Allianz Global Investors

05/2024

Market Snapshot

Equity Snapshot

United States

US equities advanced strongly, setting fresh record highs, although the market came off its best in the closing days of the month. The appreciation was mostly driven by robust gains from the technology sector. As a result, the tech-heavy Nasdaq Composite Index outperformed the broad-based S&P 500 Index, with growth stocks topping value ones by a sizeable margin. Ahead of November's presidential election, President Joe Biden stepped up the trade war with China, with additional tariffs slapped on steel, semiconductors, electric vehicles and battery/solar cells. Meanwhile Donald Trump became a convicted felon when a New York jury found him guilty of all 34 counts relating to the cover up of hush-money payments.

Hopes of moderating US economic growth were boosted by weaker-than-expected jobs growth and slower-than-forecast inflation. Non-farm payrolls rose 175,000 in April, the lowest monthly rise since November 2023. Headline inflation also slowed to 3.4% from 3.5% in March. Additionally, US GDP growth for the first quarter was revised down to an annualised rate of 1.3% from an initial estimate of 1.6%. In contrast, the flash estimate of the S&P Global US composite purchasing managers' index surged to 54.4 in May, the highest level in more than two years, helped by accelerating activity in both manufacturing and services. The Conference Board's measure of consumer confidence also showed an unexpected rise in May, marking the first increase in four months.

The Federal Reserve (Fed) kept rates on hold, signaling that US interest rates would likely remain higher for longer and that a cut should not be expected until the second half of the year at the earliest. Fed chair Jay Powell stressed the need to be "patient and let restrictive policy do its work" as minutes of May's Federal Open Market Committee meeting showed that some policymakers had been keen to raise rates. Nevertheless, the Fed chair emphasised that an increase in rates was a low probability.

Europe

European equities rallied over May, buoyed by growing hopes that the European Central Bank (ECB) would cut rates in June, although some late-month weakness capped the monthly gains. At a sector level, financials and real estate stocks were the strongest in the MSCI Europe Index, while energy was the only sector to end the month in negative territory.

Economic data continued to show signs of improvement, although inflation accelerated. The flash estimate of the HCOB eurozone composite purchasing managers' index (PMI) jumped to 52.3 in May, the highest level in a year. Services activity held steady at 53.3 while manufacturing activity contracted by the least in 15 months. Headline inflation quickened to 2.6% in May, up from 2.4% in the previous two months, while core inflation accelerated to a stronger-than-expected 2.9%, marking the first increase in nine months. ECB President Christine Lagarde indicated that it was highly likely that the central bank would cut rates in June but refused to comment on the subsequent path of interest rates.

Asia

Equity markets in Asia rose modestly over May. China equities consolidated over the month after the previous good run post Chinese New Year. Sentiment was supported by the government's step up of efforts to boost the troubled property market, with measures to address both the lack of demand and excess supply. Indian equities also delivered positive returns, underpinned by expectations that Narendra Modi will be re-elected Prime Minister. Australian stocks closed the month slightly higher, though a rising CPI print raised concerns that the Reserve Bank of Australia may keep rates high for longer. Taiwan equities were lifted by robust gains from chipmaker TSMC, but South Korean shares lagged, with Samsung Electronics announcing weak earnings. In ASEAN markets, Singapore rallied the most, but stock markets in Thailand, the Philippines, and Indonesia lost ground as early gains were eradicated by declines later in the month.

Bond

Global bonds delivered mixed performances in May. US bonds closed a volatile month with positive returns, outperforming other bond markets as US inflation slowed. In contrast, yields rose in the eurozone as headline inflation went up for the first time this year. Japanese bonds were among the weakest performers. Its 10-year bond yield rose amid growing speculation that the Bank of Japan may soon raise rates again and start to reduce its bond purchase programme.

In the US, the chair of the Federal Reserve Jay Powell indicated that investors should exercise patience and allow the restrictive policy to effectively combat inflation. Despite this, he assured that the likelihood of a further increase in rates is minimal. In the eurozone, the European Central Bank gave its strongest hint yet that rates would be cut in June, despite higher-than-expected wage growth. Hopes that the Bank of England would also cut rates in June were dashed when UK inflation fell less than forecast and the government unexpectedly called a general election, to be held on 4 July.

Outlook

After the upside surprise in US inflation and solid jobs and economic growth announced in April, the May data showed signs of moderation. Inflation slowed marginally, jobs growth was the lowest since November 2023 and US GDP for the first quarter was revised down to 1.3% on an annualised basis. The US Composite purchasing managers index (PMI) did however rise to its highest level for two years, helped by accelerating activity in both manufacturing and services. Rates were kept on hold and the Federal Reserve again signaled that interest rate cuts should not be expected until towards the end of the year. Fed Chair Jay Powell also stressed that an increase in rates was a low probability.

In contrast to the US, inflation numbers for Europe were higher than expected dashing hopes of a June rate cut by the Bank of England, although the ECB has deviated from convention, moving before the Fed and initiating its first cut in June. Economic data for the Eurozone continued to signs of improvement as the composite Eurozone PMI advanced to its highest level in a year. Different growth and inflation backdrops will grant central banks varying leeway to adjust their policy stance, with those economies that have already suffered negative or below-potential growth and are further along in the cyclical disinflation process having a much more favourable starting point. It is likely that monetary policy across industrialised countries will deviate more widely in the coming quarters.

The current business cycle has reached a critical juncture, with the global economy still navigating unprecedented post-pandemic normalization dynamics. After regional growth disparities became increasingly evident over the past two years, these gaps have started to narrow more recently. In the United States, favourable supply-side dynamics, marked by a surge in productivity and labour supply, have underpinned the successful economic rebalancing and consensus expectations of a 'soft landing' thus far. However, these tailwinds are expected to wane in the coming quarters. Conversely in the Eurozone, weak productivity growth has weighed on economic output and contributed to elevated unit labour costs, reinforcing the persistence of services inflation. While these negative forces have begun to weaken with the rebound in economic growth in recent months, significant rate cuts by the ECB beyond a gradual normalisation would still hinge on a swift reversal of the underlying adverse dynamics. The Chinese economy continues to face headwinds from the structural decline in housing markets and an unbalanced macro policy approach. Although GDP growth is expected to slow in the second quarter, the official GDP growth target of 'around 5 percent' for this year remains within reach.

Political uncertainty could also have a bigger impact on markets in the coming months. The announcement of a snap parliamentary election in France came as a big surprise, with voting taking place in early July, weeks before the Paris Olympics. President Macron made the dramatic announcement after a big victory for the right-wing National Rally in France's EU elections. It was also confirmed that the UK would elect a new ruling party on July 4th, earlier than many predicted. It remains to be seen if the recent criminal conviction for Donald Trump will have an impact on the outcome of the US election. Polls suggest a close-run race with incumbent President Biden. By the end of 2024, 40% of the World's population will have elected new leaders, before then, a range of economic and fiscal stimulus could be offered to entice voters in various directions. The ongoing war in the Ukraine and conflict in the Middle East still have potential to impact the markets, especially commodities if a there is an escalation or indeed if a diplomatic solution is found.

Company earnings have been mostly positive or improving in the recent earnings season with the MSCI AC index earnings numbers showing growth after a period of contraction. Estimates for 2024 and 2025 are also improving. Our portfolio companies have generally performed well, but with valuations at or slightly above long-term averages, any slight concern or small numbers miss has led to a significant share price reaction. While overall valuations have risen, we believe generally they are reasonable, assuming H2 is as strong as indicated. This has been a clear theme from our companies as they report: emphasis on the second half of the year as a pivot point for growth. We share the optimism of many of our management teams for the year ahead, believing earnings visibility will be key and the portfolio holdings can demonstrate the underlying profit growth that they are renowned for.