Economic and Market Commentary June Quarter 2023

Overview

Markets climbed higher over the June quarter, led by the tech sector.

Global equity markets bounced higher again in the June quarter. This was in part due to continued evidence of CPI inflation moderating, but mainly because larger cap tech stocks rallied on the prospect that they will see another surge in profitability as machine learning and related 'Artificial Intelligence (AI)' algorithms are integrated into their core products and services.

Market roundup

Global equities had the strongest returns, elsewhere performances were subdued.

Market performances are reported in Figure 1. International shares rallied strongly by around 7.5% in the June quarter, but elsewhere performances were more subdued. Australian and EM equities and global listed property increased a little over 1%, NZ equities rose around 0.5%, while bonds were flat to slightly declining, as was global infrastructure.

Over the year to June, performances are very strong for most equity markets, with global equities in NZD terms leading the pack being up 22%. This gain more than offsets the decline over 2022. However, in part this reflects that the NZ dollar also plummeted over 2022, and has not bounced back nearly as much. On a local currency basis global equities are still slightly below the peak levels they had at the end of 2021.

Global equities are now back around the peaks reached in 2021, but NZ equities and bonds still have ground to make up.

In contrast to global equities, NZ equities are still around 11% lower than their 2021 peak levels. Bonds have a similar amount of ground to recover given the large marked-to-market declines they suffered in 2022. The good news in this regard is that with running yields now around 6% for investment grade funds, and with inflation trending lower, we can reasonably expect this ground to be made up over the next year or two assuming that the macroeconomic picture evolves broadly in line with what is expected.

Reading the tea leaves

There is now little doubt that inflation rates and economic activity is declining both in New Zealand and globally. This is welcome news for central bankers trying to return CPI inflation back to their target levels, but cold comfort for almost everyone else. The key question remains have they done enough?

Central banks appears to have gotten on top of inflation, but it is too early to declare victory just yet.

Bond markets seem to think so. Interest rate yield curves are inverted, meaning that short term interest rates are higher than expectations of future short term rates. This is shown in Figure 2 for New Zealand, which is expected to be amongst the first countries to start cutting. Interest rates in one years' time are expected to be around 0.5% lower, and in 5 years' time over 1% lower. But bond markets, like macro economists, are not great at forecasting. The chart also shows that the level of the curve has jumped up from its levels of just one month ago. This reflects that while inflation is coming down 'core' inflation rates are still too high for central banks to declare victory just yet, and hence interest rates may stay higher for longer. Time will tell.

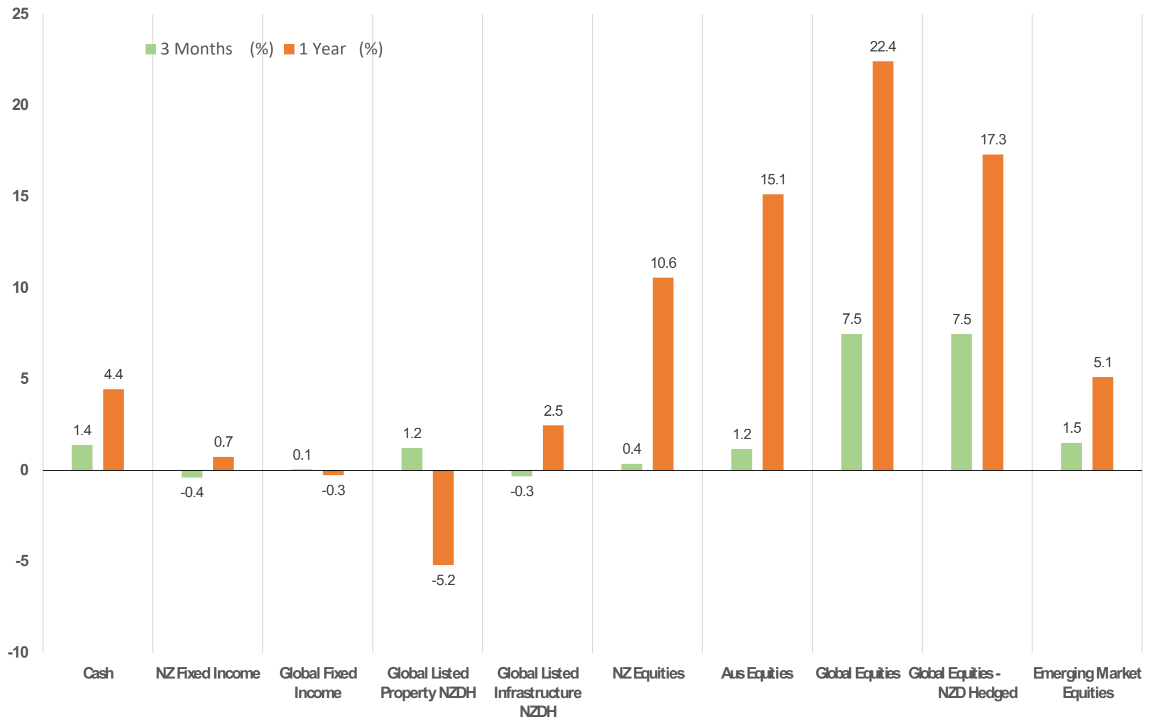
AI software advances are poised to unleash a surge in productivity.

Global geo-political risks around the Russian-Ukraine War, the tussle between the US and China, and now the divide between the so called BRICS and the West remain on the radar. As does the increasing severity of extreme weather events as climate change gathers pace.

But to end on a positive (probably) note, the AI tools rolling out across a range of applications do present a large upside potential to economic growth and productivity levels, and in that sense the surge in select tech stocks may not be all pie in the sky. Goldman Sachs[1] estimates that AI could lift global GDP by 7% and productivity by 15% over the next decade – a simply enormous gain of more than double average annual global GDP growth. While we should treat these estimates with a healthy grain of salt, it is also worth remembering that ultimately productivity is most of what propels livings standards and equity markets higher – as uncomfortable as they are at the time interest rate cycles and most other 'shocks' just cause blips along the way.

[1] https://www.goldmansachs.com/intelligence/pages/generative-ai-could-raise-global-gdp-by-7-percent.html

Figure 1: Global equities performed well, elsewhere was more subdued



Source: Morningstar Direct, MyFiduciary

Figure 2: Bond markets think the RBNZ has more than done enough