Monthly Market Commentary

The fourth quarter was very strong for global equity markets. Expectations of a lower Fed policy rate in 2024, lower inflation, and the growing belief in a "soft landing" were the most noteworthy catalysts. Sentiment is high and investors are pricing in continued strong performance this year. But a lot must go right for this to happen.

Equity markets finished the year on a high. A notable decline in interest rate and inflation expectations unleashed a broad-based, risk-on market rally. Bonds, equities, gold, and risk currencies including the AUD all rallied in the quarter. For Australian based investors this translated into a 5% rally in global equity markets. The "higher-for-longer" narrative was replaced by expectations for rate cuts as early as Q1 2024. Cyclical and rate sensitive equities outperformed. While the move was impressive, on a two-year view many indices and equities have no more than round-tripped. As we discussed in the previous section, markets are pricing in a benign outcome already, so a lot must go right in 2024 and beyond for a sustained rally.

Almost all major indices were in the green in the fourth quarter. The US led the way with the broad-based S&P500 and the tech-heavy NASDAQ up 11.2% and 13.6%, respectively. Both indices closed the quarter within striking distance of all-time highs set in late 2021. The breadth of the rally widened considerably, and the S&P 600 Small Cap index gained an impressive 14.5% in the quarter. European stocks were also up, albeit a more modest 6.4% for the STOXX 600 index where stickier inflation has proven harder to shake off. In Japan, the NIKKEI 225 index increased by 5.0% capping off a strong year for the region. The Shanghai Composite index was the only major index in the red this quarter – down -4.4% and reflective of debt woes and deflationary pressures in the Chinese economy.

All sectors except energy were up in the fourth quarter. Information technology (+17.4%) was the strongest performer. All cyclical sectors also did well with industrials (+13.5%), financials (+12.7%) and materials (+12.4%) leading the way. Defensive sectors were relative underperformers with healthcare and staples up just +4.7% and +5.6%, respectively. Energy was the only sector that was negative (down -4.8%) on the back of a weak oil price.

The big story this quarter was the change in narrative from "higher-for-longer" rates to "expect multiple rate cuts in 2024". At year end the market was pricing six interest rate cuts over the course of 2024. After nearly touching 5% in mid-October, the US 10-year yield fell back down to 3.88% at year end, a 111 bps drop.

Inflation expectations came down. The oil price fell by -21.1% to $71.65 a barrel while the Bloomberg commodity basket fell by -5.9%, reflecting a continuing easing of demand despite some ongoing supply issues (two regional wars and attacks on ships in the Red Sea). The VIX also fell by 5.1 points to 12.45, the lowest monthly reading since September 2018 and reflective of the giddy mood in financial markets.

Mexican retailer FEMSA contributed the most to performance this quarter. Solid execution on their recently unveiled strategy alongside strong organic growth in their core business supported the shares. Wheaton Precious Metals, a Canadian gold and silver streaming company, also contributed significantly to performance in the quarter. Higher gold prices and solid operating performance announced at the most recent quarterly result were the biggest drivers.

French pharmaceutical giant Sanofi was the largest detractor to performance in the quarter. The company announced an increase in R&D spend in late October that was received poorly by the market. We believe this was largely to do with less-than-ideal presentation from management rather than anything of substance. The shares have since recovered some lost ground and we continue to see upside from here. Another detractor to performance was Alibaba, an online retailer in China. Scuppered plans for IPOing several business divisions and continued general weakness in the Chinese economy weighed on the share price. We maintain our holding based on an attractive valuation.

The fund initiated two new positions this quarter. WEC, a US regulated utilities company, trades on an attractive dividend yield not seen in a decade while exhibiting a business model with defensive characteristics (revenues backed by the state). Medtronic, a US healthcare equipment maker, is a dividend aristocrat with a solid cashflow generation profile and attractive valuation. It has recently returned to mid-single digit organic growth, and we believe they can continue this momentum. The fund exited Japanese equipment manufacturer Mitsubishi Electric on valuation grounds.