ANZ INVESTMENTS 2024 MARKET OUTLOOK

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A LOOK BACK AT 2023 – A GOOD YEAR FOR INVESTORS

After a challenging 2022, the investment landscape improved in 2023, thanks in part to a slowing of inflation in developed nations, which saw most global central banks end, or signal that their interest rate hiking cycles were over.

The prospect that interest rates may have peaked was good news for equity markets. For the year, the NASDAQ 100 Index had a stellar year, gaining 44.6%, just one year removed from its worst yearly performance since 2008, while the broader S&P 500 Index also had a good year, gaining 26.3%.

At a sector level, companies involved in the Artificial Intelligence (AI) space were some of the big winners.

Elsewhere, Japan's Nikkei 225 Index was another standout performer, gaining 31% in 2023, reaching its highest level in more than 30 years. The strength was helped by a weakening Japanese yen, which made its companies more competitive compared to their international counterparts, while Japanese financials outperformed as the Bank of Japan (BoJ) eased its ultraloose monetary policy stance.

Closer to home, New Zealand equities underperformed, with the domestic NZX 50 Index ending the year up 2.6% as the economy struggled with sticky inflation and waning consumer and business sentiment. Across the Tasman, the ASX 200 Index took its lead largely from commodity prices, which see-sawed over the year. The index ended the year up 12.4%.

In fixed interest markets, 2023 was a game of two halves. As central banks extended their interest rate increases in the first half of the year, bonds continued to struggle. However, as many central banks paused, or slowed the pace of rate increases, bonds found some support, rounding out the year on a positive note.

As we look ahead, we are approaching 2024 with some caution. The global economy appears to be slowing as the cumulative effect of the interest rate hikes are weighing on households, while labour markets, which have been the pillar of the post-COVID economic recovery, are starting to show signs of weakening. Furthermore, geopolitical tensions remain elevated, which could have ramifications for global financial markets.

Despite some caution, there are many things to be optimistic about. Unpacking what lies ahead, here's ANZ Investments' 2024 Market Outlook.

EQUITY AND BOND MARKETS DELIVER STRONG GAINS

- S&P 500 **+26.3%**
- NZX 50 **+2.6%**
- ASX 200 **+12.4%**
- EURO STOXX 50 **+22.2%**
- NZ LISTED PROPERTY **+6.2%**
- GLOBAL GOVERNMENT BONDS* **+6.3%**
- NZ GOVERNMENT BONDS **+5.4%**
- GLOBAL LISTED INFRASTRUCTURE* **+0.4%**

* Hedged to NZD.

WE EXPECT BONDS TO PERFORM WELL AMID SLOWING GROWTH AND LOWER INFLATION

Central banks appear to have finished raising interest rates

Over the past couple of years, bonds have experienced some of their weakest periods on record, struggling against the backdrop of decade-high levels of inflation that saw interest rates surge in most developed nations.

However, looking ahead, we believe the outlook for fixed interest investments is much brighter, and the global economic backdrop should favour defensive assets such as bonds. Furthermore, with the yields on some government bonds reaching levels not seen since before the Global Financial Crisis in 2008 and 2009, bonds are attractively valued from a historical perspective.

Historically, bonds have outperformed during times of slower or negative growth, and as we head into 2024, the outlook for global growth is trending in that direction. Furthermore, we are comfortable that inflation is on a path back towards central bank target rates, and further tightening by major central banks is unlikely, which should be supportive of the return from bonds going forward.

In the US, inflation in the back half of 2023 was driven in part by ongoing rental price rises (known as shelter inflation). However, we saw a slowdown in this over the last few months of the year, and leading indicators suggests this should continue to moderate. Meanwhile, goods inflation is now close to zero, with the transportation and education components trending lower. Elsewhere, Europe is seeing a similar trend, with inflation dropping below 3% in 2023.

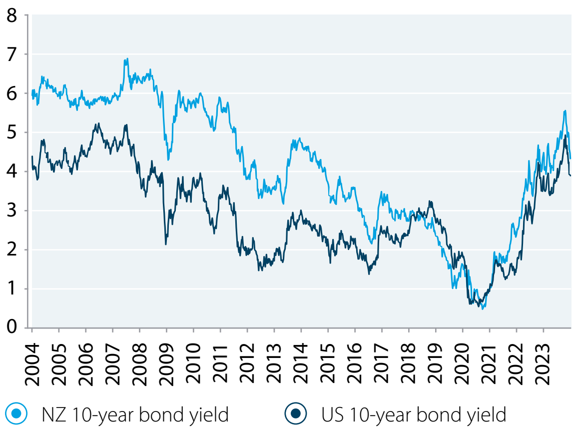
In New Zealand, we believe the Reserve Bank of New Zealand (RBNZ) has finished its tightening cycle. Although inflation remains sticky, and relatively high compared to several other developed countries, consumer demand is clearly slowing – a trend that looks set to continue in 2024. This should help drag down inflation and support local bond prices.

Of course, there are risks to our view. One concern is that investors have overestimated the number of cuts this year, setting the market up for disappointment. The second is that inflation reaccelerates once central banks lower interest rates, leading to a stop-start year for monetary policy. In this instance, we could see bonds struggle.

"The pace at which interest rates have risen in the last two years has been much faster than previous hiking cycles, arguably too fast to fully gauge the impact of higher rates. However, we expect that, in time, higher rates will pressure governments, companies and consumers. Central banks have a formidable task to calibrate interest rates to support growth while ensuring inflation does not reaccelerate."

Maaike van Tol, Head of Asset Allocation at ANZ Investments

Bonds yields are at close to multi-year highs



Source: Bloomberg

GLOBAL GROWTH APPEARS TO BE SLOWING

The outlook for 2024 is looking like a shift towards slower growth, and the increased likelihood of the global economy falling into a recession.

In the US, the economy was remarkably resilient in 2023, driven in part by non-residential fixed investment – some of this the result of the spending of funds set aside in the CHIPS and Science Act (which aims to incentivise the manufacture of semiconductors in the US) and the Inflation Reduction Act. Furthermore, the US consumer was far more resilient than many had expected, which kept corporate profits healthy.

Meanwhile, in Europe, surveys of economic activity for manufacturing and services fell well into contractionary territory in 2023, and Germany, the region's economic powerhouse, faced an uphill battle as it struggled from weak demand. In China, the property market slump saw its economy wane.

What this means for 2024 is that Europe and China are more likely closer to the bottom in their economic cycle, while the US economy, given the resilient 2023, faces greater downside risks in 2024.

The labour market will be the key variable that determines whether the global economy heads for a 'hard landing' (a more sudden slowing in activity which tips the global economy into recession), or a 'soft landing' (where we see growth moderating but remaining in positive territory).

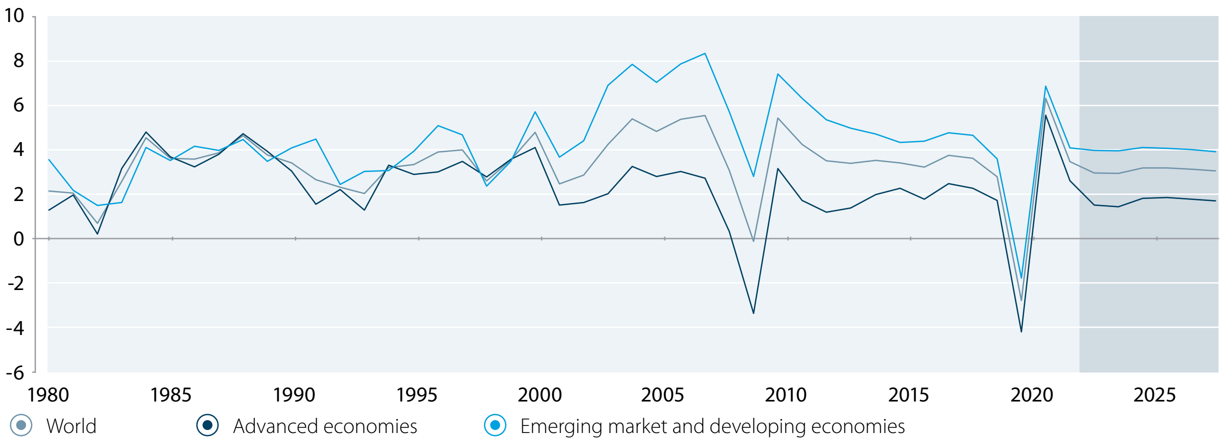
We see early evidence of a hard landing growing in the US: job openings are declining, and continuing claims for unemployment are slowly increasing. Moreover, the state of consumers' balance sheets is trending in the wrong direction and is likely to worsen. Notably, auto loans and credit card delinquencies have ticked up above pre-pandemic levels, while excess savings are being depleted. This points to a slowdown in consumer spending (which makes up about two-thirds of the US economy) and would ultimately lead to a deterioration in growth.

As for Europe and China, while both may be closer to the bottom of their economic cycles, we see limited upside for 2024. Tight monetary policy and high energy prices are currently hampering Europe's recovery – if the ECB eases on comfort that inflation is at target and can remain there, this would allow more upside. China has the better upside potential with the government more likely to embark on a range of fiscal stimulus programmes.

"We expect global growth will slow into 2024, driven by a pullback in consumer spending. With the excess savings accrued during the pandemic now wearing down, we anticipate consumers will start to feel the pinch of tighter monetary policy. Credit card and auto loan delinquencies have historically been a good bellwether for future growth, and these have ticked up to levels not seen in ten years in the US. It suggests consumers are beginning to struggle to meet higher interest payments without their savings buffer as a backstop."

Erin Hasemore-Slieker, Investment Analyst at ANZ Investments

Global growth forecasts (forecasts from 2023)



Source: International Monetary Fund

NZ ECONOMY TO ENTER RECESSION

We expect the RBNZ to cut interest rates

Since central banks around the world began lifting interest rates to curb inflation, the New Zealand economy – and its equity market – has been one of the laggards on the global stage. In 2023, the NZX 50 Index underperformed, while many other global share markets finished with double-digit gains, while on the growth front, the New Zealand economy underperformed when compared to Australia and the US.

Higher interest rates have hit New Zealanders particularly hard. In 2021 and 2022, many homebuyers opted for short-dated mortgage rates as one and two-year mortgage rates fell below 3%. Now, as borrowers refinance this debt at interest rates which have more than doubled, many households are feeling the pinch, which is eating into their savings and weighing on consumer spending.

According to Centrix, a New Zealand-based credit bureau, in October 2023, there were more than 19,000 mortgage accounts past due, up 25% year-on-year, while vehicle loans and car loans in arrears were also sharply higher.

New Zealand businesses have also struggled. Many are finding it harder to borrow, leading to declining capital expenditure, while higher interest rates have made it particularly challenging for the New Zealand listed property sector.

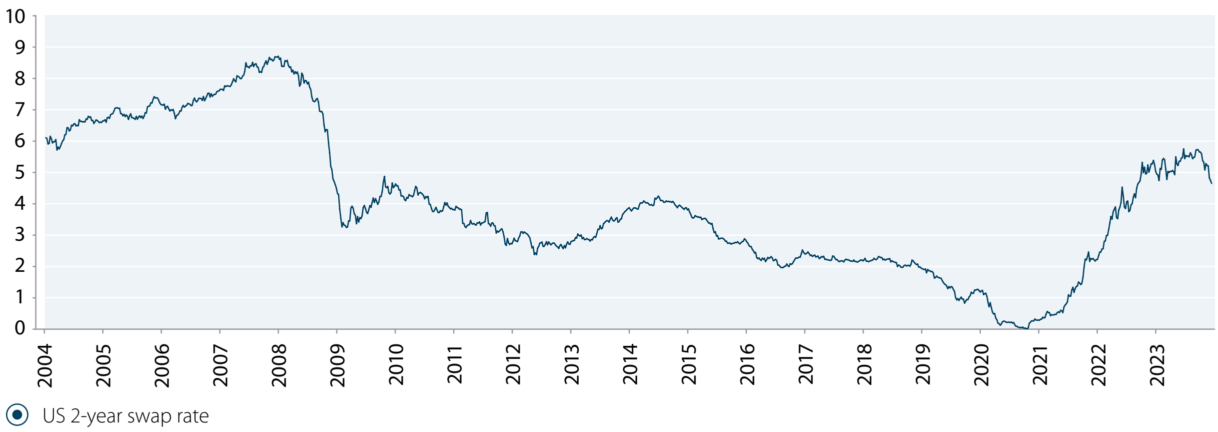
As we look to 2024, we see these challenges worsening, exacerbated by a slowing job market. Leading indicators show job ads are on the decline and we believe the unemployment rate bottomed in 2023 and will rise throughout 2024. A worsening labour market is likely to impact domestic demand, pushing the New Zealand economy into a recession.

Meanwhile, after maintaining a hawkish bias into the early stages of 2024, we believe the RBNZ will be forced to abandon this policy stance and will eventually be forced to cut interest rates to support what will be a slowing economy.

"There is evidence the New Zealand economy is slowing fast. Late in 2023, we saw several cyclical businesses downgrading their revenue and earnings outlooks. The Christmas retail period will be crucial for retailers and should give us a good lead on how the economy is trending. Meanwhile, our in-house employment data indicates that employment conditions and unemployment weakened significantly going into December, with the potential for more widespread layoffs early in 2024. This, combined with a continued tightening in financial conditions from mortgage refinancing, means further financial pressures on many households and businesses early next year."

Ray Jack, Credit Analyst at ANZ Investments

Chart of 2-year NZ swap rates, representative of mortgage rates



Source: Bloomberg

RESPONSIBLE INVESTING

Change is the new normal

Reflecting on 2023, we saw several extreme weather events domestically which caused severe disruption to businesses and livelihoods across the country. On a global front, the 2023 United Nations Climate Change Conference (also known as COP28) dominated headlines for the divergence in views from countries around the phasing out of fossil fuels, and several countries introducing new regulation around disclosures on climate change.

ANZ Investments was pleased to be recognised as a Responsible Investment Leader in the 2023 Benchmark Report by the Responsible Investment Association of Australasia (RIAA), in recognition of how we integrate environmental, social and governance (ESG) considerations into our investment process.

The year ahead will see both opportunities and challenges in terms of responsible investment. Here are some of the prominent themes we will be focusing on:

Climate-related disclosures will further contribute to investment decision making

This year, ANZ Investments will release its first climate-related reporting for several of the investment schemes we manage, and we will also see many investee companies and organisations in New Zealand report under the framework. By having a required and consistent format for reporting we will better understand the forward-looking risks and opportunities our investee companies face, which can then be effectively factored into our investment decision making process. Australia is quickly following suit with mandatory climate reporting expected in 2024, and we will likely see several other countries around the world adopt similar standards in the next few years.

Engagement in the spotlight as a means of demonstrating investor stewardship

One of the prominent developments of 2023 was the continued work by the Aotearoa New Zealand Stewardship Code, of which we are proud to support as a Founding Signatory. The Code outlines nine principles and provides a solid foundation for good practice in responsible investment in New Zealand. There is strong alignment with ANZ Investments' existing practices and approach, given the importance we already place on stewardship as part of our responsible investment framework. As part of the requirements under the code, ANZ Investments and other signatories will enhance reporting around stewardship activities, such as engagement and proxy voting. You can find out more about our approach to stewardship on the ANZ website.

The increasing importance of third-party verification in Responsible Investment

Third-party memberships and certifications help set a minimum level of expectation across the market on how to incorporate responsible investment, while also giving investors a way to compare how different investment managers consider ESG factors in their investment decision-making process. Over the last couple of years, we have expanded our industry memberships, and have successfully applied for the certification of many of our funds through the Responsible Investment Association Australasia (RIAA). RIAA set out to champion responsible investing and a sustainable financial system in Australia and New Zealand. As at the end of 2023, we had 24 products that were certified by RIAA, making up more than $20 billion in assets under management. We will look to apply for further certifications across our investment products in 2024.

These are just a few of the many areas in focus for 2024, however the environment we invest in is constantly changing due to events such as extreme weather and geopolitical tensions. Taking these events into account as they arise, and applying a responsible investment lens, remains a key part of our broader decision-making approach.

"Responsible Investment, including the incorporation of ESG factors, is not just a trend but a necessary response to the changing environment we find ourselves in. By embracing stewardship and ESG principles, we look to create a more resilient and sustainable investment future for our customers and generations to come."

Helen Skinner, Head of Responsible Investing at ANZ Investments

UNCERTAINTY AHEAD – BUT PLENTY OF OPPORTUNITIES

From an investing standpoint, 2023 was a relatively good year. With double-digit gains in many global equity markets, diversified portfolios were able to deliver positive returns. However, it was 12 months that posed many challenges outside of the investing world – many of which will continue into 2024.

Inflation eroded many households' wealth and drove up the prices of essential goods and services. This was particularly evident for New Zealanders, who dealt with further pricing pressures following Cyclone Gabrielle early in the year.

Meanwhile, the war in Ukraine is showing no signs of ending, while the conflict between Israel and Hamas has created a devastating humanitarian crisis – one that is still unfolding. These events have added to rising partisanship and social unrest.

Society will face further challenges in 2024. Countries with more than half of the world's population will see their citizens vote in general elections, with all eyes likely to be on the 2024 US Presidential Election.

Both the Democrats and the Republicans continue to face criticism from the opposite sides of the aisle, and from within their own parties. President Joe Biden has been criticised for his fiscal spending, which has pushed national debt above US$33 trillion, while more recently, he has faced pressure from within his own party on several cultural issues.

On the right, former President Donald Trump – despite facing mounting legal challenges – is the current front-runner for the Republican Party. His populist and combative messaging continues to add to the growing hostility in American politics.

Nevertheless, amongst these challenges, there is plenty to be optimistic about. The rise of Artificial Intelligence (AI), though still in its early days, has the potential to bring about positive change in society. For example, in 2023, research centres in the US had success using AI to detect cancer – a potential gamechanger for the medical industry. AI is starting to improve productivity for many businesses – from customer support, software development, testing, and automating routine tasks.

Meanwhile, the ongoing work in the ESG space, and the various commitments countries are making, can only be positive for the future.

As we wrap this all up, one thing that will not change is our investment philosophy where we aim to invest in high-quality companies that will put our investors in the best place to be rewarded in the long term.

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