Investment Newsletter – February 2024

Mixed company results amid investor anticipation for rate cuts

Welcome to the February 2024 letter.

Unremarkable reporting season

February is the month when ASX-listed companies report their half-year and/or full-year results for the period ending 31 December of the prior year. Roughly half of the listed companies have reported their results so far. Approximately half of these reported results positively surprised the market, while a third reported an underwhelming result, and 20% were in line with expectations. The number of earnings misses and beats is more or less balanced with long-term trends.

The key theme arising from the current reporting season so far is that companies with earnings dependent on the domestic consumer are either holding up well or at least exceeding downbeat expectations by managing their costs and holding profit margins (money that sticks to the hand) in a weaker sales environment. This explains why, despite JB HIFI delivering a revenue and profit decline of 2% and 20% respectively, its share price still rallied 7% on announcement, as clearly the market was expecting much worse. More impressively, the market decided to reward the company with a record share price. While others, such as Wesfarmers, are experiencing revenue increases by delivering value-oriented products and services that address consumers' need for managing the high cost of living—think Kmart!

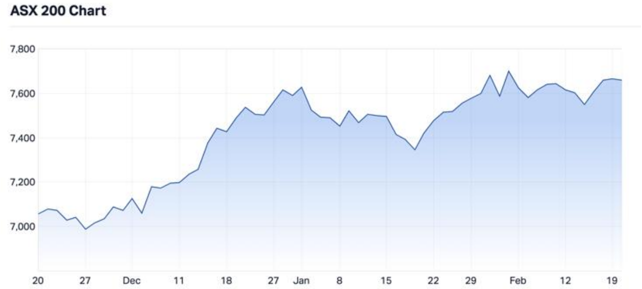
The best-performing sectors through these results have been those that were previously most fearful of high-interest rates and a recession, namely the consumer discretionary, IT, and industrials sectors. Energy and Materials delivered the big profit misses. Pleasingly, more than half the companies so far have increased their dividends, funded from cost savings and generally well-capitalized balance sheets.

In the US, about two-fifths of S&P 500 companies have now reported December quarter earnings, and 78% of them have delivered better than expected results.

Directionless Market

As you can see in the chart below, so far, the overall net impact of this reporting season has not been much despite some individual impressive results. Suffice to say investors are still assessing the overall direction of the market in 2024 while they take these latest company results in their stride.

Figure 1: Market's been directionless in this reporting season

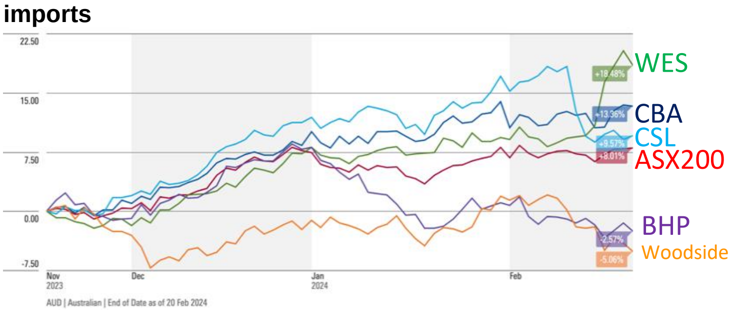


The direction of the market over the short term is not primarily driven by earnings as much as the interest rates, it appears. We have written more on this topic in the back article. The market rally from November 2023 to January 2024 (+9%) was driven by expectations of slowing inflation and the potential for interest rate cuts in 2024. Equity markets are now expecting more rate cuts than what the central banks have hinted, so we shall continue to watch this drama play out as elevated volatility in 2024.

As for corporate earnings in 2024 and their impact, our sense is that so long as the economy ticks along, albeit in a lower gear in 2024 with employment largely intact, then corporate profits should continue to print in pluses and minuses without significantly impacting the market based on earnings. The earnings trajectory in 2024 could well be in a narrow range, giving us hope for the all-important dividends to be well supported this year, which is not an insignificant consideration for many of our clients.

Below, we have showcased the bellwether consumer stocks and provided their result synopses for readers to understand why their shares have rallied, as depicted in Figure 2.

Figure 2: The past three-month rally was in consumer stocks while energy & materials lagged on soft China imports



Commonwealth Bank

Commonwealth Bank's share price hit a record high as investors gave its management the thumbs up for keeping the profits ticking along and delivering a 2% increase to the dividend despite the challenging operating environment for the bank. CBA's chief executive officer thinks the economy will slow down gently and although some people are falling behind on their home loans, it's not as bad as it was before the pandemic. However, the bank is preparing for things to possibly get worse, so they're putting aside more money just in case. The CEO said that they'll be careful about risk in writing loans, but they'll still try to grow.

CSL

Despite a setback in the development of their heart attack treatment, which led to a slight pullback in the share price on the reporting day, CSL's CEO remains optimistic about the company's future. He emphasized the valuable lessons learned from the trial, which will contribute to improved trial execution in the future. Apart from that, CSL reported impressive financial results for the half-year, with revenue increasing by 11% and net profit soaring by 20%. The overall performance was in line with market projections. The CEO also expressed enthusiasm about the increasing role of AI in enhancing productivity within the company.

Wesfarmers

Wesfarmers CEO Rob Scott is optimistic about the company's performance, expecting shoppers to continue seeking value despite inflation. The success of Kmart's budget home brand, Anko, has contributed to a 3% rise in net profit to $1.4 billion for the half-year. Kmart's record-high earnings of $601 million, driven by the popularity of the Anko range, reflect strong consumer demand. Bunnings' focus on affordable products has also paid off, leading to increased sales and foot traffic. Wesfarmers remains upbeat about its future prospects. Analysts have praised the company's strong results and effective cost control measures.

GLOBAL MARKETS OVERVIEW

	Units	Month End Value	Price Performance (% Chg) 1-day	1-mth	6-mths	1-year
Developed Markets Equities						
ASX 200	AUD	7,681	1.06%	1.18%	3.65%	2.73%
ASX 200 Futures	AUD	7,643	1.00%	0.76%	4.18%	4.64%
Dow Jones	USD	38,150	-0.82%	1.22%	7.29%	11.92%
S&P 500	USD	4,846	-1.61%	1.59%	5.59%	18.86%
Stoxx Europe 600	EUR	486	0.01%	1.39%	3.04%	7.16%
FTSE 100 (UK)	GBP	7,631	-0.47%	-1.33%	-0.89%	-1.82%
DAX (Germany)	EUR	16,904	-0.40%	0.91%	2.78%	11.74%
CAC (France)	EUR	7,657	-0.27%	1.51%	2.12%	8.11%
Nikkei 225	JPY	36,287	0.61%	8.43%	9.39%	32.79%
Emerging Markets Equities						
MSCI Emerging Markets	USD	976	-0.49%	-4.68%	-6.79%	-5.40%
Shanghai Composite	CNY	2,789	-1.48%	-6.27%	-15.27%	-14.35%
South Korea	KRW	2,497	-0.07%	-5.96%	-5.15%	2.97%
Taiwan	TWD	17,890	-0.80%	-0.23%	4.34%	17.19%
Brazil	BRL	127,752	0.28%	-4.79%	4.76%	12.63%
South Africa	ZAR	68,034	-0.10%	-3.49%	-7.60%	-7.35%
Foreign Exchange						
AUDUSD	Currency	0.6568	-0.51%	-3.58%	-2.22%	-6.90%
AUDGBP	Currency	0.5176	-0.43%	-3.26%	-1.10%	-9.61%
AUDEUR	Currency	0.6071	-0.28%	-1.64%	-0.61%	-6.53%
AUDCNY	Currency	4.73	-0.11%	-2.33%	-1.44%	-0.79%
Commodities						
LME ALUMINUM 3MO ($)	USD/mt	2,280	0.24%	-4.36%	-0.11%	-13.77%
LME COPPER 3MO ($)	USD/mt	8,609	-0.08%	0.58%	-2.53%	-6.66%
LME NICKEL 3MO ($)	USD/mt	16,269	-1.45%	-2.01%	-27.02%	-46.38%
SILVER FUTURE Mar24	USD/oz	23.17	-0.24%	-3.81%	-9.87%	-7.37%
ICE Newc Coal Fut Mar24	USD/mt	118.10	-1.99%	-10.50%	-21.27%	-49.98%
62% Import Fine Ore in USD	USD/t	129.47	0.00%	-1.77%	16.52%	9.84%
Gold Spot $/Oz	USD/oz	2,040	0.12%	-1.14%	3.79%	5.76%
WTI Oil	USD/bbl	75.85	-2.53%	5.58%	-3.82%	0.88%
Henry Hub	USD/mmBtu	2.19	-3.10%	-15.12%	-15.12%	-17.67%
Corn	USD/Bu	448.25	0.11%	-4.88%	-11.06%	-34.06%
Wheat	USD/Bu	595.25	-1.69%	-5.21%	-10.59%	-21.81%
Fixed Interest						
10-Yr Bond Yield						
Australia	AUD	4.01%	-0.13%	+0.06%	-0.05%	+0.46%
US	USD	3.91%	-0.12%	+0.03%	-0.05%	+0.41%
Germany	EUR	2.17%	-0.10%	+0.14%	-0.33%	-0.12%
Japan	JPY	0.73%	+0.02%	+0.12%	+0.12%	+0.24%
Italy	EUR	3.73%	-0.07%	+0.03%	-0.37%	-0.43%
Australian Rates						
Cash Rate	AUD	4.35%	+0.00%	+0.00%	+0.25%	+1.25%
90-Day BBSW	AUD	4.33%	-0.02%	-0.03%	+0.05%	+0.99%
180-Day BBSW	AUD	4.39%	-0.05%	-0.06%	-0.28%	+0.71%
CBOE Options						
CBOE VIX (Volatility Index)	Index	14.35	7.81%	15.26%	5.28%	-26.03%

Data as of 31 January 2024

ECONOMIC NEWS

• **In Australia** – The RBA left the cash rate unchanged at 4.35%. Inflation slowed down in the last few months of 2023. Prices went up by 4.1% compared to the previous year, and producer prices increased by 0.9% from the previous quarter. Consumer confidence went down in January because more people are feeling pessimistic about the economy. This is likely because interest rates went up quickly, making people worried about their finances.

• **In US** - The Federal Reserve kept its benchmark interest rate steady at 5.25-5.5% for the fourth consecutive meeting. However, they made notable changes to their statement, removing the description of the banking system as 'sound and resilient' and warning that tighter credit conditions could drag on the economy. Jerome Powell, the Fed Chair, stated that it's unlikely the bank will lower rates in March.

According to the Fed's Beige Book survey, strong consumer spending has been a driving force for the US economy, compensating for weaknesses in sectors like manufacturing. Businesses have noticed a decrease in inflationary pressures as consumers become more price-sensitive, prompting retailers to narrow profit margins and resist suppliers' efforts to raise prices.
In January, employment saw a significant boost, adding 353,000 jobs, the highest increase in a year, while the unemployment rate held steady at 3.7% for the third consecutive month. Wage growth surged the most since March 2022, with average hourly earnings rising by 4.5% year-over-year and 0.6% month-over-month.

Consumer confidence reached its highest level since July 2021 in January, with both current conditions and expectations showing improvement. Year-ahead inflation expectations dropped to 2.9%, the lowest level since the end of 2020, while 5-to-10-year inflation expectations declined to 2.8%, a four-month low.

In January, factory activity hit a 15-month high, driven by strong growth in orders, although the prices-paid index indicated that materials costs rose for the first time since April. Business activity expanded the most in seven months, with service providers and manufacturers feeling more confident about future demand, particularly from domestic sources.

• **In China -** In 2023, the GDP grew by 5.2% compared to the previous year. However, several indicators related to home prices and property spending were disappointing. Deflation persisted, as the GDP deflator, which measures overall price changes in the economy, saw its longest streak of quarterly declines since 1999, despite efforts to combat it.

Chinese Premier Li Qiang indicated that Beijing wouldn't rely on massive stimulus measures to boost growth. Profits at large Chinese industrial companies fell by 2.3% year-over-year in 2023, reflecting widespread challenges due to falling prices and weak demand both domestically and internationally.

Foreign direct investment in China dropped by 8% year-over-year to 1.1 trillion yuan, reaching the lowest level in three years. Factory activity shrank again in January, as modest improvements in foreign demand couldn't offset poor domestic sentiment.

China's home sales continued to decline sharply in January, with the value of new sales from the largest real estate companies dropping by 34.2% year-over-year to 235 billion yuan.

• **In Europe -** The euro zone unexpectedly avoided the first recession since the pandemic in second half 2023 with GDP stagnating in December quarter 2023, dodging a two-quarter downturn once again by the slimmest of margins following the -0.1% decline in September quarter 2023, as firmer growth in Italy and Spain offset the malaise in Germany. Inflation eased less than anticipated in January with CPI rising +2.8% y/y and core-CPI rising +3.3% y/y. Consumer confidence unexpectedly declined in January with European Commission warning the consumer confidence is scoring well below long-term average.

• **In India.** The Reserve Bank of India (RBI) has maintained its interest rates unchanged for five consecutive policy meetings. Governor Shaktikanta Das has emphasized a relatively cautious approach, stating that discussions about rate cuts are not even on the table. The Indian government has projected a GDP growth of 7.3% year-over-year for the fiscal year 2023-24, which is slightly faster than the RBI's projection of 7% year-over-year. The forecast includes growth rates of 1.8% year-over-year for agriculture, 8.1% year-over-year for mining, 6.5% year-over-year for manufacturing, 8.3% year-over-year for power and gas, 6.3% year-over-year for trade, hotels, transport, and telecom, 8.9% year-over-year for finance and real estate sectors, and 7.7% year-over-year for public administration and defence sectors.

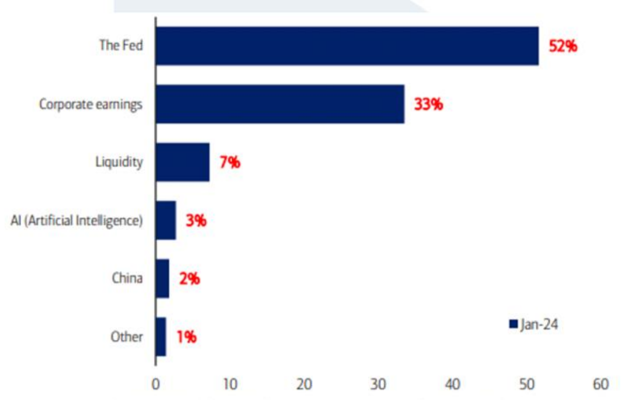
THE LONG READ

The Influence of the U.S. Federal Reserve on Global Markets

The decisions made by the U.S. Federal Reserve, a central bank, also commonly referred to as the U.S. Fed, hold immense significance for global markets. The impact is far-reaching due to several key factors as follows: the U.S. dollar serving as the global reserve currency essentially means that higher US interest rates causes l fewer dollars to move around in the global economy, which equals lower share prices near term and vice versa happens when interest rates are cut in the US, which triggers equity market rally. Additionally, the U.S. economy ranks as the largest and strongest globally, and the depth and liquidity of U.S. equity markets, which attract substantial investments from around the world.

It's no surprise then that many investment fund managers view the actions of the U.S. Fed as the primary driver of equity prices in 2024, as indicated by the Jan-2024 Fund Manager Survey conducted by Bank of America.

Figure 1: BofA FMS Survey – Most important driver of equity prices in 2024 (Jan)



Source: BofA Global Fund Manager Survey (January 2024 survey)

A striking example of the U.S. Fed's influence occurred in December 2023. During the Federal Open Market Committee (FOMC) meeting on December 13, the Fed chose to maintain the key interest rate but hinted at the possibility of three rate cuts in the calendar year 2024. This signalled a more accommodative stance, prompting a rally in markets. Notably, the Australian market experienced significant gains following the U.S. Fed's dovish pivot, despite showing little movement throughout the year until that point.

Figure 2: Key equity markets' price movements over calendar year 2023 (CY23)

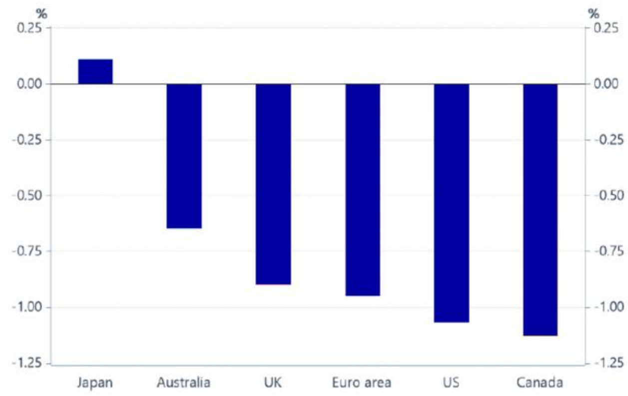
Price Change (%)	CY23 YTD to Nov-23	23-Dec	CY23	1H23	2H23
U.S. - S&P 500 Index	19.0%	4.4%	**24.2%**	15.9%	7.2%
Europe - STOXX Europe 600 Price Index	8.6%	3.8%	**12.7%**	8.7%	3.7%
Australia - S&P/ASX 200 Index	0.7%	7.1%	**7.8%**	2.3%	5.4%
U.K. - FTSE 100 Index	0.0%	3.8%	**3.8%**	1.1%	2.7%
EM - MSCI Emerging Markets Index	3.2%	3.7%	**7.0%**	3.5%	3.5%

Source: Banyantree, Bloomberg

However, there is a cautionary note regarding market expectations of rate cuts. While the U.S. Fed projected three rate cuts, the market anticipates more aggressive easing, with projections exceeding four cuts in the next 12 months. This discrepancy between market expectations and the Fed's guidance could lead to increased market volatility, especially if the Fed decides to deviate from the anticipated rate cuts, particularly if the economy experiences a "soft landing."

Looking beyond the U.S. Fed, other major central banks are also expected to cut rates over the next year, indicating a broader trend toward monetary easing among developed economies.

Figure 3: Projected policy rates – 12-mths ahead forecast less 3m ahead forecast



Source: Haver Analytics, Banyantree

Nevertheless, historical data suggests that the U.S. Fed may not be bound to follow the market's expectations. There have been instances in the past where the Fed resumed rate hikes after a prolonged pause in monetary policy. Should inflation accelerate significantly, the Fed could revise its stance, potentially surprising investors leading to a market sell off.

In summary, the influence of the U.S. Federal Reserve on global markets is undeniable, and its decisions will continue to be closely watched and analysedy investors worldwide.

For enquiries:

- geoff.walley@investwisely.co
- Phone (02) 9634 6698 (within Australia), or
- Write to:
  Investwisely Pty Ltd
  PO Box 6127
  Norwest NSW 2153