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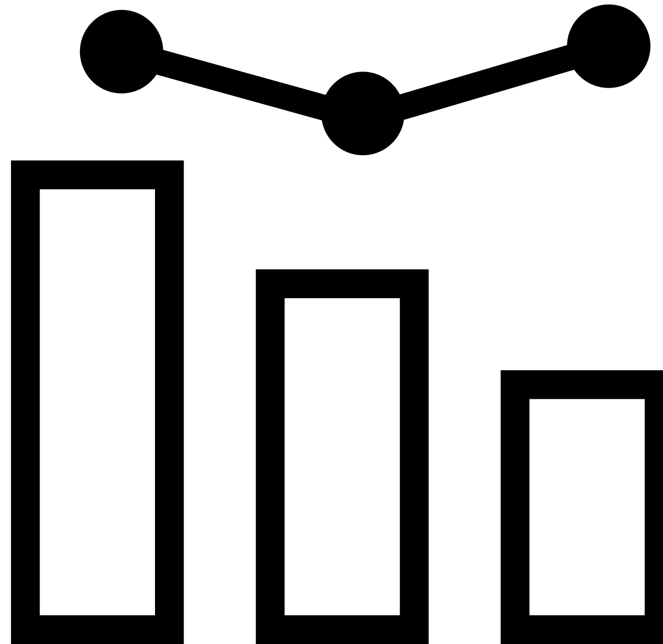


Marketupdate

May 2024

May 2024: a stock market recovery

European and US stock markets rebounded from April's declines. This was less true for Asian equities, and not at all for emerging markets. On balance, European government bonds showed a flat price development, but European corporate bonds performed well.

Stock markets rallied in May, following the moderate month of April. The recovery was however seen mainly in European and US equity markets, with price increases of 3.3% for the MSCI Europe Index and 3.5% for the MSCI North America Index. Asian equity markets also performed reasonably well, with the MSCI Asia Pacific Index returning +0.6% for the month. Emerging markets showed a very different trend. In April, emerging markets were the only equity region with a positive monthly return, but in May this was the only region with a negative monthly return, of -0.5% for the MSCI Emerging Markets Index. The malaise in emerging markets was widespread, from Brazil and Mexico in Latin America to China, South Korea and Indonesia in Asia. Russia and South Africa also performed moderately. In fact, only the Indian stock market managed to escape the negative sentiment in emerging markets.

While European equities performed well in May, European listed real estate did even better. This asset class has been very mixed in recent months (and years), but in any case it was the best performer in May, with a monthly return of 4.7%.

On balance, capital market interest rates barely moved in May. As a result, European government bonds were virtually flat, with a monthly yield of -0.1%. Corporate bonds rebounded in May, as did equities, from the declines in April. Investment grade corporate bonds delivered a monthly return of 0.3% and the more risky high yield bonds a return of 1.0%.

Financial markets have shown a mixed picture in the first two months of this quarter, but the picture has been much clearer since the beginning of the year and over the past 12 months. Equities have performed particularly well in both 2024 and 2023, with emerging markets and Asian equities as relative underperformers. Corporate bonds also performed well, but not as well as equities. The picture for government bonds and real estate is less clear: reasonable to good over the past year, but moderate to poor so far in 2024.

The returns on the various asset classes were as follows:

Return (total return, in euro's)	May	Q2	2024	12 mths
Bloomberg Barclays Eurozone Staatsobligaties	-0.1%	-1.5%	-2.2%	2.0%
Bloomberg Barclays Euro Bedrijfsobligaties	0.3%	-0.6%	-0.1%	5.3%
Bloomberg Barclays Euro High Yield Bedrijfsobligaties	1.0%	0.9%	2.5%	10.6%
FTSE/EPRA Europe Onroerend Goed	4.7%	2.0%	-1.6%	21.4%
MSCI Europe Aandelen	3.3%	2.3%	10.1%	17.6%
MSCI North America Aandelen	3.5%	-0.2%	12.4%	25.4%
MSCI Asia Pacific Aandelen	0.6%	-0.3%	7.2%	12.5%
MSCI World Developed Markets Aandelen	3.1%	-0.3%	10.6%	21.1%
MSCI Emerging Markets Aandelen	-0.5%	0.5%	5.2%	10.6%
EUR/USD	1.1%	0.5%	-1.7%	1.6%

Source: Bloomberg

Trend of cooling US economy continues

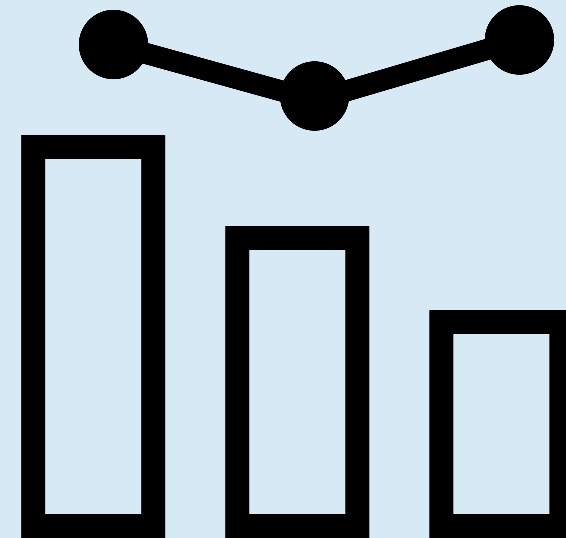
There were no figures on the macro side in May that cast a radically different light on the development of the global economy. The figures released during the month mostly confirmed trends that were already visible. Perhaps the most important point is that the US economy is still performing reasonably well, although it has been slowing recently. Following reports that economic growth in the US for the first quarter had fallen to its lowest level in almost two years, this quarterly growth rate has now been revised downwards from 1.6% to 1.3% annualised, mainly due to a lower estimate of consumer spending in the first quarter. On the producer side, meanwhile, there are signs of weakening, despite still strong corporate profits. Producer confidence indices in both industry and services have now fallen below the 'neutral' 50 per cent limit. In March, both these indices were still above 50 per cent. Current levels do not suggest an impending recession, they show that the economy is cooling.

Disappointing consumer spending may have something to do with the fact that the US labour market finally seems to be cooling down a little. Employment rose less than expected last month and unemployment rose slightly from 3.8% to 3.9%. As a result, unemployment in the US is still well below the historical average of 5-6%. Another bright spot is that US consumer confidence rose unexpectedly in May, mainly due to the sub-index measuring consumers' outlook. This has fallen further every month so far in 2024, but now looks to have reached a turning point. That would be potentially good news for US President Biden, who hopes to be re-elected in November.

European economy climbs out of the trough, Japan and China struggle

In contrast to the cooling US economy, the economy in Europe appears to be increasingly climbing out of the trough. Quarterly economic growth in the first quarter was still a modest 0.3%, but this was better than the 0.1% growth that analysts had expected. On the producer side, it is noticeable that not only is confidence in services still above average, but industry also seems to be increasingly recovering from a low point. Meanwhile, European consumer confidence is also gradually rising. Undoubtedly, this is also partly due to unemployment in the euro area falling to 6.4%, its lowest level since the introduction of the euro in 1999.

Besides Europe and the US, it is striking that the Chinese economy got off to a stronger than expected start in 2024, with growth of 5.3% year-on-year in the first quarter, but it appears to be having difficulty in maintaining this growth rate. Figures on the Japanese economy have also been disappointing lately. In the first quarter of 2024, the Japanese economy showed a stronger-than-expected contraction of 0.5% quarter on quarter, and recent figures do not suggest a turn for the better is imminent. Japanese consumers in particular are becoming increasingly cautious.



US inflation still above 3%, helped by wage increases

Not much changed in May, in terms of either economic growth or inflation. The inflation wave in 2021-2023 is increasingly out of the picture in both Europe and the US, but the remaining obstacles to reaching the Fed's and the ECB's 2% inflation target are proving to be the most difficult. In the US, inflationary pressures continued to ease slightly last month, but remain too high at 3.4% year-on-year. US inflation has been hovering around 3-3.5% for almost a year now.

The downward trend in US core inflation (excluding volatile food and energy prices) that started in the last quarter of 2022 is still intact, but this is still higher than desired, at 3.6% year on year. The persistence of inflationary pressure is partly due to wage developments: in the US, where hourly wages rose by 3.9% year-on-year last month. For workers, the good news is that wages have been rising faster than prices for some time, increasing their purchasing power. For employers (and for the Fed), the good news is that wage inflation is gradually easing: two years ago, wages were up 6% year-on-year. As a result, the risk of a wage-price spiral is easing each month.

Persistently high inflation problematic for central banks

The eurozone has to some extent a similar inflation problem to the US, but there are also differences. Here, inflationary pressures are now lower in absolute terms than in the US, whereas they were higher at their peak in 2022: more than 10% year-on-year in the euro area and 9% in the US respectively. This is positive in itself, but a less positive difference is that inflationary pressures in the euro area increased last month, while they continued to decline in the US. Inflation in the eurozone is now 2.6% y-o-y (2.4% last month) and core inflation has increased to 2.9% y-o-y (from 2.7% a month ago). Inflation pressures are still expected to ease towards 2% in the second half of the year, but the latest figures put the ECB in a difficult position. ECB representatives have repeatedly hinted that the ECB will cut the base rate in the short term, which would be the first rate cut in more than eight years. Even DNB Chairman Klaas Knot, not normally a leading advocate of an easier monetary policy, indicated in April that he sees room for this. However, the most recent inflation figures give little cause for an interest rate cut, let alone more than one.

Complicating the situation is the fact that the US central bank, the Fed, has always made it clear that it will not be cutting interest rates for the time being, given the persistently high inflationary pressures. The base rate in the US has been higher than in the euro area for some time: 5.25% and 4% respectively. If this interest rate differential increases further, for example due to lower interest rates in the euro zone, this would not (at least in theory) be favourable for the exchange rate of the euro against the dollar. With a more expensive dollar, imports from the US will also become more expensive and thus contribute to 'import inflation' in the eurozone. More inflationary pressures are the last thing the ECB wants to see. The expectation therefore is that ECB President Lagarde will clearly indicate that a first rate cut will not be the start of a series of cuts in the euro area. This expectation is also shared by the interest rate markets. Whereas at the beginning of this year around six rate cuts were expected from the ECB (and also from the Fed) in 2024, interest rate markets now assume no more than one rate cut by the ECB in the second half of 2024. For the Fed as well, interest rate markets are anticipating only one or a maximum of two rate cuts this year, starting in September at the earliest.

Adjusted interest rate expectations limit upside potential of 'risky assets'

The current estimate by interest rate markets that central banks will reduce interest rates to a limited extent at most in the coming period seems to us to be justified. So far, the prospect of interest rates remaining higher in the longer term has not noticeably spooked more risky asset classes such as equities, but this may still change. Especially with the risk of a further cooling US economy and ongoing geopolitical tensions, we see significantly less upside potential for equities and other risky assets in the coming period, such as real estate and corporate bonds, after the strong price increases of recent

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