Economic and Market Commentary December Quarter 2024

Performances were mixed over the December quarter.

Following September's blow-out quarter, performances were mixed for December. Equities in general performed well but some interest rate sensitive asset classes suffered, and currency had a large impact on returns.

Differing macroeconomic conditions were the key driver of the performance differences. In the US, markets backed off the view that the Federal Reserve will slash interest rates over 2025 given ongoing strength in the US economy, and upside inflationary risks following Trump's election. In contrast, large cuts are still seen as necessary in New Zealand, Europe, China and most other countries given weak economic conditions.

Market roundup

Unhedged global equities performed very strongly, while EM and NZ equities also performed well.

The US dollar rallied strongly over the quarter against most currencies given the macroeconomic picture, including by over 11% versus the NZ dollar. As a consequence, while global equity returns at around 2% were respectable on a local currency (and NZD hedged basis), they were exceptionally strong at around 13% on an unhedged basis (see figure 1). This brought the annual return of global equities to just over 34% on an unhedged basis, and around 13.5% on a hedged basis. This performance was a reversal of fortune from the September quarter results, where NZD hedged returns were much stronger at around 30% in the year to September. While it is exceedingly difficult to forecast currency movements, we do know that portfolio risk is – in general – reduced by having exposure to both unhedged and hedged international equities.

Emerging markets performed reasonably well, rising 4.5% over the quarter, as did NZ equities which returned around 5.5%. In contrast, Australian and global small cap equities eked out a small positive return of around 0.5%, while global value stocks fell by around 2% on a local currency basis. Interest-rate sensitive listed property and infrastructure also struggled, with property falling by around 7.5% on an NZD hedged local currency basis.

Bond markets and real asset returns were soft, but gold and alternatives performed well.

Bond market performances were also mixed. New Zealand investment grade bonds increased 0.6% in the quarter, and around 5.3% over the year. International investment grade bond returns, which has a large weight on US bonds, were softer at around -1.2% in the quarter and 3% over the year. While the prospect of higher US inflation weighed on US bonds, this, and the greater geo-political tensions from Trump's election, boosted gold – yet again – to new records in NZD terms. The large swing in currency markets also favoured select trend following strategies and related 'alternatives'.

Finally, figure two shows that US equities have contributed almost all of the performance of global equities in 2024. Does this mean we should forget about other equity markets? No. In our feature this quarter we summarise some of the research findings from Elroy Dimson, Paul Marsh and Mike Stanton (DMS), three academics who have compiled what is regarded to be the best long term financial markets data going back to the early 1900s.

Their research shows massive shifts in both the country compositions and sectoral compositions of global equity markets looking back over time. At the beginning of the 20th Century the US constituted only around 15% of global market capitalisations, many emerging market exchanges didn't exist, and Western Europe and Russia accounted for around 75% of the global market. Today, the US dominates at over 60% and European country exchanges are in the low single digits. In 1900 railway stocks were around 60% of the US market and 45% of the UK stock market. Today they do not feature as a major sector in either country, whilst technology in particular has become a major sector.

Given all of these shifts it is tempting to think that allocating to sectors or countries that are on the rise could provide superior performances. But DMS caution against this. Their research suggests that, if anything, markets tend to over-price sectors on the rise, and investors would have been better off allocating to sectors on the wane. The allocation we make to equity funds that incorporate 'value' as a factor effectively replicates this. They typically underweight the in-favour expensive sectors and over-weight out of favour cheap sectors and stocks.

The same conclusion holds for countries. The US market has been exceptional, but so was Japan from post WW2 to the early 1990s where its market capitalisation topped out at 45% of the global market. From 1990 to 2023 Japan had the worst performing market and its global market cap weight is now only around 6%. This is not to say that the US market and tech stocks are necessarily in for a long period of under-performance like Japanese stocks. But it is a risk given the extraordinary run of the US market and its now large concentration in large cap technology stocks like Google, Nvidia and Apple. As mentioned, we guard against this risk by allocating globally with a bias to value and smaller cap stocks.

Figure 1 – Mixed performances in the December quarter

	3 Months (%)	1 Year (%)
Cash	1.1	5.5
NZ Fixed Income	0.8	10.4
Global Fixed Income	-1.2	3.0
Global Listed Prop NZDH	-7.5	3.5
Global Listed Infra NZDH	1.0	18.5
NZ Equities	5.6	12.2
Aus Equites	0.6	14.6
Global Equities	13.4	34.1
Global Equities NZDH	1.9	21.5
Emerging Market Equities	4.5	21.5

Figure 2: The US rules the roost