Allianz Global Investors

12/2023

Market Snapshot

Equity Snapshot

United States

US stocks rallied in December, with the S&P 500 Index closing the year close to the all-time high it reached in January 2022. Meanwhile, the Nasdaq touched a fresh record peak. The rally was driven by rising hopes of a soft landing for the US economy, as well as signals from the Federal Reserve Board (Fed) that rates were likely at their peak and that borrowing costs would be lowered in 2024. Smaller companies outperformed larger ones significantly over the month.

There were growing hopes that the US economy would experience a 'Goldilocks' outcome, where growth is neither too hot nor too cold. Third-quarter gross domestic product (GDP) growth was revised slightly lower to an annualised rate of 4.9% from the previous estimate of 5.2%. Non-farm payrolls increased 199,000 compared with October's 150,000 gain but remained below the average monthly gain of 2023, while the University of Michigan's consumer sentiment index rebounded to 69.4 in December, its strongest level since July. November's S&P Global US composite purchasing managers' index rose to a five-month high of 51.0, with activity in the services sector accelerating to the strongest pace since July, although manufacturing activity weakened to a four-month low.

Europe

European equities advanced in December, closing the year near their highest level since January 2022 amid growing expectations that borrowing costs would be reduced in 2024. The US Federal Reserve's dovish pivot contributed to the positive tone. While European policymakers said it was far too early to be talking about rate cuts, the anaemic pace of growth in Europe and the sharply falling inflation sparked hopes that rates would also be reduced in Europe. At a sector level, real estate companies led the advance, followed by the industrials and materials sectors. By contrast, energy stocks retreated slightly, with the consumer staples and communication services sectors also lagging.

Economic activity in Europe remained subdued at best. The HCOB euro-zone composite purchasing managers' index (PMI) fell to 47.0 in December compared with 47.6 in November, with services activity remaining close to October's 32-month low, while activity in the manufacturing sector was unchanged from the previous month at 44.2. Headline euro-zone inflation fell to 2.4% in November, nearing the European Central Bank's (ECB) target. At its December meeting, the ECB kept rates on hold. While policymakers acknowledged that rates were unlikely to rise further, they warned that it was too early to declare victory in the fight against inflation and that they need to remain attentive to ensure inflation is beaten.

Asia

Asia Pacific equities posted solid gains in December. In general, shares were lifted by the Federal Reserve's (Fed's) more dovish stance, with US policymakers indicating that rates had peaked and forecasting 75 basis points of rate cuts in 2024. A correspondingly weaker tone to the US dollar was also helpful. Within the region, Australian equities led the way, ending the year close to a 20-month high. Equity markets in Taiwan and South Korea also gained, with technology stocks amongst the bright spots. Rounding out the gainers, ASEAN markets rallied strongly on signals from the Fed. Conversely, Chinese equities closed 2023 on a weak note, with shares hit by news that Chinese regulators had tightened restrictions on the gaming market. The draft regulations were quickly put on hold, but market movements highlighted the weak sentiment.

Bond

Global bonds extended the rally that started in November. Bond yields moved sharply lower as inflation came in below expectations. The yield on the 10-year US Treasury traded below 3.9% for the first time since July, whilst the 10-year German bund yield fell to a one-year low of below 2.0%. Yields on 10-year UK gilts briefly slipped below 3.5% after UK inflation tumbled in November. In contrast, Japanese government bonds lagged the gains in other markets amid rising speculation that the Bank of Japan (BoJ) would soon end its below-zero interest rate policy.

Outlook

December saw a continuation of the strong equity market gains from November, with interest rate expectations remaining the focus for investors. Inflation data dropped to the lowest levels since mid-2021 in the US and 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, slowing of US jobs growth and comments from Jerome Powell that were interpreted as 'dovish' shifted expectations around monetary policy. From a situation where rates were 'paused' with a possibility of a further rise in early 2024, the market consensus is now that rates have peaked, and central banks will be able to adopt a more accommodative stance.

The current economic data suggests that the outlook for 2024 differs between regions and economies. Growth in the US remains stable, and the economy looks resilient, with job figures and purchasing managers indices (PMIs) remaining neutral to slightly positive. The hopes of a 'Goldilocks' outcome, where growth is neither too high (which could be inflationary) or too low (recessionary), increased markedly towards the end of 2023. The Chinese economy is still struggling relative to its history but may have reached an important turning point, with the ruling politburo pledging further stimulus measures to help boost domestic demand. The country does, however, need to urgently resolve the issues in the real estate sector, which makes up about 20% of the country's gross domestic product (GDP). Europe and the UK could face tougher conditions, with more pronounced recessionary risks and inflation that may prove more difficult to tame. This could be especially true if energy security becomes threatened by rising geo-political tensions.

The most recent earnings season saw a widening disparity of company results. Predicted earnings growth for FY 2023, as measured for the MSCI AC World Index, is flat but returning to a high single-digit growth in FY 2024. This figure slightly obscures the leadership shown by a handful of industries and especially the Magnificent 7 (Apple, Microsoft, Amazon, Alphabet, Nvidia, Meta and Tesla). Global growth is slowing and with re-financing costs much higher than in the last decade, the earnings disparity between companies that can structurally grow and those that have relied heavily on cheap financing will increase. If the most recent inflation numbers become a wider trend and we have indeed reached the peak of the rate environment, a period of relative calm should put the focus back on fundamentals and create a good hunting ground for stock pickers. We are confident that the structural growth, low debt levels and high earnings visibility of our companies mean the portfolio is well positioned to take advantage.

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