PERSONAL INVESTMENT CENTRE
FINANCIAL PLANNERS AND INVESTMENT ADVISERS

Economic Commentary

14th November 2024

Share markets	Performance – NZD	
	3m	12m
NZX 50 (NZ)	1.9%	17.5%
ASX 200 (Aus)	2.4%	26.3%
S&P 500 (USA)	3.4%	34.7%

Interest Rates	10-yr Govt Bonds	
	Oct 24	12m ago
NZ	4.50%	5.53%
US	4.28%	4.85%

Markets have bounced up and down over recent months as some nervousness has taken hold, but overall portfolio returns are in the black for the quarter. Both the NZ Reserve Bank and the US Federal Reserve have begun reducing Official Cash Rates, which is the start of what we expect to be an ongoing cycle of cuts over the next 12 months or so. This is against very different economic backdrops, with the US economy continuing to do well whilst NZ remains in a deep slump. Generally, a declining interest rate environment is positive for portfolios, helping sharemarket performance and bond prices. The US election produced a clear result, and we now await the implications for markets and the global economy as President Trump's policy agenda is rolled out. As always, there will no doubt be a mixture of good and bad, although perhaps with a little more volatility along the way.

NZ inflation is now back within the target bank of 1-3%, falling to a headline figure of 2.2% for the September quarter. After a long period of significant price increases, this is something of a relief! Even so, many of the unavoidable costs which households face continue to rise at well above this rate, including rates and insurances. It seems that earlier in the year the Reserve Bank seriously underestimated the weakness in the NZ economy, which on a per capita basis has contracted more over the last year or two than during the Global Financial Crisis in 2008. After cutting in August, the RBNZ followed up with a 0.50% cut on 9th October, bringing the OCR down to its current level of 4.75%. Expectations are that there will be a further reduction of another 0.50% at their last meeting for the year in November. The projections are now for the OCR to come back to a neutral position of 3.5% over the next year or so. This would likely bring 12-month term deposit rates back to perhaps under 4.0% over that time.

We generally believe that the actions of the Bank since the Covid outbreak at the beginning of 2020 have served to increase the volatility of the economic cycle, rather than smooth it as should be the case. The use of the OCR as a tool is designed to keep inflation under control and moderate cycles. When the economy is struggling, reducing the OCR provides stimulus through lower borrowing costs. To avoid inflation picking up when the economy is strong, increasing the OCR is intended to slow things up and take the heat out by reducing demand for goods and services. Although the Covid pandemic was unprecedented, and the initial measures taken (reduction of the OCR to 0.25% and the printing of billions of dollars) to prevent the economy collapsing were clearly necessary, it is now apparent that rates were kept too low for too long, leading inflation to blow out. The increase in the OCR from 0.25% to 5.5% between October 2021 and May 2023 to combat this inflation has caused the NZ economy to fall into a deep hole. We have to wonder whether inflation could have been brought under control without pushing rates up to 5.5%, a level which has caused a lot of collateral damage. *As a side note, plenty of people will remember much higher rates in the 70s and 80s. The difference then was that house prices relative to incomes were much lower and as a result the level of overall debt in the economy was much lower.*

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The US election is now behind us and despite predictions that it would be one of the closest in modern history, President-elect Trump and the Republican party swept to a very convincing victory. After all of the rhetoric, bluster, abuse, and absurdity, it is a relief to be able to put aside the personalities and actually consider the important issues of policy. From an economic perspective, it is widely expected that Trump's agenda will involve higher levels of US government spending and lower taxes, which will put upward pressure on inflation and interest rates. With massive budget deficits and spiralling government debt, the US fiscal position will deteriorate further. On the trade side, Trump has proposed significant increases in tariffs, around 10-20% across the board and over 50% on goods from China. If implemented as stated (which does seem unlikely), these would be the highest since the 1930s and stoke inflation, as tariffs are ultimately passed through to consumers in higher prices. The overall trend is toward protectionism and deglobalisation. We have already seen US wholesale interest rates spike, with the 10-year government bond moving from 3.60% in September to around 4.45% lately. On the sharemarket side, these policies will have an uneven effect, being positive for some sectors and companies while hurting others. So far, US sharemarkets have reacted positively, rising strongly since the election result.

We'll continue to tweak portfolios as needed to ensure that they remain aligned with current conditions and that the composition of holdings is optimal. In general, we're comfortable that the fund managers that we use for sharemarket exposure remain best of breed in their respective areas, but continually evaluate this in conjunction with our colleagues in our wider group and the independent consultants we collectively employ. There are always risks and challenges in the global environment from conflicts, pandemics, elections, politicians etc, and markets are continually "climbing a wall of worry". That has always been the case and always will be. Ultimately, it is economic fundamentals such as company performance, interest rates, and inflation that drive returns, rather than the comparatively short-term effects of political trends and "culture wars".

Links of Interest this Month:

- **Why I'm a perma-bull on stocks (firstlinks.com.au)**
- **The challenges of building a portfolio from scratch (firstlinks.com.au)**
- **How to Think About Risk with Howard Marks (oaktreecapital.com)**
- **US election implications for investors and Australia (firstlinks.com.au)**