➢ Market and Economic Update – February 2024

Peter Flannery CFP, FA

"People calculate too much and think too little."
-Charlie Munger

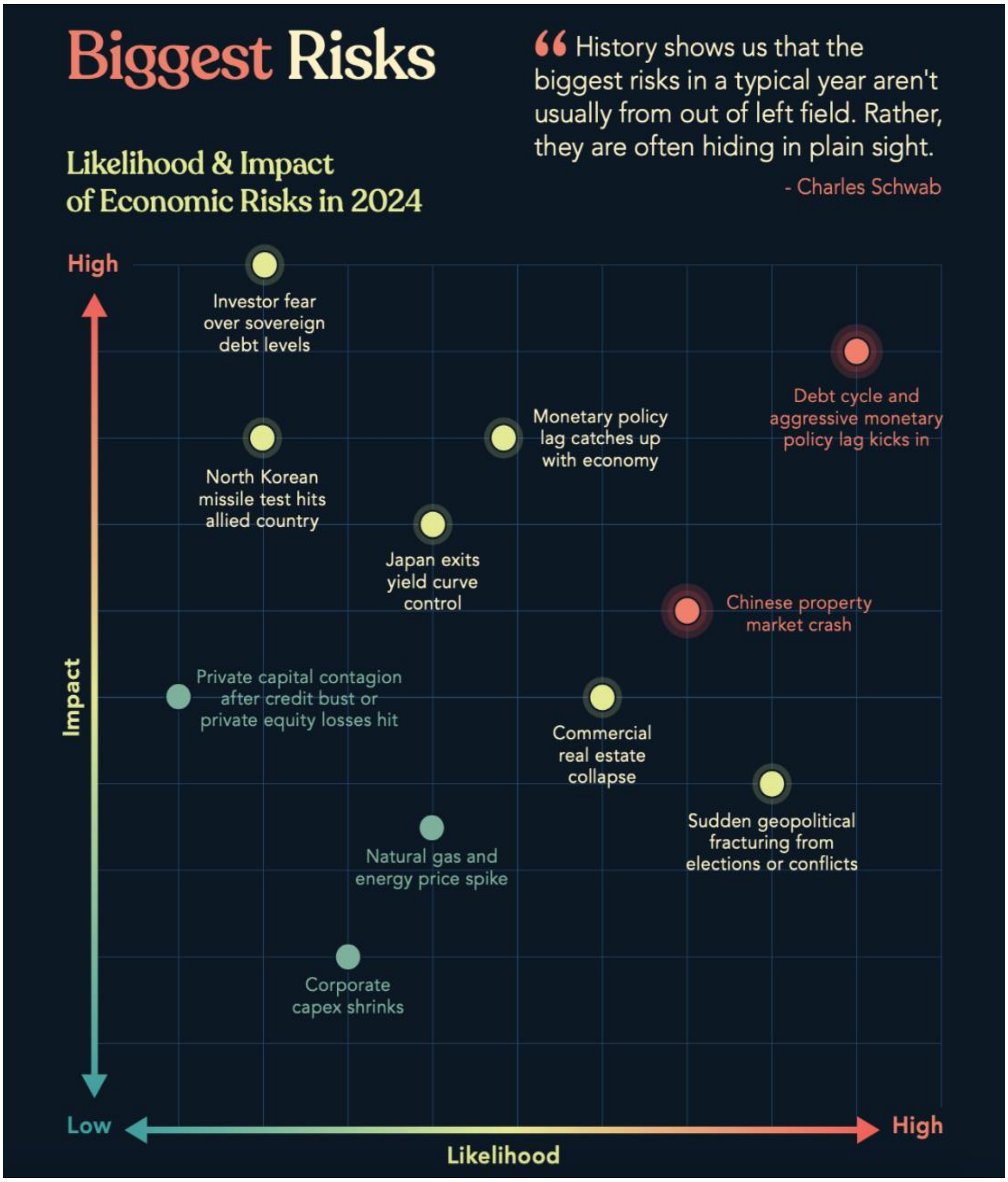
The Markets

Happy markets look for direction.

This graph shows the movement in the S&P 500 from 2020 up to now, as well as different scenarios in the future.

There are lots of moving parts to the markets and lots of variables. We know what they all are. We don't know which ones will suddenly surprise/scare markets, causing trading prices to move sharply.

Let's take a closer look at some material risks to market prices and the probabilities …



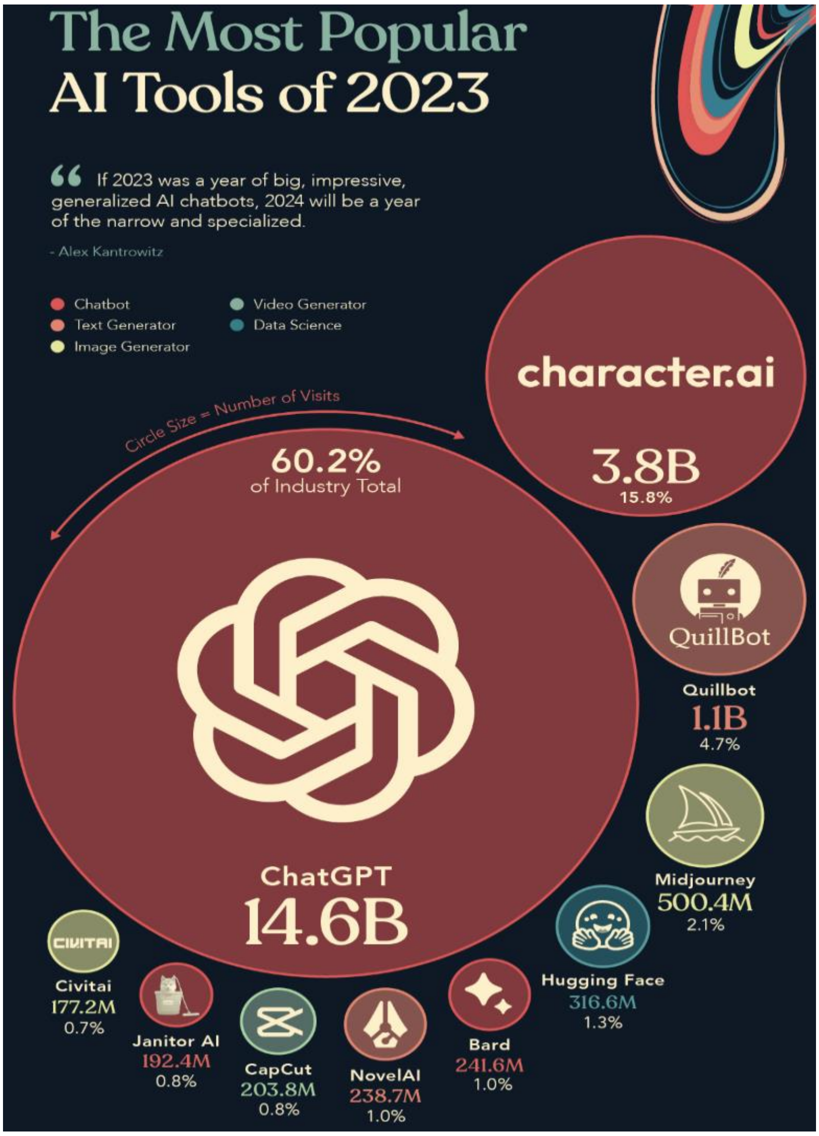
This graph shows some current risks, probability, and potential impact.

Whatever the risks, we know that they can have the biggest impact on investment portfolios when markets are happy and trading prices are high. The higher the trading price, the further there is to fall.

On the other hand, we don't mind lower trading prices because that … *is when the value emerges.*

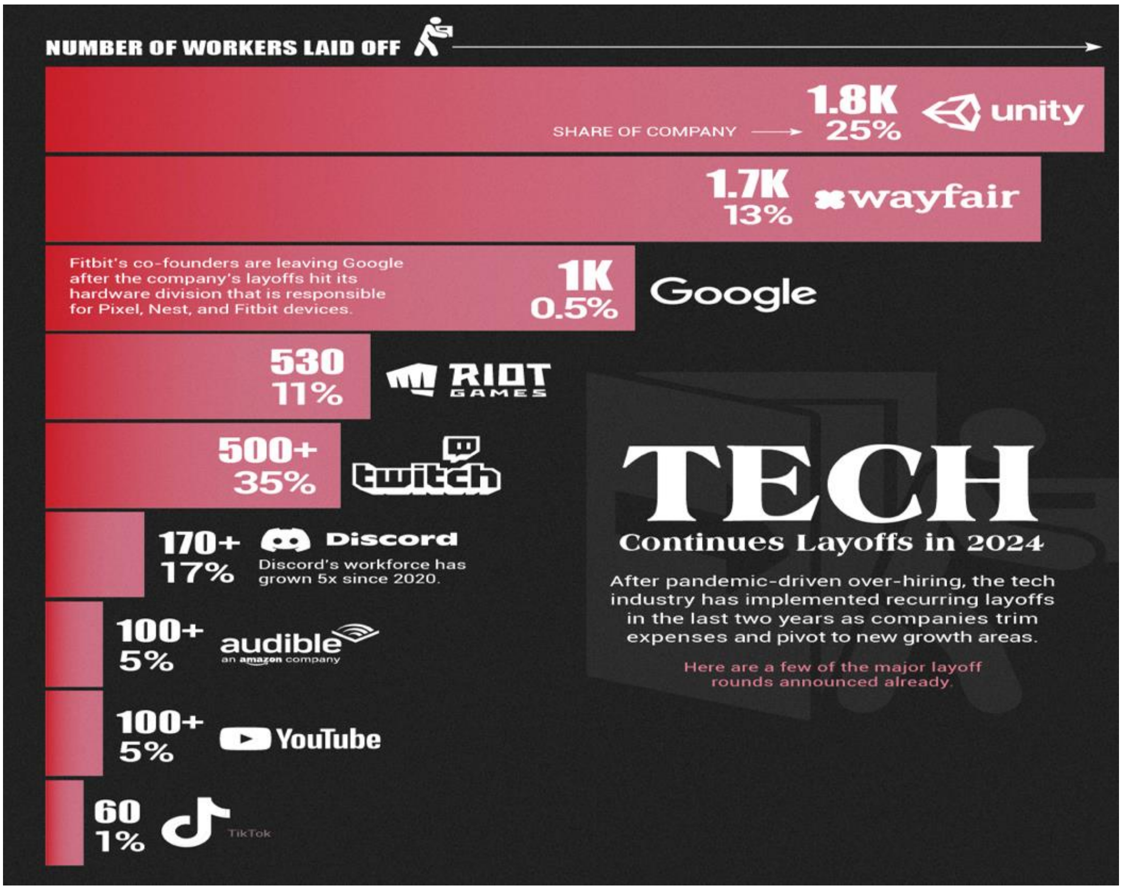
This graph measures the tech sector as a percentage of the overall market.

AI (artificial intelligence) has emerged as the next development in the tech sector. The Magnificent 7 are more mature businesses now and are less speculative by comparison. They are profitable and some are also involved in AI.

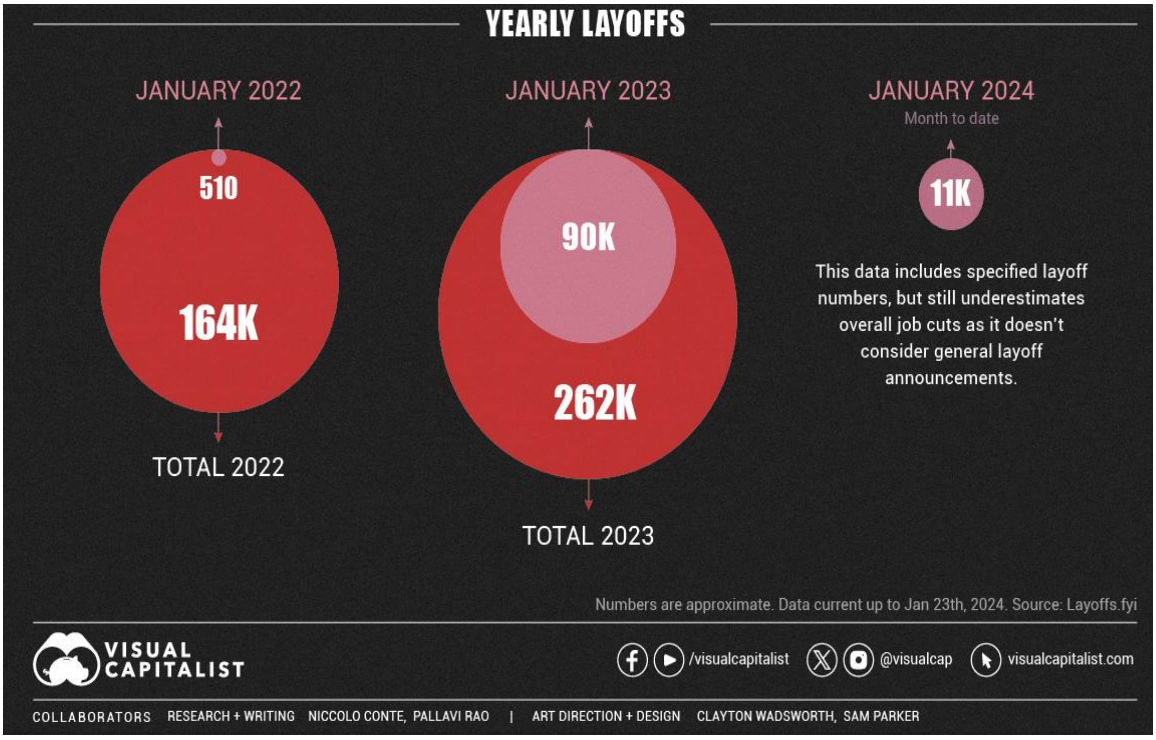


The diagram above shows the main AI tools developed/used over 2023.

So, we now move into the underlying story that investors should be aware of over the next three to six months…



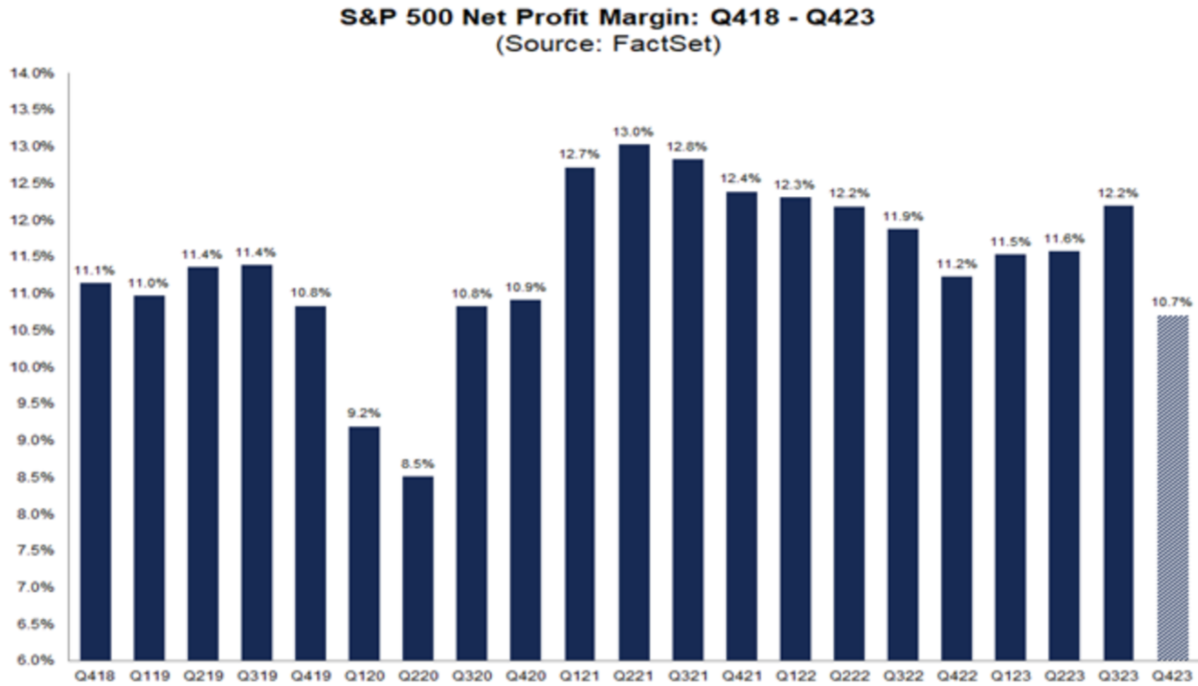
The diagram above shows the number of people laid off in the technology sector so far in 2024.



The diagram above shows the number of people laid off in the technology sector for Januarys 2022 & 2023 and the whole year 2022 and 2023, as well as the layoffs for January 2024.

The layoffs from 2022 and 2023 appear to be continuing in 2024 although at a slower pace. This ties in with a mixed earnings outlook.

At the same time earnings and profit margins appear to be declining as well. This seems at odds with the recently rapidly rising share market though!

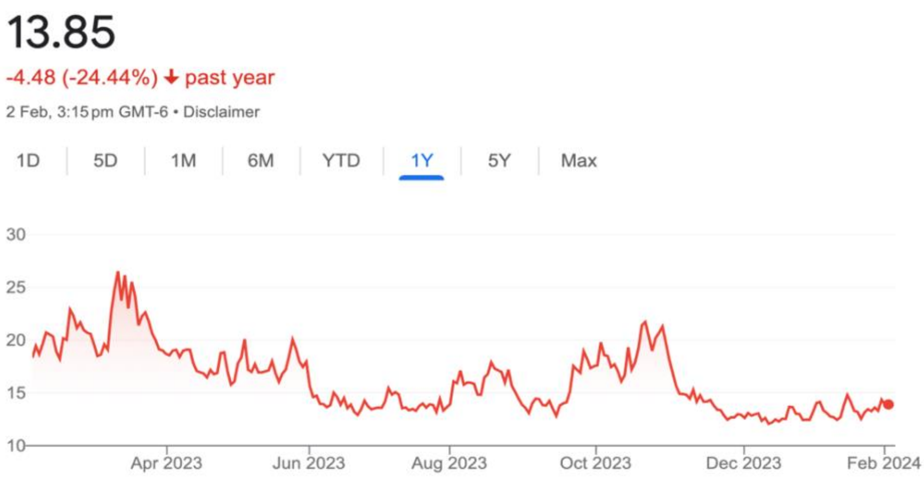


This graph tracks the quarterly change in profit margins across the S&P 500.

Note the grey bar to the right of the above graph at 10.7% for Q423 (fourth quarter of 2023) on the graph above, compared to the previous quarters.

Although we are OK currently, when share prices and markets get too far ahead of underlying earnings, this can be when the downside correction can be sharp and material.

The Vix Index (CBOE)



Open	13.95	Low	13.39	52-wk high	30.81
High	14.23	Prev close	13.88	52-wk low	11.81

This graph tracks US share market volatility.

The upside volatility over January 2024.
This was how it went for the first month of 2024:

- The Dow Jones finished the month + 1.22**%**
- The S&P by + 1.59%
- The Nasdaq by + 1.20%

The upside volatility over December 2023.
This was how it was for the last month of 2023:

- The Dow Jones finished the month + 3.98**%**
- The S&P by + 4.40%
- The Nasdaq by + 5.90%

The upside volatility over November.
Here is what happened:

- The Dow Jones finished the month + 6.30**%**
- The S&P by + 5.24%
- The Nasdaq by + 5.82%

The downside volatility over October.
Went like this:

- The Dow Jones finished the month down -1.14**%**
- The S&P by -2.21%
- The Nasdaq by -3.43%

The downside volatility over September.
Here is how it went:

- The Dow Jones finished the month down -3.5**%**
- The S&P by -4.9%
- The Nasdaq by -5.8%

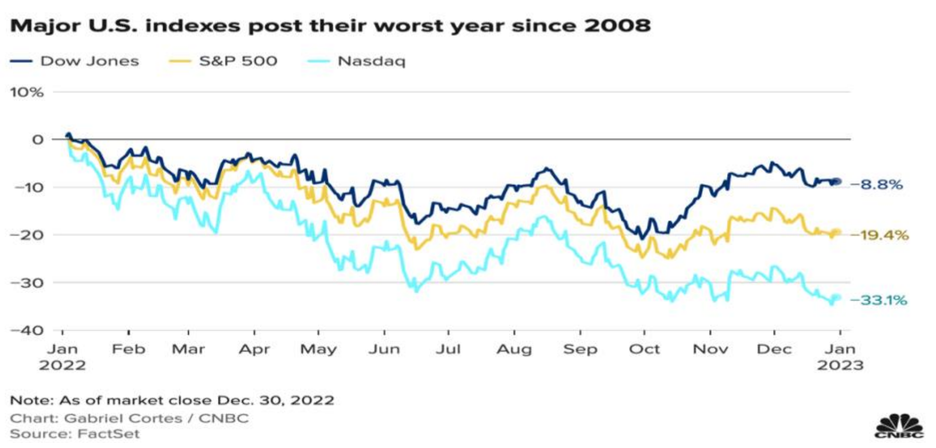
August 2023 downside volatility.
Here is how August went:

- The Dow Jones finished the month down -2.35**%** (from a low of -4.30%)
- The S&P by -1.77 (from -5.52%)
- The Nasdaq by -2.16% (-8.25%)

From the peak of 35,630 on August 01, 2023, The Dow Jones Industrial Index declined to 32,417 by the end of October 2023. The Dow Jones currently sits at 38,519 as of February 01, 2024.

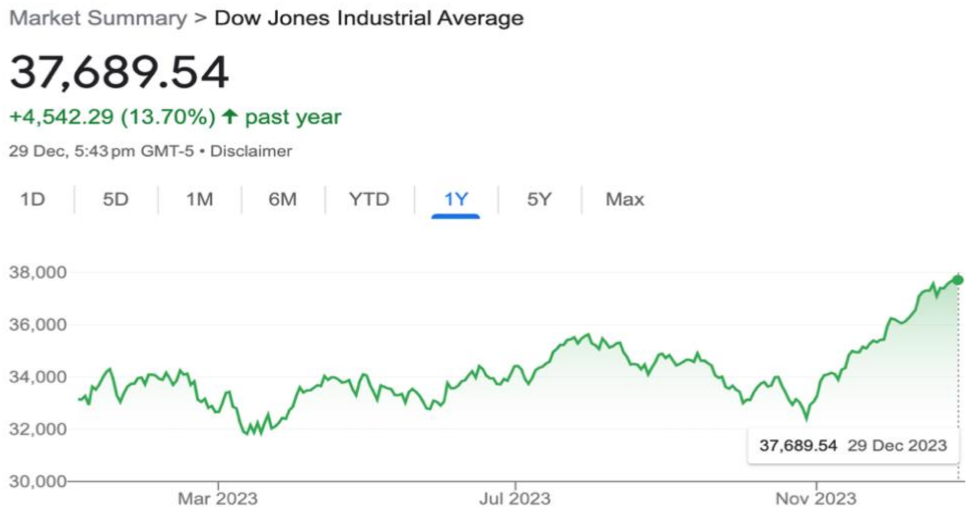
Although I am not making any predictions about random markets, generally, with the possibility of interest rate cuts on the way in 2024 in the US, markets may continue the upward direction over 2024, all things equal. We will need to keep an eye on earnings though.

The US share markets January 2022 – December 2022



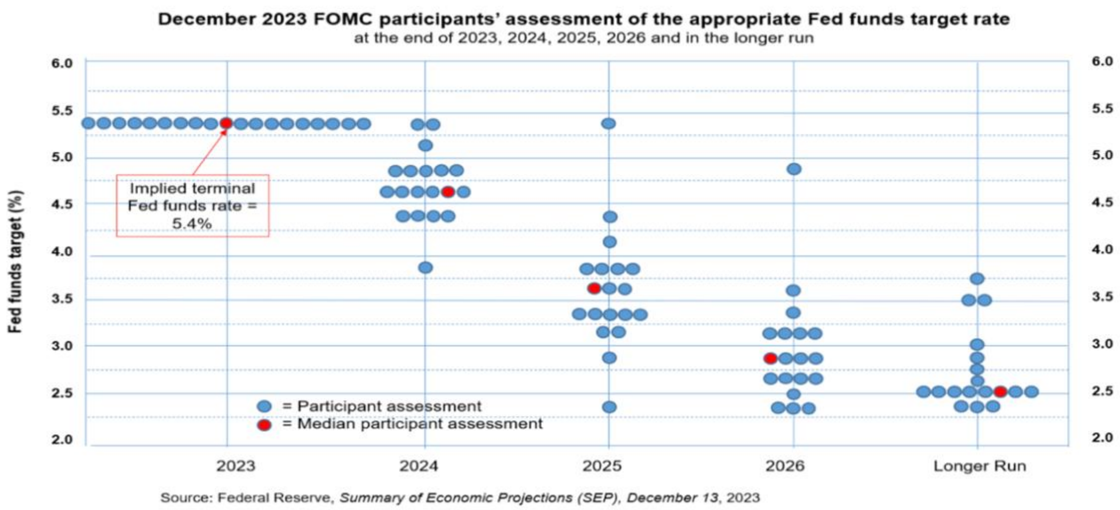
The above graph tracks the movement in the Dow Jones, the S&P 500 and the Nasdaq over 2022

The US share market January 2023 – December 2023



The above graph tracks the movement in the Dow Jones over 2023.

The market remains focused on when interest rates will be cut.



The graph above is 'the fed dot plot', added here again this month from January's Market and Economic Update. It shows the consensus thinking about interest rate direction in the US by the US Federal Reserve Committee.

The red dots on the graph above suggest the Fed Funds Rate to decline to 4.6% this year and 3.6% in 2025. The markets look to be expecting almost twice that.

I have mentioned a couple of times previously elsewhere, that trading prices may already reflect lower interest rates by the time those lower interest rates arrive. The point is that higher trading prices will need the support of earnings and revenue growth too.

The Global Economy

By Morgan Edwards – brief bio

$900 billion over the next 30 years is the estimated cost to fix this deficit. Quite sizable!

Several months ago, I wrote about the infrastructure deficit and the looming cost impact that will have on us all.

In the intervening period, I've had some interesting (albeit brief) email conversations with people from all over the world. Some information that I've been directed to has been on the topic of 'off-balance sheet fiscal agencies' (OBFAs).

Essentially, OBFAs are defined as 'special purpose vehicles that complement treasuries in supporting public investment, offering solvency insurance for banks, providing capital insurance of last resort for other treasuries, and expanding the stock of safe assets.

Supporting public investment?

Perhaps a New Zealand OBFA could be established, with input from both central and local government, with the goal of supporting investment in public infrastructure?

Perhaps a one-off annual levy of $365 for every household in New Zealand that benefits from infrastructure could be set to fund principal and interest arising from the issuance of long-dated bonds by the OBFA.

Maybe these bonds could be used as interest rate-setting instruments by the Reserve Bank to ensure low-interest rates for financing long-term intergenerational infrastructure.

There is a strong case for this.

We have seen the news over the past few days (years really) regarding Wellington's horrendous water pipe issues and the suspected cost of fixing them. Note that this is one city's issue – there's a whole country to think about.

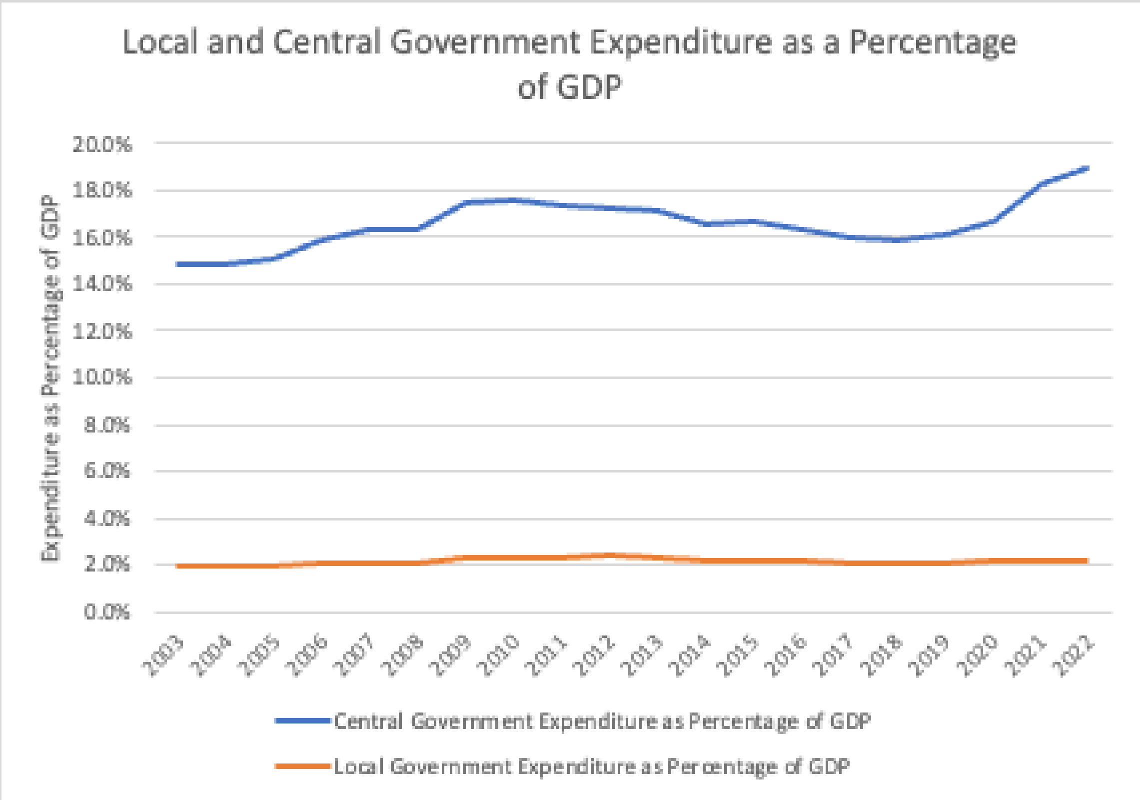
How about roads?

How about climate resilience infrastructure?

The list of significant infrastructure that needs to be funded goes on, with not many solutions in sight.

What's more, New Zealand's local government expenditure has been stagnant at about 2% of GDP for some time. The relevance of this point?

Local government is largely responsible for water, roading (not State Highways!) and climate resilience infrastructure.



The graph above depicts local and central government expenditure from 2003 to 2022.

Moreover, as stated by Local Government New Zealand (LGNZ) ‘continuing to rely so heavily on household and business rates is not a sustainable funding approach for local government’.

Further, the President of Āpōpō (association for infrastructure asset management professionals) noted that ‘we are staring down the barrel of a tragedy without a longer-term and committed plan of investment in old and new infrastructure assets.

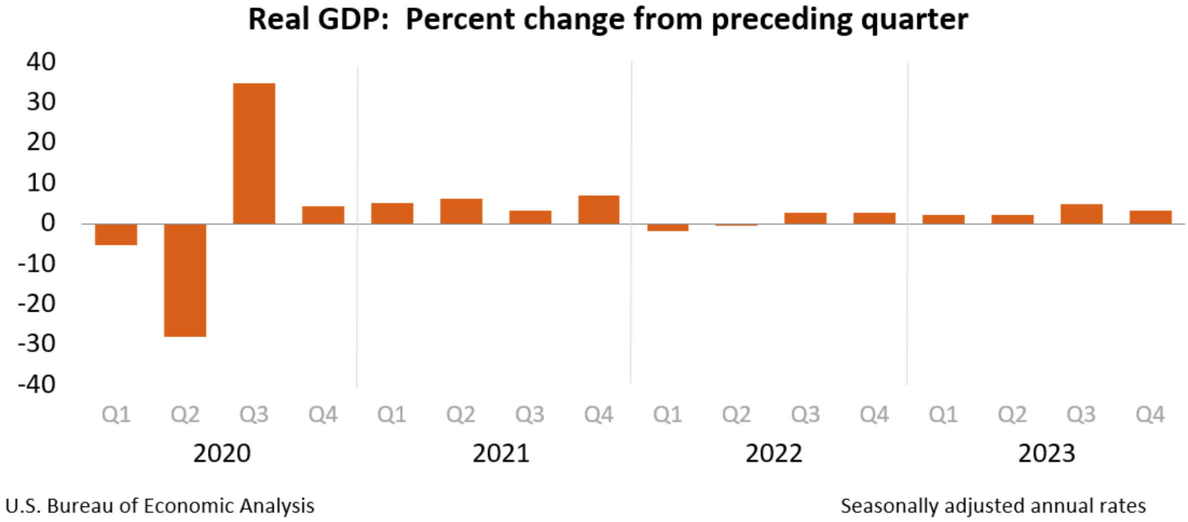
While inflation does appear to be trending down, as you’ll see in this economic update, the future ramifications of the immense costs associated with filling the infrastructure deficit make the downward trend of inflation in New Zealand rather hollow.

If transformative proposals don’t materialise within the next or two, then we are in for a prolonged period of painful cost increases and infrastructure woes.

And with that, let's crack into our monthly tour of the global economy.

United States

US GDP data for Q4 2023 demonstrated continued economic growth. Between Q4 2022 and Q4 2023, economic growth increased by 3.3% (where is the recession!?).

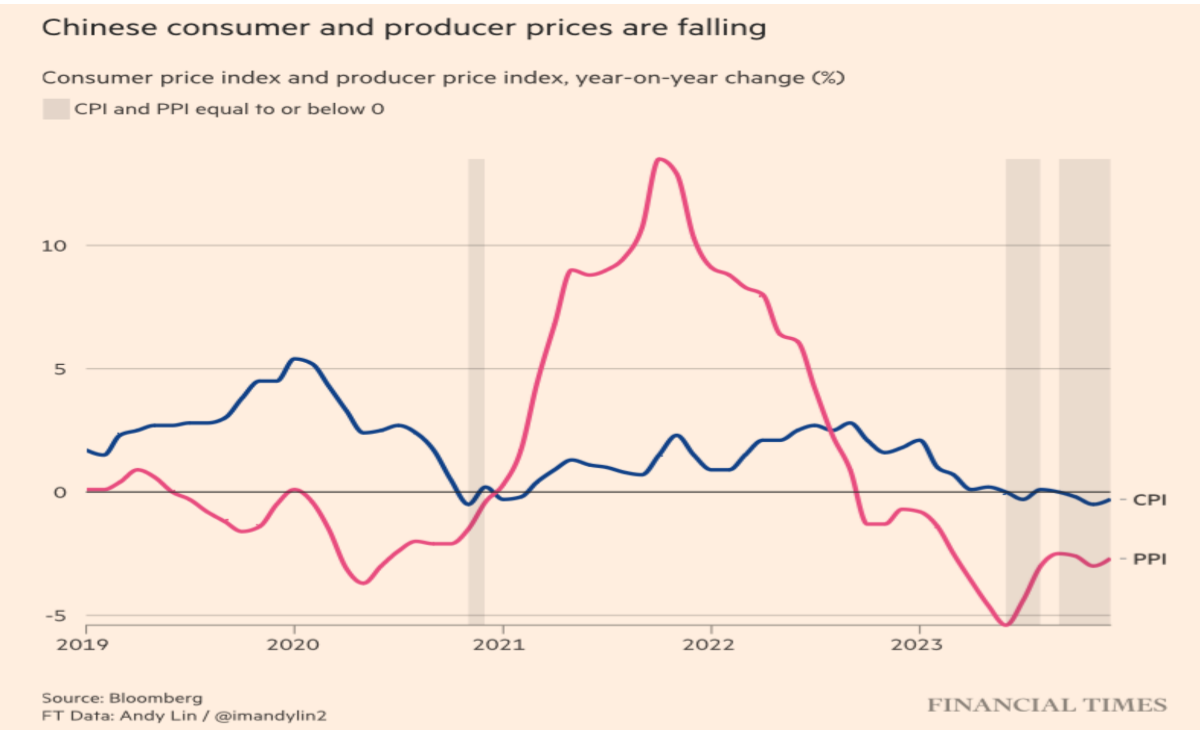


The graph above depicts quarterly GDP growth from Q12020 to Q42023.

Note that this data is an advance estimate and is therefore likely to change. However, this will give policymakers (especially those situated in the Eccles Building – the headquarters of the Federal Reserve) some breathing space in their near-term decision-making.

China

The Chinese economy continues to demonstrate a significant deflationary bias.



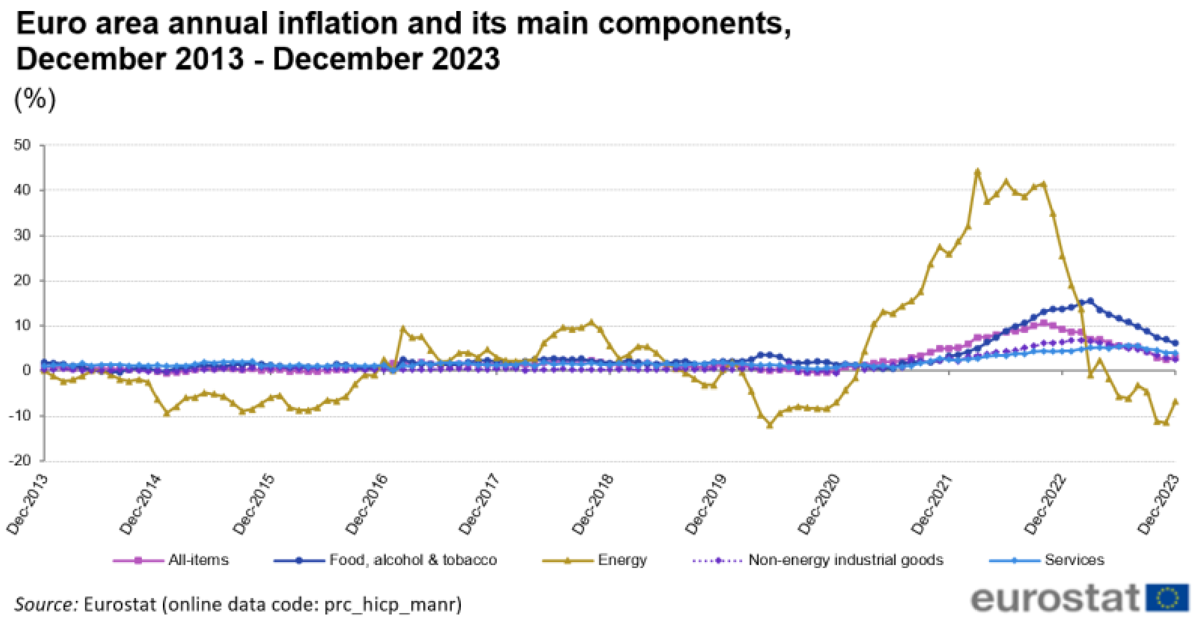
The graph above depicts the CPI and PPI within China between 2019 and the present day.

Deflation is, rather obviously, at odds with other economies globally. It is interesting to see these price dynamics emerge given the Chinese response to COVID-19, woes within the real estate market, and the apparent credit slowdown. Worth keeping a close eye on over the next few months.

Euro Area

Interest rates in the Euro Area remained unchanged.

Based on its current assessment, the Governing Council of the European Central Bank (ECB) noted that it 'considers that the key ECB interest rates are at levels that, maintained for a sufficiently long duration, will make a substantial contribution to [returning inflation to the 2% midpoint]'.

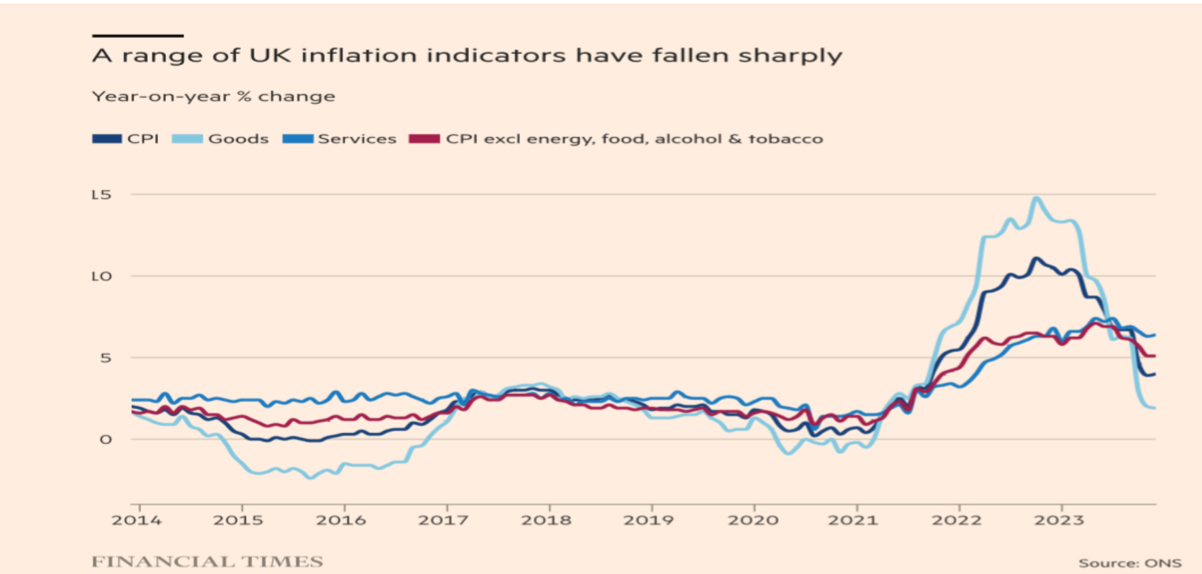


The graph above depicts Euro Area inflation and its key components.

It looks like there is little upside risk to Euro Area interest rates at this point in time.

United Kingdom

The United Kingdom has demonstrated consistently declining price levels over the past few months. Do you remember the gas price graph that's been shown several times over the past few months? Well, that is certainly not as exciting anymore (thank goodness).



The graph above depicts year-on-year inflation indicators, sourced from the Financial Times.

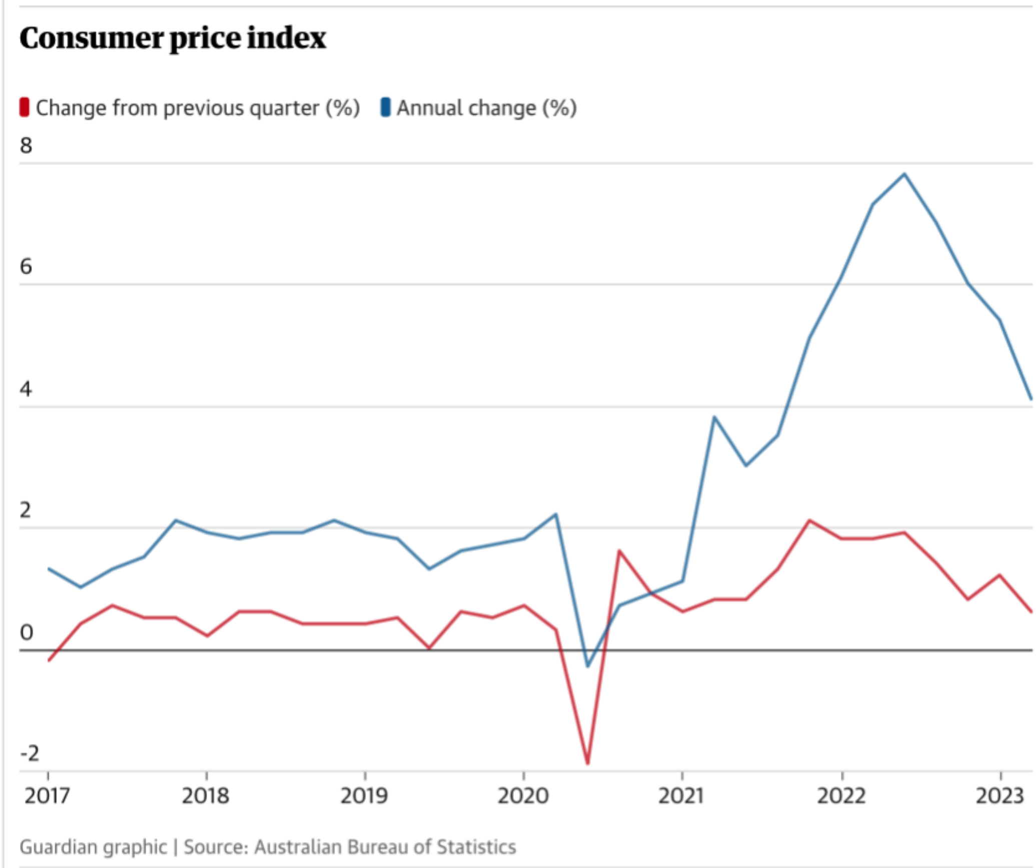
As widely expected, the Bank of England (BoE) held interest rates at 5.25% at its meeting on February 1, hinting that the next move could be down.

If inflation continues to decline, it will be interesting to see how long interest rates are kept at this level.

Australia

Australians will be very pleased at the higher-than-expected decline in inflation between Q3 and Q4 2023.

However, this is offset by trepidation over how the Reserve Bank of Australia (RBA) will respond to these latest figures.

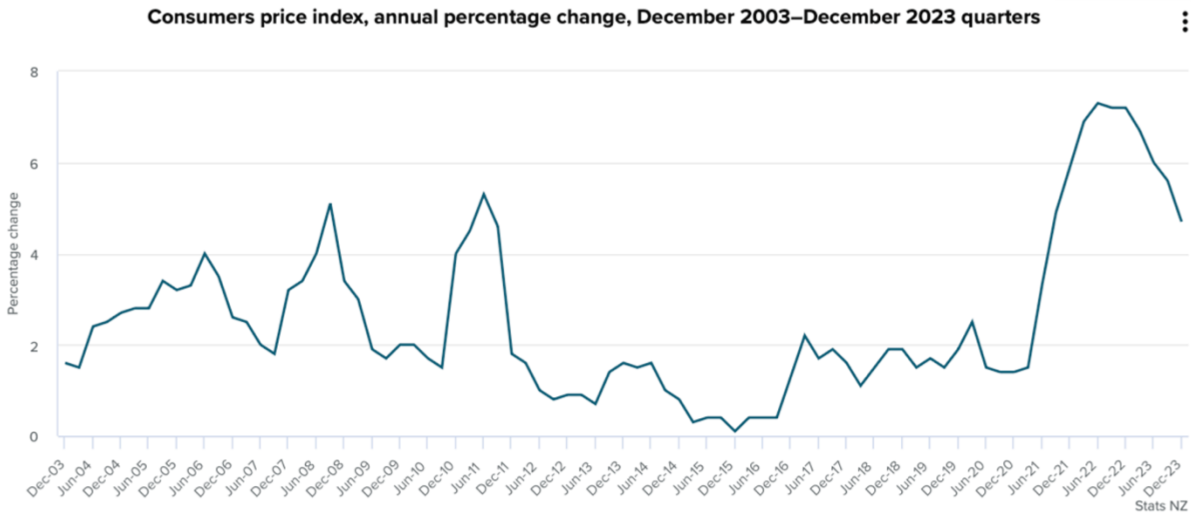


The graph above depicts both annual and quarterly changes in inflation from 2017 to the end of 2023.

While the continued downward trend in inflation bodes well for inflation expectations, the ever-present *ideological* link between interest rates and inflation, as well as previous ‘hawkish’ RBA sentiment clouds the prediction of what future interest rate decisions may hold.

New Zealand

Annual inflation between the December quarter of 2022-2023 has slowed to 4.7%. This is compared to 5.6% between the September 2022-2023 quarter.



This graph depicts the annual change in CPI for New Zealand.

From this, *perhaps* we can interpret that inflation is starting to come down to the RBNZ's target range. BUT, it is early days yet. Also, it is worth noting that there will be a great deal of antagonism between perceived levels of inflation and the steadfastness of central bankers in lowering interest rates.

In Conclusion

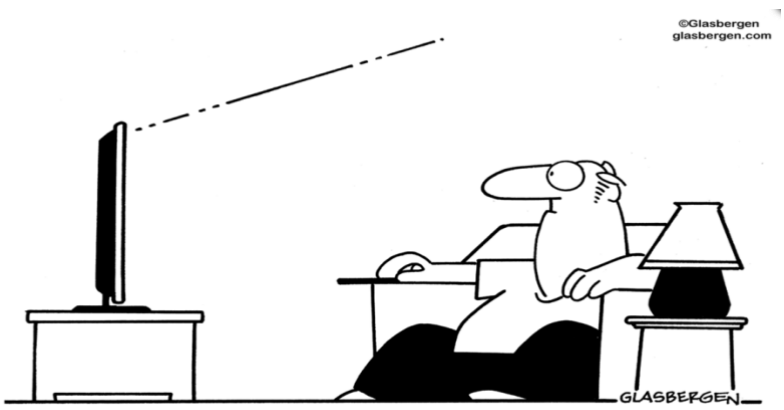
While price pressures appear to be easing more consistently, it continues to remain unclear as to how long central bank interest rates will remain elevated.

The continued antagonism between (potentially) declining inflation and elevated interest rates will likely continue well into 2024.

Recall that the link between interest rates and inflation is more ideological than empirical. There still may be some changes in inflation, evidenced primarily by the impacts of attacks by Houthi Rebels on shipping in the Red Sea.

As we have seen with the Ukraine War, the global economy has become somewhat resilient to oil price shocks.

Until next month!



"Marijuana officially became legal today. In reaction to the news, Wall Street soared to an all-time high."

Cartoon from Toonfinder.com

information about The Money M – A – T – R – I -X programme other services and products, please telephone 03 375 7001, fax 03 386 0686 or email admin@wiseplanning.co.nz

 The views and opinions expressed are those of the author, and are not necessarily those of WISEplanning, and are not intended to be a personalised service for an individual retail client. The views and opinions are general in nature and may not be relevant to an individual's circumstances. Before making any investment, insurance or other financial decisions, you should consult a professional financial adviser for personalised advice.

Any calculated projections or any predictions given by me to you are not guaranteed and are merely an expression of opinion and are intended for illustration purposes only.

Product performance can vary over time. The payment of a particular rate of return and the repayment of your capital is not guaranteed by myself, the company or any of its officers, Historical information and performance may not necessarily be a good guide to future performance.

While every care has been taken to supply accurate information, errors and omissions may occur. Accordingly, WISEplanning accepts no responsibility for any loss caused as a result of any person relying on the information supplied.

Any mention of Warren Buffett or other successful investors is not intended to mislead anyone to think that WISEplanning or clients of WISEplanning will be as successful as Warren Buffet and other successful investors.

Click here to view our Disclosure