

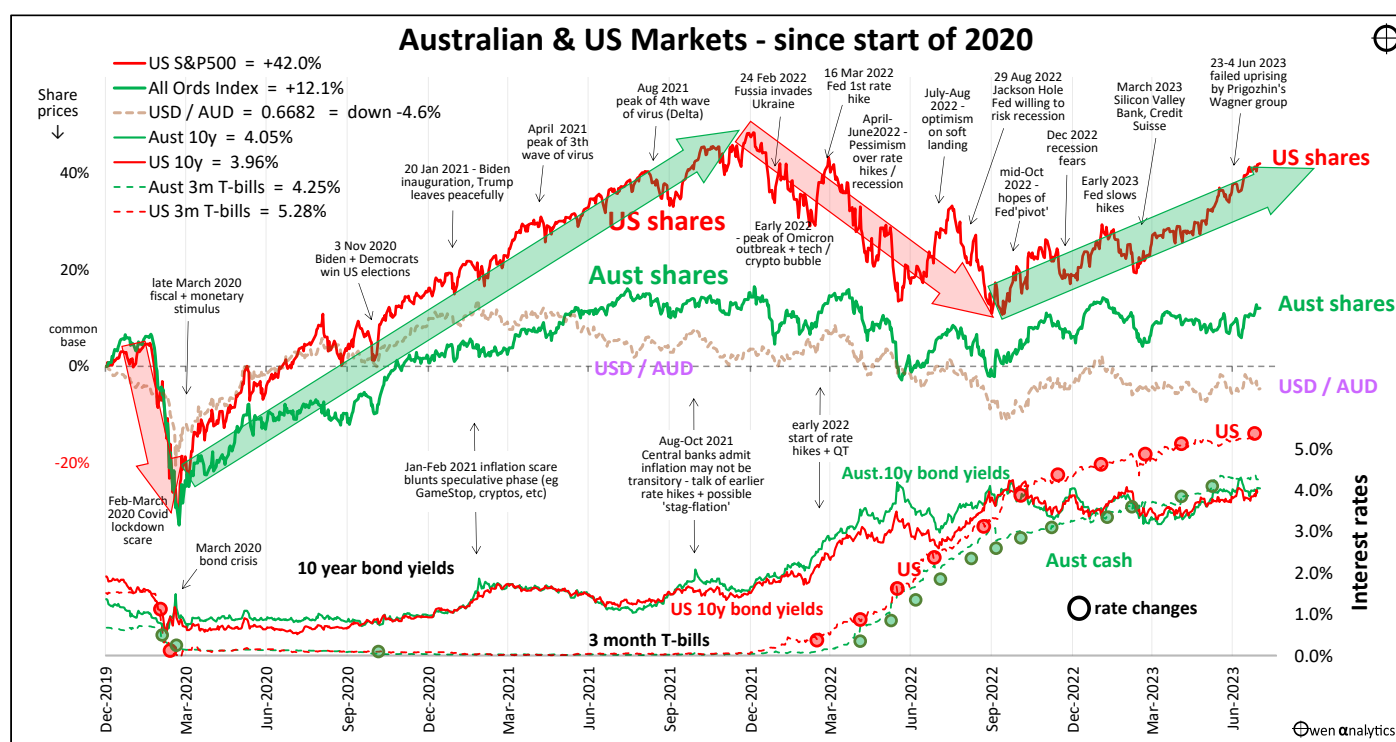


## Ashley Owen's Market Monitor – end July 2023: 'Are you feeling lucky?'

Share markets are surging back toward their 2021 covid stimulus tech-bubble peaks! After a dozen rate hikes, inflation is easing, rate hikes are slowing, jobs & wages remain strong. What's not to like? (Well, Profit outlooks and Pricing, for a start!)

Since the beginning of 2020 (the end of the 'pre-Covid' era – remember that?) there have been four phases for financial markets: collapse – rebound – collapse – rebound. How long will the current rebound stage last? As [Dirty Harry](#) said in 1971: "You've got to ask yourself one question: 'Do I feel lucky?' Well, do you....?"

Here are the four phases. The upper section of our quick snapshot chart shows Australian shares (All Ordinaries index in green) and US shares (S&P500 index in red). US shares are powering global stock markets back toward their January 2022 peaks. (Australia's tech cycles are more muted than the US as we only have a very small tech sector here). The lower section shows short term rates (dotted lines), bond yields (solid lines) and rate cuts/hikes (dots).



We will get to the four phases in a moment. But first, what happened in July (which is powering 'phase four').

### Economic growth – remaining relatively strong – 'hard landing' less likely

In particular, US growth posted a relatively strong 0.6% quarter, lifting annual growth to a healthy-ish 2.6% for the year to June (up from 1.9% pa for the year to March, and a very weak 0.9% for the year to December 2022). On the other hand, China reported June quarter GDP up 0.8% for the quarter (down from 2.2% for the March quarter). The grand (and very late) Chinese re-opening in 2023 has clearly stalled. The positive news is that Xi Jinping announced new stimulus measures to boost consumer spending. (If history is any guide, that will not work, so they will just revert to plan A: boost infrastructure spending instead – a quick sugar hit for our rock diggers!)

### Inflation – easing everywhere – rate hikes are working!

In Australia, inflation is down to 6% pa, but the quarterly rate is down to 0.9%. Better, but still above the 2-3% pa target range. US inflation is down to 3% pa, with just 0.2% in June. Core inflation was also just 0.2% in June, better than expected. UK inflation is down to 'just' 7.9% pa, but only a very low 0.1% monthly rate. In Japan, inflation is up (which is good for Japan given its deflationary problems!) to 3.3% pa for June, but a monthly rate of just 0.2%. Eurozone inflation is down to 5.5%, with a monthly rate of 0.3%. All are going in the right direction. Job nearly done?

This is not just the rate hikes working, but also the easing of a raft of supply constraints (Covid restrictions, Russia, unrelated weather events) bringing down prices and feeding through to lower inflation rates.

#### Cash rates – rate hikes nearing an end (for this phase anyway)

Australia's RBA paused at its 4<sup>th</sup> July and 2<sup>nd</sup> August meetings, leaving cash rates at 4.1% after 12 hikes. The US Fed made its 11<sup>th</sup> hike on 26 July – up by +0.25% to a 5.25-5.5% range. Then on 27 July the European Central Bank raised the main deposit rate by +0.25% to 3.75%. Next day, the Bank of Japan kept cash at (-0.1%) and 10y bond yields at zero, but widened the band of bond yields, signalling it may allow yields to rise soon. In all cases, despite slowing hikes, central bankers still warn of inflationary pressures and further rate hikes ahead. Which brings us to. . .

#### Unemployment – the spanner in the works

The 'problem' (if you're a central banker, but try telling this to the unemployed!) is that jobs markets and wages are still too strong. Unemployment rates have fallen from 3.7% back to 3.6% in the US, and from 3.6% back to 3.5% in Australia. That's the wrong direction!! The RBA's incoming chief Michele Bullock would like to see unemployment rise to at least 4.5% to take pressure off inflation. That could mean a few more rate hikes (and more mortgage stress) here yet. Rate hikes in Australia have been later, slower, and lower than in the US (see the rate hike dots on the chart), but all measures of inflation are still higher here.

The above factors combined to paint a relatively benign picture for financial markets – here is what they did in July:

#### Share markets continue to surge – across the board

The local Australian share market gained +3% for the month. The main contributors were the big banks, rising on the 'soft landing' scenario (except Macquarie was down on lower global deal flow). Fossil fuel producers were up on higher oil and coal prices (global soft landing), and speculative tech stocks were also up – lifted by the global A.I.-inspired tech boom.

Global share markets were also up +3% in July. The best gains were by Nvidia, Adobe, Facebook, Alphabet/Google – on encouraging earnings outlooks. All global sectors were up across the board (including Healthcare – just. Healthcare has been the global laggard this year). It is the first time we've had two straight months of across the board gains all global sectors since November-December 2022, which was in the middle of the Covid lockdowns. All major countries up for the month, across 'developed' and 'emerging' markets.

#### Commodities

Share prices of fossil fuel producers were lifted by higher oil and coal prices, on lessening fears of hard landings. That, plus signs of more stimulus in China, lifted prices of most industrial metals, although iron ore was down a little, and lithium is still deflating from its recent bubble. Gold also rose +3%, recovering the prior month's decline.

#### Currencies

In July, the AUD rose a little against the USD (the usual pattern in share rallies), but fell against everything else, especially a stronger Yen. The US dollar fell back further (also the usual pattern in share rallies). The chart shows the AUD in its usual element – as a 'risk' currency that rises and falls with share markets.

Now to the issue of the four market phases, and what has been driving them -

#### Phase 1 – start of 2020 to 23 March 2020 – Covid lockdown sell-off

Covid lockdowns triggered sharp sell-offs in share markets everywhere (eg Australia down -37%, US down -34%), as governments suddenly and unilaterally locked people in their homes and shut down virtually all economic, social, and physical activity. Countries everywhere posted their deepest and steepest economic recessions since the 1930s Great Depression. Central banks cut rates to zero and propped up faltering bond markets.

#### Phase 2 – 23 March 2020 to the start of 2022 – strong rebound

Share prices rebounded strongly, driven by massive global stimulus – both 'monetary' (zero interest rates, central bank bond buying, ultra-cheap loan programs, money-printing), and 'fiscal' (governments everywhere running up wartime-like deficits and wartime-like debts to throw free money at anything and everything). People everywhere threw this free money, plus cheap borrowed money, at any and every crazy, speculative idea, whether or not it had any prospect of making a profit (who needs profits when money is free?). The floods of free money lifted prices of all assets, including things and non-things that weren't even assets.

Governments and central banks ignored rising inflation and kept doling out free money.

### A quick 'Fact Check' on inflation – for the benefit of central bankers and governments

Central bankers and governments conveniently blame Russia (or 'problems overseas') for the inflation problem they themselves created with their lockdowns, spending sprees and money-printing. True, Russia made it worse, but it was certainly not the cause. Here are the facts –

CPI Inflation was already running out of control by the end of 2021, which was BEFORE Russia invaded Ukraine (February 2022). But by December 2021, inflation in the US was already running at 7.4% pa (and annualised quarterly rate of 9.8% pa). In the UK it was running at 5.4% pa (and an annualised quarterly rate of 9.4% pa). In Australia, inflation was running at 3.5% pa (and an annualised quarterly rate of 5% pa). All of these were well above target ranges already, and central bankers completely ignored them. Nothing to do with Russia.

(It is the same with the 1970s inflation – central bankers and government still routinely blame the oil shocks of 1973 and 1979, but inflation was already running high well before the oil shocks, not because of them! Introspection and self-assessment are not strong points with central bankers and governments).

### Phase 3 – start of 2022 to mid-October 2022 – sharp sell-off



Central banks finally woke up to inflation and started aggressive rate hikes to try to rein in inflation caused by the tidal waves of free money (duh!). Speculators and investors dumped shares and bonds, fearing economic 'hard landings' (deep recessions and deep cuts to profits and dividends), if central banks went too hard and too far with rate hikes. Share markets fell back sharply (but not to Covid sell-off levels), and bond markets posted their worst losses in a century.

### Phase 4 – mid-October 2022 to now – strong rebound



The key to the turnaround from sell-off to rebound in October 2022 was the shift from steep rate hikes to shallower rate hikes (the dots in the lower right of the chart). In the current rebound phase - bond yields have been flat (factoring in a combination of 'sticky' inflation and weak economic growth), but share prices have surged. True, most of the overall rise has been due to just a handful of US tech/online stocks (Apple, Microsoft, Nvidia, Adobe, Amazon, Tesla, Alphabet/Google, Meta/Facebook), but all share market sectors are up, virtually across the board, and virtually everywhere.

Company revenues and profits have been supported by strong spending, which has held up well despite the rate hikes. However, households having been partially neutralising the impact of the rate hikes by running down their mountains of cash from the Covid spending sprees. This will run out in time.

### Questions to tackle – mainly Profits and Pricing

Profit outlooks are very bullish – and not just for the tech stars. Investors in aggregate are currently assuming global profits will surge in the coming year (ie a 'soft landing' at worst).

Second, the pricing of those already bullish profit outlooks ('how much am I paying per dollar of future profits') also appears very stretched.

Although [shocks](#) often come out of the blue, the most likely candidate to trigger a sudden mass re- rethink on pricing (ie trigger the next collapse) would be further rate hikes. [How many more rate hikes](#) are going to be needed to keep inflation at target levels? Will central bankers go soft and settle for higher than target inflation to avoid deep recessions? Are governments going to be willing and able to ramp up spending and [borrowing](#) again like they did in Covid?

We cover these issues and more in the coming days. Stay tuned!



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