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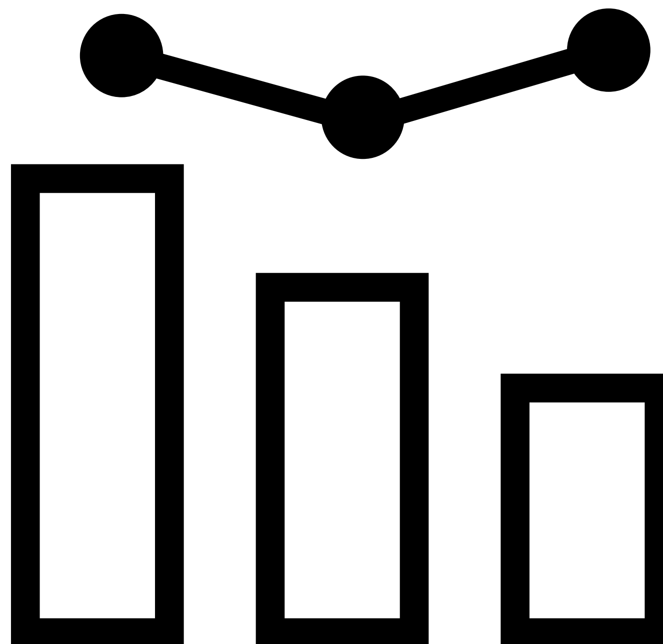


Marketupdate

November 2023

November 2023: Strong recovery in stock markets

Things can change. After a few bad months, stock markets showed a particularly strong recovery in November, while bond investors benefited from further falling long-term interest rates.

While stock markets still fell in September on higher interest rates and continued to fall in October on lower interest rates, November provided a very different picture for investors. Long-term interest rates did fall further, but stock markets showed a particularly strong recovery. As a result, all asset classes delivered positive returns, with listed real estate (+13.6% in November) as the absolute standout. Nevertheless, listed real estate remains the strongest underperformer over all of 2023 so far, with a return of less than 2% since the beginning of this year.

Apart from listed real estate, returns on the various equity markets were fairly similar in November, at least measured in euros. Although the US stock market showed price gains, the depreciation of the dollar against the euro (approximately -2.5% in November) left a monthly return of 'only' 6.9% for the MSCI North America Index measured in euros. That still left US equity markets just ahead of European stock markets, with a monthly return of 6.4% for the MSCI Europe Index. Yields on Asian stock markets and emerging markets were again slightly lower in relative terms at around 5.5% in November, but were still exceptionally high in absolute terms.

As an aside, not only over last month, but over all of 2023 so far, Asian stock markets and emerging markets are trailing behind. With year-to-date returns of about 4%, they are trailing the MSCI World Developed Markets Index by about 10%-point so far in 2023.

Remarkably, not only equity investors, but also bond investors experienced a good month in November. Long-term interest rates fell further, giving European government bonds a monthly yield of 3.0%. European corporate bonds trailed slightly in this regard, with a monthly yield of 2.3%. In turn, the more risky high yield corporate bonds did slightly better, with a monthly yield of 2.8%.

The returns on the various asset classes were as follows:

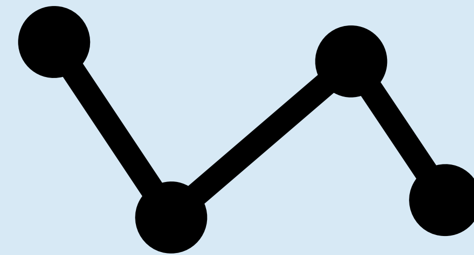
Return (total return, in euro's)	November	Q4	2023	12 months
Bloomberg Barclays Eurozone Government Bonds	3.0%	3.4%	3.4%	-1.4%
Bloomberg Barclays Euro Corporate Bonds	2.3%	2.7%	5.3%	3.4%
Bloomberg Barclays Euro High Yield Corporate Bonds	2.8%	2.5%	9.0%	8.2%
FTSE/EPRA Europe Real Estate	13.6%	9.6%	1.9%	0.2%
MSCI Europe Shares	6.4%	2.6%	11.7%	7.8%
MSCI North America Shares	6.9%	3.3%	17.9%	7.3%
MSCI Asia Pacific Equities	5.3%	0.0%	4.5%	0.8%
MSCI World Developed Markets Shares	6.7%	2.6%	13.9%	5.4%
MSCI Emerging Markets Shares	5.5%	0.5%	3.6%	-1.2%
EUR/USD	2.4%	3.3%	2.0%	5.4%

Source: Bloomberg

Lower inflation, so lower interest rates too?

The sharp turn in sentiment in stock markets in November appears to be mainly due to adjusted expectations of market participants and analysts about future interest rate moves by central banks. Until recently, interest rate markets assumed that not only were further interest rate hikes by the Fed and the ECB off the table, but also that central banks would probably start reducing their base rates around the summer of 2024. During November, the latter expectation was brought forward even further. Now, first interest rate cuts by both the ECB and the Fed are expected as early as spring 2024, and interest rate markets assume that by the end of 2024, the base rate in the US (now 5.25%) will have fallen to 4% and in the eurozone (now 4%) to less than 3%.

The main reason for the revised interest rate expectations is the better-than-expected inflation figures of late. In the eurozone, inflation slowed again faster than expected in November, to 2.4% year-on-year, no longer very far from the ECB's 2% inflation target. The Netherlands even briefly experienced deflation in October (-0.4% year-on-year), but in November inflation did return above zero at 1.6%. In the US things are slowing slightly, but with an inflation rate of 3.2% in October, inflationary pressures there too are now significantly lower than at the beginning of the year.



Effect of previous interest rate hikes begins to show through more and more clearly

Now that central banks' inflation targets seem within reach, the question is how much longer they should keep interest rates at above-average levels, especially since current interest rate levels also have a clear inhibiting effect on economic activity. In the US, although economic growth in the third quarter was still particularly high at 1.3% quarter-on-quarter, signs of an imminent growth slowdown are increasing. To the extent that that slowdown in growth has not already set in, the current consensus expectation is that the US economy will slow significantly in at least the first two quarters of 2024, possibly even coming to a virtual standstill. The eurozone economy has had little or no growth this whole year, and there seems little prospect of that changing in the short term either. At best, economic growth in the fourth quarter is still just positive, after last quarter's -0.1% quarter-on-quarter growth. This would then narrowly avoid a recession. That has already proved unsuccessful for the Dutch economy, incidentally. Here, growth has been negative every quarter for the past three quarters.

Looking ahead, analysts are slightly more optimistic for the European economy than for the US economy, at least in relative terms. The consensus expectation is that the low point in terms of economic growth in the eurozone has now passed and that growth will pick up tentatively in the quarters ahead. This is also what can be inferred from the latest macroeconomic figures. For instance, both European business and consumer confidence rose slightly last month, with other indicators also mostly exceeding expectations recently.

Interest rate cuts may also come too soon, as long as spectre of inflation is not yet contained

Even though inflation is now significantly lower than several months ago and many countries are not in great economic shape, the question is how real is the expectation that central banks will start cutting interest rates within a few months. The recent sharp fall in inflation is mainly due to substantially lower food and energy prices compared with the crisis levels of a year ago. While this has had a strong dampening effect on headline inflation, that effect will gradually wear off in the months ahead. Apart from food and energy prices, core inflation has also fallen, but considerably less sharply than headline inflation. In the eurozone, core inflation is still 3.6% and in the US 4.0% year-on-year.

Relatively high core inflation is mainly due to upward wage pressures, resulting from the tight labour market in both Europe and the US. While wage increases initially lagged behind price increases, this has changed recently. With unemployment still historically low in both the eurozone (6.5%) and the US (3.9%), upward wage pressures will also continue for now. As long as core inflation is still nowhere near the 2% inflation targets, central banks will be wary of cutting interest rates too early, and thereby rekindling the inflation fire. That is also what central bankers tried to highlight in recent weeks, while stock markets kept rising further at the prospect of lower interest rates.

Lower interest rates are not necessarily favourable: 'be careful what you wish for...'

Price increases in stock markets are a problem in themselves for central banks, as they can indirectly lead to price increases and thus higher inflation again via the wealth effect. The conflict between central bankers, who will continue to say that interest rates will not really be cut any time soon, and financial markets, which continue to assume lower rates regardless, is expected to continue for a while. It is difficult to pinpoint a winner in advance, but it does seem that financial markets got ahead of themselves in recent weeks. In this respect: 'be careful what you wish for...'. Any interest rate cuts could, of course, in a favourable scenario be the result of better-than-expected inflation figures, but in a less favourable scenario could also be the means by which central banks try to combat an economic downturn. Certainly in such a latter scenario, stock markets do not seem very appealingly rated at present.

In terms of tactical investment outlook, we therefore remain cautious for all asset classes. As long as interest rates on cash remain as high as they are now, the bar for other asset classes will also be high, and the prospect of potentially lower interest rates is not equally favourable in all cases (and for all investments). In addition, liquidity in financial markets normally dries up further as December progresses, and in an uncertain geopolitical and macroeconomic environment, this can cause sharp share price declines in the event of unexpected developments. For the next few weeks, therefore, we prefer to keep our powder dry, under the motto 'new round, new opportunities' in 2024.

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