November 30, 2023

2024 Outlook

Some of the issues and trends for investors to watch in the coming year

The good fight against inflation

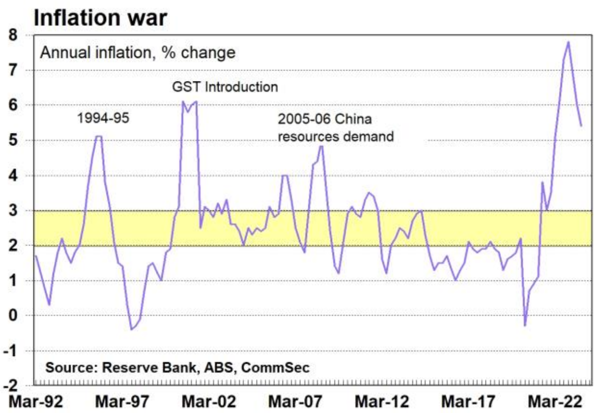
Let's face it, investors have had a trying time over 2023. Sharemarkets have been buffeted by inflation, the rising cost of living, soaring bond yields, recession fears and a Middle East war.

But there have been redeeming features. Unemployment remains low, businesses have been resilient, and recessions have been avoided in many parts of the globe...so far.

In line with other central banks, the Reserve Bank has tightened policy aggressively, lifting rates from 0.1 per cent to 4.35 per cent. The good news is that inflation rates are being brought under control.

The concern is the speed of the correction. The fight could become protracted – so it is important to watch how bond yields track.

The bond market is always a great guide to assessing the outlook for sharemarkets, economic activity and inflation. Bond yields have been especially volatile of late in response to local and global economic data.

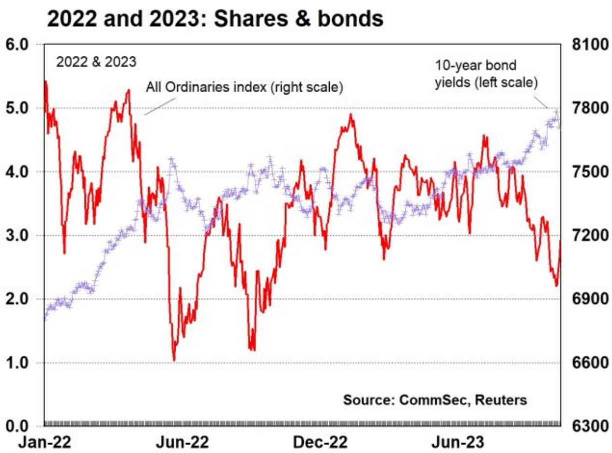


Complications, issues and trends

Each year has its particular complications – in 2023 it has been wars and an oil 'shock-lite'. (Not a shock per se, but OPEC commitment to restrain production) and the Middle East war (from October 2023).

Structural influences such as the mismatch of skills in the job market, the aging population and Covid after-shocks also influenced the sharemarket in 2023.

Now the macro picture is always important for sharemarkets. But then there are the factors that generate interest and excitement at a stock or sector level.



In 2023, lithium (especially the use in electric vehicles), weight-loss pills (Wegovy and Ozempic), artificial intelligence (AI), cybersecurity, ESG – environmental, social and corporate governance (ESG) have all been the talk of financial markets. And that is unlikely to change in 2024.

The key questions that investors must answer: who are the winners & losers; are the issues or trends mania or mainstream; what will be the short and longer-term influences?

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The State of Play

Over the past few years sectors have been bounced around, influenced by changes in inflation and interest rates. **In 2021**, defensive telecom and property sectors were out-performers. Growth-focussed information technology under-performed. The All Ordinaries index rose 13.6 per cent and the ASX 200 rose by 13 per cent.

In 2022, investors switched to the energy sector, attracted by higher oil prices. Tight global supplies and the Ukraine war were influences. Materials were supported by strong building activity and attempts by China to support economic growth. The All Ords fell 7.2 per cent and the ASX 200 fell 5.5 per cent.

Sector Returns %

2021		2022		2023	
Telecom	32.6	Energy	49.0	Info Tech	21.6
Property	26.1	Utilities	30.0	Consumer Disc	15.3
Financials	25.2	Materials	13.0	Telecom	9.1
Consumer Disc	24.3	Financials	1.6	Materials	8.0
Materials	13.9	Industrials	-3.0	Industrials	6.6
Industrials	13.9	Consumer Staples	-4.7	Property	5.1
Consumer Staples	10.2	Health	-7.2	Financials	3.7
Utilities	9.8	Telecom	-10.5	Energy	2.6
Health	9.3	Consumer Disc	-20.4	Utilities	1.4
Energy	0.5	Property	-20.5	Consumer Staples	-4.2
InfoTech	-2.2	Info Tech	-33.7	Health	-6.9
ASX 200	**17.2**	**ASX 200**	**-1.1**	**ASX 200**	**4.6**

Source: IRESS, CommSec. Jan-Nov 2023. Accumulation indexes.

In 2023, the Information Technology sector has led returns with investors looking ahead to the winding down of rate hikes. Defensive health, consumer staples and utilities have responded to high inflation, high interest rates and the elevated cost of living environment. The sharemarket has posted modest gains over the 2023 year to date.

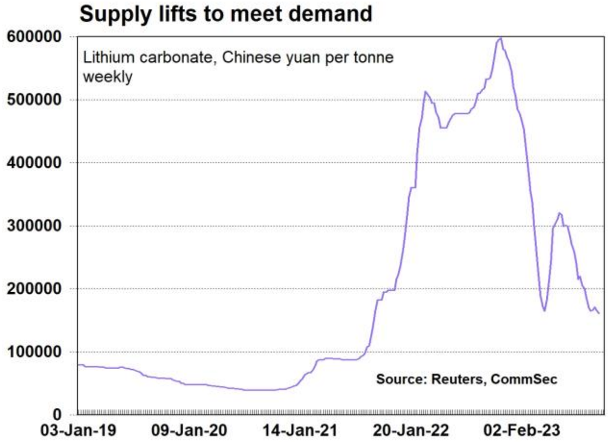
Trends or issues to watch in 2024

Lithium

Global car manufacturers have been hastening plans to replace petrol or diesel-powered vehicles with electric vehicles. Lithium is the key ingredient in the lithium-ion batteries that drive the electric vehicles.

Lithium is used more generally in both rechargeable and non-rechargeable batteries that power a raft of appliances and used in heat-resistant glass and ceramics. Lithium carbonate and lithium citrate are used to treat patients with bi-polar disorder.

Supply lifts to meet demand



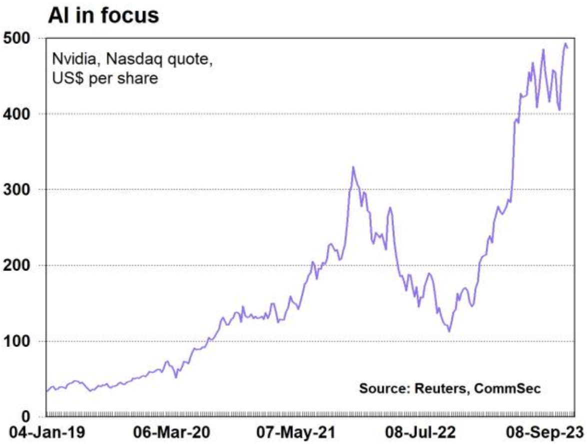
On the Australian Securities Exchange (ASX) there are around 67 companies that produce or explore for lithium as part of their operations. Rio Tinto, Mineral Resources, Pilbara Minerals and Allkem are the biggest companies with exposure to lithium.

Statista notes that *"the total global supply of lithium amounted to more than 634,000 metric tons in 2022. By 2030, it is projected that the world's lithium supply will increase to more than 2.14 million metric tons. Despite the more than threefold lithium supply growth that is anticipated in 2030 relative to 2022, it is expected that there will be a supply shortfall relative to the projected lithium demand in 2030 of 2.3 to 2.45 million metric tons (depending on the source). With the year-over-year increases in global lithium demand expected to be* *considerable over the next decade, significant lithium deposits will need to come online every year in order for supply to keep pace with demand increases."*

The lithium carbonate price stands at 161,500 Chinese yuan per tonne, down 75 per cent on a year ago but four times higher than the price of three years ago. Australia is estimated to account for 47 per cent of global production and has the second largest level of reserves behind Chile.

Artificial Intelligence (AI)

Businesses have been stampeding to get their own versions of AI. Depending on who you talk to, AI is either the saviour for companies seeking to lift productivity or it is a major global threat.



AI is regarded as potentially valuable for dealing with repetitive manual tasks. It can also be used in translation, creative functions like song writing, creating art or visuals by analysing computer code.

Google describes AI as *"a broad field that encompasses many different disciplines, including computer science, data analytics and statistics, hardware and software engineering, linguistics, neuroscience, and even philosophy and psychology."*

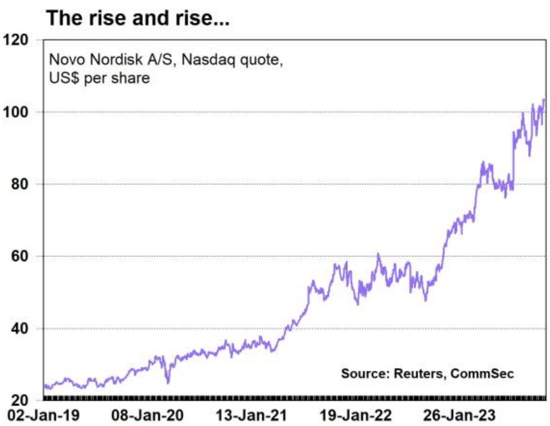
Given the range of potential uses and benefits, it will be important for investors to include AI as one of the issues to cover off when researching companies. Some companies, such as Apple and Amazon have already been accused of falling behind with their use of AI compared with Microsoft and Google. While others like Nvidia have benefitted from the trend to AI. The share price of this producer of AI hardware and software has tripled in price over the past year.

Banks in Australia and the US have rolled out AI products and functions in recent months. Appen (APX), Cirrus Networks (CNW), Brainchip (BRN), Soco Corp (SOC) are just some of the AI-focussed stocks to watch on the Australian sharemarket.

AI use could lift at a logarithmic pace over the next few years. So it's important for investors to keep abreast of new technological developments.

Weight-loss drugs

While it may appear odd to include weight-loss drugs on the list of issues to watch, they have been cited as affecting the outlook for health and recreational stocks. For instance some brokers contend that wide use of drugs like diabetes treatment, Ozempic, and prescription medication, Wegovy, could reduce demand for sleep apnoea products, marketed by companies such as ResMed.

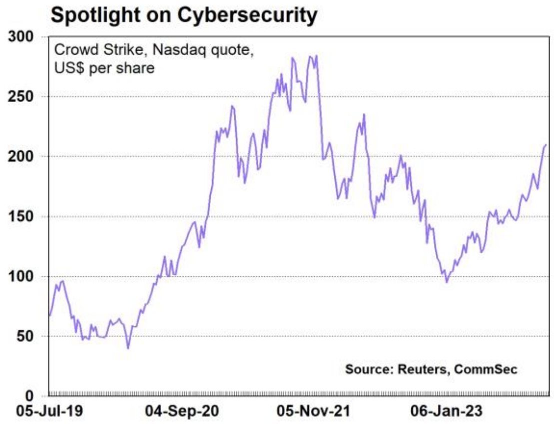


Certainly, shares of Ozempic maker, Novo Nordisk, have more than tripled in the past three years in response to strong demand for the drug. The company has indicated that it will continue to struggle in keeping up with demand for Ozempic. Novo Nordisk also produces diabetes drug, Mounjaro, while rival product, Rybelus, is produced by Eli Lilly.

If users of the weight loss drugs are successful in reducing excess weight, will these lead to changes in behaviour on diet and exercise? The Australian Financial Review cite Morgan Stanley forecasts that 24 million people in the US will be on anti-obesity medication by 2035.

Cybersecurity

With technology continuing to affect more of our lives, the security of home, office and corporate systems is paramount. As part of an expanded range of research issues and topics, investors will need to assess what measures have been made to secure a company's computer systems.



While having measures to prevent hacks in the first place, the importance of back-up and redundancy systems is vital. And, in the worst case where a hack has occurred, investors should focus on the impact it has on the reputation of the company.

Webber Insurance Services has compiled a list of data breaches in Australia since 2018 including Dymocks, DP World and Medibank Private in 2023.

Environmental, social and governance (ESG)

The importance of ESG has significantly grown over time, but this is expected to continue, increasingly taking precedence over traditional investor considerations.

Demographic groups such as Generation Z and Millennials are already placing greater importance on the industry sectors they favour, in preference to selecting companies on traditional financial criteria such as profitability, debt, cash and revenue/expenses.

The share prices of individual companies and the performance of sectors may potentially be influenced by the changes in investment behaviour. A number of sustainable exchange traded funds (ETFs) are available on the Australian sharemarket that meet ESG standards but returns over time have been mixed. Investors can use screener-type tools to narrow the search to stocks and ETFs that meet their ESG requirements.

The road ahead

Past inflation-fighting periods such as 1994 and 2005-2007 provide broad guidance to investors. When rate hike cycles end, or are seen to be ending, forward-looking investors understandably take the view that the economy will lift at a faster than 'normal' pace. Investors then look to the prospects of companies that are dependent on a growing economy. Consumer discretionary led the sectors higher in 1995, after a period of rising rates in 1994. The sector is also amongst the leading sectors in 2023.

Now every cycle has its differences – politics, geo-politics, structural and cyclical economic factors will vary over time. So there are no guarantees which sectors will under or over-perform.

But this is precisely why it is important to watch the issues and trends of the time. It should get us thinking about how different companies and sectors are positioned. And asking what comes next.

Last year we noted that *"Central banks must not just lift rates to slow down the economy, but they must constantly warn that they will do what it takes to get inflation back to desired levels. In Australia, that is 2-3 per cent. In the US, it is 2 per cent.*

In 2023, all eyes will be on inflation readings, but also they will be very much focussed on surveys or financial market indicators of inflation expectations. If inflation rates and expectations of inflation stay stubbornly high, the central banks will lift rates even higher, raising the risk of recessions occurring."

Our views haven't changed. But now central banks have done the heavy lifting and 2024 will be especially important for investors to determine how quickly the inflation goals can be achieved and what this means for where financial investments are headed.

The bond market is always a great guide for investors. The key risk to holding longer-term bonds is inflation, eroding their value over time. If longer-term yields notably ease, then the implication is that tighter monetary policy is working to slow demand, reducing inflationary pressures.

CommSec expects the ASX 200 index will lift to a 7,300-7,600 range by June 2024.

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