

Is a soft landing on the cards? The December 2023 Quarterly Market Update

By Perpetual Wealth Management

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The December 2023 Perpetual Private Quarterly Market Update looks at the factors influencing global monetary policy and what they could mean for markets in 2024. You can watch the video above, download our full report, or read our concise review below.

Please note: except where otherwise noted or quoted, the views in this article are those of Perpetual Private's Investment Research Team.

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December Quarter 2023: What happened?

- Markets were surprisingly robust throughout 2023 and global economies managed to avoid the recession that many commentators expected. Despite this strength, we still believe a short, shallow recession in the year ahead is possible.
- Local share markets finished the year up 8% with global markets delivering similarly impressive returns of 5%. Higher interest rate expectations also helped push U.S. 10-year bond yields to their highest levels since 2007, before inflation optimism drove them back down as we came through November and December.

- Fixed income assets broadly, are delivering better yields with higher cash rates providing a floor for income producing assets.
- Geopolitical conditions deteriorated throughout the year, however neither Russia's invasion of Ukraine nor the ongoing Israel-Gaza conflict have had a significant medium-term impact on markets. The likelihood of additional regional conflicts flaring up in 2024 may briefly drive a spike in volatility but this is unlikely to have lasting impact.

Despite much consternation, 2023 proved to be a surprisingly good year for markets. Early predictions of recession failed to crystalise, tighter monetary policy improved income yields for many assets, and a rally in AI-linked tech stocks drove markets and bolstered sentiment.

The December quarter marked a strong finish to an unusual year, with Australian stocks generating more than 12% over 12 months. Global stock markets also generated an impressive 21%.

While that's certainly a nice note to end the year on, it's by no means the whole story. Although the quarter was generally positive, there were significant gaps between the market winners and losers. In Australia, listed property gained 16.5% while energy stocks lost 8%. A similar story played out in global markets, where listed property gained 9% while energy lost 8%.

Soft landings are hard to come by

Investors widely expected to endure a recession in 2023, but the Australian economy proved surprisingly robust and avoided that fate. Some investors are even now talking about a 'soft landing', in which central bank policy manages to cool the economy without tipping into recession.

Looking at the data, we think the likelihood of a soft landing has certainly increased but remains unlikely. Soft landings are exceedingly rare, because the lag between rate rises and their impact is both long and variable, making it difficult for central bank governors to know when their policy changes have had the desired effect.

Our central case is for a short and shallow recession in the year ahead, driven by a drop off in consumer spending.

Let's explain that in some more detail. Typically, companies only lay off staff when their earnings are falling. Healthy consumer spending throughout 2023 supported corporate earnings and helped keep the economy ticking over. However, if consumer spending slows, some workers may face the prospect of losing their jobs, and these layoffs would have knock-on effects on consumer confidence.

For example, if just one person in a group of five friends loses their job, it may prompt the others to cut back on their spending, fearing that they too could find themselves out of work. Cutting back on spending would then likely hurt corporate earnings, leading to further layoffs, creating a cycle.

How fast this cycle spins determines how severe a recession could be. A small number of layoffs, prompting only a small cut in spending would be relatively benign – this is our core case. Although, if those layoffs cascade more quickly, we will start to see some genuine risks emerging.

Geopolitical tensions flare

In the past several years, markets have seen a gradual reversal of the globalisation we've enjoyed since the end of World War II. This has led to some rising tension between geopolitical players – an issue that's being exacerbated by the rise of new and future economic superpowers such as China and India.

Fractures are starting to appear between countries and those rifts can affect trade relationships, increasing the chance of conflict and tougher market conditions for investors.

Even so, we don't think the geopolitical climate as it stands today will have a lasting impact in the medium or long term.

If we look at what's happening in Ukraine and the Middle East right now, both these conflicts have captured headlines and certainly scared a lot of investors into thinking about not only their portfolios but the safety of themselves and their families.

At the start of each of these conflicts, we saw volatility rapidly spike only to dissipate later as investors became more comfortable. The effect each has had on investment assets has been fleeting, and indeed oil prices are lower at the time of writing than they were in the immediate wake of each invasion.

We'll keep watching these and other conflicts for signs that they're worsening, but our current view is that these events will not have an enduring impact on portfolios.

Perpetual Private's Quarterly Investment Update for December 2023 covers the changing nature of investment dynamics and looks at the outlook for shares, fixed income, real estate, currency and alternatives.

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