Allianz Global Investors

04/2023

Market Snapshot

Equity Snapshot

United States

US equities closed the month of April slightly higher, lifted by a raft of better-than-expected corporate earnings from high-profile tech companies in the last days of the month. This helped the US market overcome fears of an economic slowdown as well as expectations that the Federal Reserve (Fed) would raise interest rates at its next meeting in early May. In general, first-quarter earnings beat forecasts, although overall earnings are expected to decline for the second consecutive quarter.

The US economy grew 1.1% on an annualised basis in the first quarter of 2023. The data was weaker than expected and represented a sharp slowdown from the 2.6% expansion recorded in the final quarter of 2022. Strong consumption growth offset a drag from inventories and a slowdown in housing and business investment. Headline US inflation fell to an annual rate of 5.0% in March, compared to 6.0% in February, but core inflation picked up slightly to an annual rate of 5.6%.

Europe

European equities moved higher over April (in EUR terms) as fears of a banking crisis waned and optimism over the economic outlook outweighed concerns about further hikes in interest rates. Consumer staples companies were among the strongest performers, as companies such as Nestlé reported that demand was holding up well despite higher prices. However, the technology sector underperformed expectations.

The euro-zone economy grew 0.1% in the first three months of the year, missing forecasts. While the German economy stagnated, the French GDP expanded by 0.2% and the Italian and Spanish economies each grew by 0.5%. The flash reading of the HCOB Eurozone Composite Purchasing Managers' Index (PMI) rose to 54.4 in April, the highest reading since May 2022, although the survey highlighted the broadening gap between robust service sector activity and manufacturing, which slid deeper into contraction territory.

Asia

Asian equity markets were mixed in the month but were broadly lower. China was notably weaker, due to concerns about the sustainability of the economic recovery, despite a much stronger than expected Q1 GDP figure of 4.5%. China's official manufacturing purchasing managers' index (PMI) disappointed in April, although there were signs of green shoots in the property market, with new home sales and new house prices both improving.

Elsewhere in the Asia ex Japan region, Taiwan lost ground with semiconductor stocks seeing some profit taking as the expected industry recovery looks set to be pushed back to later in the year. Korean shares closed the month modestly higher. Indonesia was the strongest of the smaller ASEAN markets, closing the month solidly higher. On the other hand, equities in Thailand slumped, and stock markets in Malaysia and Singapore declined slightly.

Bond

In April, investors continued to assess the potential macroeconomic impact of the banking stresses that emerged in March. Despite the strong policy action to support the banking sector after a series of bank failures in the US and Europe, questions are growing about the near-term path of economic activity, given expectations of constrained credit expansion ahead. Weaker-than-expected US regional business surveys, consumer confidence and headline CPI inflation (at 5% y/y) resulted in 2-year and 10-year US Treasury yields ending the month slightly lower. In Europe, 10-year German yields ended the month at 2.31% (up 2 bp), even as markets began to pare back expectations on how high the terminal rate will go in the Euro area in this cycle. In Japan, all eyes were on the new Bank of Japan Governor Ueda's first policy meeting. In the event, the BOJ disappointed market expectations of a possible near-term shift in its dovish policy stance, especially in relation to the Yield Curve Control policy. The JPY ended the month on a weak note, falling over 2.5% versus the USD in April. The 10-year JGB yields ended the month at 0.39%.

Outlook

In a period of monetary policy adjustment, the financial sector becomes the primary mechanism of transmission. The smouldering fire burning through US banking stocks is a direct reflection of this. M2 money supply has contracted for eight straight months, yet the full consequences are typically only felt with a lag of four to six quarters. Other industries and consumers, therefore, may not yet be feeling the full effect of money once again having a cost.

Economic indicators are deteriorating, albeit slowly. The latest manufacturing PMIs in the US, Eurozone, UK, and China are all firmly in contraction territory. US job numbers similarly show that while unemployment remains at a multi-decade low, the pace of hiring is decelerating. Against this trend, China's reopening and India's steady economic expansion increasingly points to a two-speed global economy. Even if a global recession in 2023 appears to have been averted, the prospects for 2024 are less clear.

Inflation does at last appear to be easing in parts of the world. In the US, the consumer price index (CPI) for March rose 5% year-on-year, easing to its lowest level in nearly two years. Recent financial stress has further reduced banks' willingness to lend, with the European bank rate of lending falling 22% in Q1. As a result, market participants now expect the US Federal Reserve to start cutting interest rates as early as September, with a peak of 5% in June.

Yet with core US CPI (which strips out volatile energy and food costs) rising 5.6%, there is reason to believe that price pressures for some goods and services will remain elevated even as economies slow, especially with rising labour costs. The risk of stagflation cannot be ignored. Weighing the risk of a policy mistake, central banks may still take the view that a recession and significant damage to labour markets are necessary prices to pay to mitigate cyclical inflation.

At the corporate level, aggregate earnings revisions remain negative. While the pace of these negative revisions has slowed from the depths of Q4 22, market participants have been quick to punish companies with lacklustre guidance, even if earnings on the day have been strong. The extent to which organisations can pass on input costs without impacting transaction volumes will be vital going into H2.

As our clients know, we do not seek to take a position or even a strong view on near-term economic matters. Rather, we seek to own the companies most likely to outperform through a range of macroeconomic environments. So far this year, quarterly sales and earnings have been robust, with a high proportion of portfolio companies beating and raising expectations for the year ahead. As the effects of monetary policy continue to work their way through the system, we remain focused on opportunities that will best compound client wealth over the long-term.