Allianz Global Investors

11/2023

Market Snapshot

Equity Snapshot

United States

US stocks soared in November, with the S&P 500 Index recording its largest monthly gain since July 2022, buoyed by hopes of a soft landing for the US economy. In particular, sentiment was lifted by a larger-than-expected drop in US inflation and private sector job creation, which fuelled hopes that US interest rates had peaked and that the Federal Reserve (Fed) would embark on multiple rate cuts in 2024.

US jobs growth slowed significantly in October, with non-farm payrolls showing just 150,000 jobs were added versus the 297,000 positions created in September. US retail sales fell 0.1% in October versus the 0.9 % growth of the previous month, though this was a less pronounced decline than economists had forecast. Meanwhile, the University of Michigan US consumer sentiment index declined to a six-month low of 61.3 in November.

Europe

European equities rallied strongly in November, delivering their strongest monthly return so far this year, as inflation and interest rate expectations dropped. Real estate and information technology were the top two sectors, with industrials also delivering double-digit gains. Energy was the only sector to end the month lower.

Euro-zone inflation fell to 2.4% in November, the slowest annual pace since July 2021 and approaching the European Central Bank's (ECB) target rate of 2%. Core inflation, which excludes food and energy, slowed to 3.6% down from 4.2 % in October. Meanwhile, the flash estimate of the HCOB euro-zone composite purchasing manager's index (PMI) rose to 47.1 from October's 46.5, suggesting a modest improvement in economic activity.

Asia

Asian equities joined the global advance spurred by falling US interest rate expectations. However, the region lagged returns in Western markets as overall performance was held back by subdued returns in China and Australia. In contrast to other central banks, the Reserve Bank of Australia hiked interest rates by 0.25% to 4.35% following its November meeting, marking its first increase since June. Taiwanese equities were sharply higher, with sentiment for chipmakers boosted by strong demand for AI technology and signs that the cyclical slump in demand for semiconductors is nearing an end. Korean equities also delivered strong returns supported by a regulator ban on the short selling of Korea-listed stocks. Elsewhere, ASEAN markets advanced slightly, with the Philippines and Indonesian markets taking the lead while Thailand remained the weakest market as growth continued to fall short of expectations.

Bond

Global bonds rallied sharply, boosted by rising optimism that rates may be cut in 2024. In the US, yields tumbled across the yield curve as a bigger-than-anticipated fall in US inflation and signs of slowing economic growth caused investors to assign a greater probability to the potential for US interest rate cuts in 2024. European bonds rose sharply over November as inflation and interest rate expectations declined. Yields on peripheral euro-zone bonds declined even more, particularly in Italy after Rome avoided a potential downgrade of its credit rating to 'junk' status.

Outlook

The strong equity market gains in November underscored the huge impact that interest rate expectations have in the current equity market environment. Inflation data dropped to the lowest levels since mid-2021 in the US and the euro zone, with the UK also showing an acceleration in the rate of decline, although starting from a higher base. The larger-than-expected drop in US inflation, the significant slowing of US jobs growth and comments from Jay Powell that were interpreted as ‘dovish’ shifted expectations around monetary policy. From a situation where US rates were ‘paused’ with a possibility of a further rise early next year, many now believe rates have peaked and that the loosening of monetary policy is likely in the first half of 2024.

As high-quality growth investors, we can generally tolerate higher interest rate levels well, given our companies generate superior earnings growth to support their valuations. However, it is the uncertainty around interest rates that makes a tougher environment for growth stocks. Growth stocks have a higher skew towards future earnings, so any volatility in the discount rate used to value these future cash flows will have a greater impact on the valuation of these companies.

The most recent earnings season saw a widening disparity of results, but our portfolio of quality growth companies generally outperformed the wider market. Predicted earnings growth, as measured for the MSCI AC World Index, is flat and with re-financing costs much higher than in the past decade, this disparity could increase. If the most recent inflation number becomes a wider trend and we have indeed reached the peak of the rate environment, a period of relative calm should benefit companies that have structural growth, healthy balance sheets and strong cash flows.