Allianz Global Investors

09/2023

Market Snapshot

Equity Snapshot

United States

US stocks retreated over September, suffering their worst monthly decline of 2023. Sentiment was undermined by signals from Federal Reserve (Fed) policymakers that interest rates are likely to stay high for an extended period. Speaking at the Jackson Hole summit of central bankers, Fed chair Jay Powell reiterated that US inflation remains "too high", meaning the central bank needs to either hold interest rates at their current level or raise them to bring inflation down to its 2% target.

Headline inflation accelerated to an annual rate of 3.7% in August, although core inflation eased to 4.3%, the lowest level in almost two years. The core Personal Consumption Expenditure Index, the Fed's preferred measure of inflation, eased to 3.9% in August, a level last seen in May 2021. The Fed enacted a 'hawkish pause' at its September meeting: while it kept rates on hold, policymakers hinted there may be another 25-basis-point hike before year-end and suggested that rates would only be cut twice in 2024.

Europe

Euro-zone equities retreated over September, undermined by the European Central Bank's (ECB) continued hawkish stance and by concerns over the outlook for the euro-zone economy. The Italian government raised its fiscal deficit projections for this year to 5.3% of GDP, citing the ballooning costs from a tax incentive scheme which offered Italians a 110% tax credit for house renovations to enhance energy efficiency.

While the HCOB euro-zone composite purchasing manager's index (PMI) improved modestly to 47.1 in September, from August's 34-month low of 46.7, new orders fell at the steepest rate since November 2020. Headline euro-zone inflation fell to 4.3% in September, down from 5.2% in August and the lowest level since October 2021, while core inflation eased to 4.5%, compared with 5.3% in August.

Asia

Asian equities slid in September with sentiment knocked by worries that US rates would stay higher for longer. A stronger tone to the US dollar also weighed on returns in USD terms. China and Hong Kong equities declined. While economic data in China remained weak, it showed a modest improvement compared with recent months. The tech-heavy markets of Taiwan and South Korea also fell, with semiconductor stocks negatively affected by news that TSMC had warned that the recent boom in artificial intelligence interest was not sufficient to offset a broader slowdown in demand. ASEAN markets mostly lost ground, although returns in the Philippines and Singapore were positive. Indian equities also advanced, with the BSE Index hitting a record high mid-month. India's economy remains robust, with the S&P Global India composite purchasing managers' index indicating one of the strongest expansions in economic activity in more than 12 years.

Bond

Global bonds sold off sharply as hawkish central bank comments reinforced the belief that rates would stay higher for longer. US government bonds fell, undermined by a growing sense that US rates would stay higher for longer and as investors started to worry about a potential shutdown of the US government. The yield on the US 10-year Treasury Note went passed 4.6%. With yields at the longer end of the curve rising the most, the inversion of the yield curve (2s to 10s) lessened to around 50 basis points (bps) compared to around 75 bps at the end of August. Euro-zone sovereign bonds also declined in September as investors started to recognise that the European Central Bank (ECB) will need to keep interest rates higher for longer to keep inflation in check. Yields on peripheral euro-zone bonds rose even more, particularly in Italy as the Italian government raised its fiscal deficit forecast.

Outlook

Optimism for a soft landing of the world and the US economy, particularly, has surged in recent months, fuelled by robust economic data, declining inflation and strong performance in risky asset markets during the first half of the year. Analysts, responding to this more favourable than expected trend, have upgraded their short-term growth forecasts for the US, while reducing the estimated likelihood of a recession. The most recent economic data however, shows signs that growth may be beginning to moderate in the US and to a lesser extent Japan, which have been economic bright spots in the Global landscape.

The much-watched US PMI index fell to its lowest level since February, as the strong growth seen in the services sector began to reduce, while manufacturing output remains in contraction territory. Whilst consumer spending levels remain healthy and jobs continue to grow in the short term, tightening lending standards and more costly credit means the landscape for the US consumer appears to be worsening.

Hawkish statements from the Federal Reserve, 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. Data for September showed that disinflation momentum may be waning, with favourable base effects fading and higher energy prices resurfacing. Labour markets remain tight and enduring repercussions from COVID and the war in Ukraine mean that inflation could be more deeply rooted than anticipated. An extended period of tight monetary policy and below-potential GDP growth may be necessary to return cyclical inflation sustainably back to central banks' target level.

The most recent quarterly reporting season was mixed, with a rising divergence in results and outlook among the stock market 'winners' and 'losers'. Companies within the portfolio generally exceeded expectations, primarily driven by recovering margins and in many cases re-iterated or raised guidance. Earnings per share figures also showed signs of growth, especially in the US indices, after 12 months of declines. Corporate margins may have held up reasonably well but there will be doubts as to whether companies can continue to pass on increasing costs to consumers. If growth does become scarcer and borrowing costs remain high, structural growth, low levels of debt and solid cash generation will be key to company performance.