky, there is reason to believe price pressure for services will remain robust, even as economies potentially begin to slow. Significantly, labour costs are rising in many sectors even as raw material costs soften. The pick-up in euro zone wage growth to 5.6% in Q1 2023 (vs 4.8% in Q4 2022) will concern the ECB, for example.

In the US and the UK, many economic indicators are pointing downward. Money supply measures, which indicate the total amount of money in the economy, have been shrinking for several months. The latest manufacturing purchasing managers' index (PMI) figures—closely watched measures of business activity—also showed ongoing declines.

Despite this, unemployment has remained at multi-decade lows in most Western economies, helping to delay the sort of contraction in consumer spending that might have pulled them into recession. With employment at a 30-year high and the OECD predicting growth of 0.9% in the euro zone this year, Europe's technical recession shows unusual characteristics. A recession would normally feature weaker data on both fronts.

China's economy, which rebounded in Q1 2023 thanks to its post-Covid reopening, is now weakening again on the back of lower global demand for its exports because of slowing economies elsewhere. There is also the impact of some reorganisation of global supply chains, e.g., the "China-plus-one" trend, where companies additionally expand their operations outside China with the aim of building more resilient supply chains.

As the focus shifts from interest rates to the timing of a recession or slowdown, volatility could return to equity markets, particularly as earnings expectations appear out of kilter given the shifting macroeconomic visibility.

As always, our focus will remain on opportunities that best compound client wealth over the long-term. We believe our higher-quality, structural growth companies will prove more resilient to higher input costs and any margin pressure that an economic slowdown might bring.

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