

Quarterly economic and market update

June quarter 2024

Quarter in review

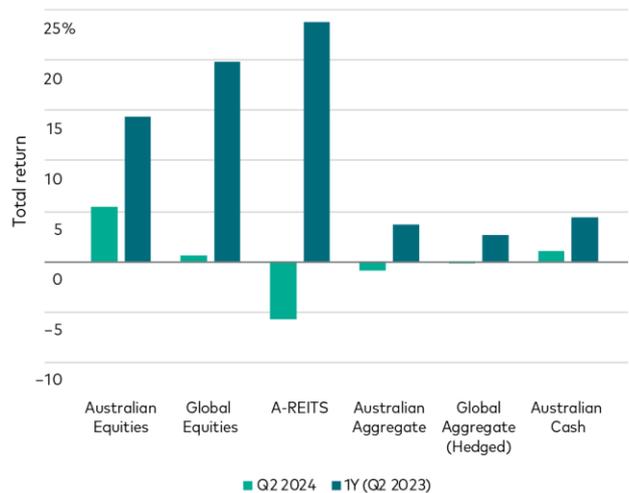
Global equities reached record highs after faltering in April, as the inflation outlook became more favourable as the quarter progressed. The 'bad news is good news' dynamic reemerged as weaker economic data, particularly in the United States, contributed to more interest rate cuts priced in by markets. However, compared with the start of the year, the outlook for most major central bank cycles is higher interest rates for longer. While the RBA kept the cash rate steady at 4.35% in June, commentary became more hawkish. After strong yearly growth, A-REITS underperformed the broader equity market in line with global counterparts (**Figure 1**).

The intensifying AI boom and a strong U.S. earnings season for technology companies saw global growth stocks outperform, with the share price of the largest seven companies concentrated in the technology and communication sectors, more than doubling since the beginning of 2023. The European Central Bank cut interest rates, but European stocks fell (**Figure 2**) as political uncertainty weighed and euro area yields shifted higher. Australian equities also fell 1.2% over the quarter with the materials sector and small caps detracting. Despite Chinese authorities supporting the real estate sector, domestic equities continue to show a stark divergence from peers. Overall, emerging markets outperformed developed markets, boosted by Asia ex-Japan equities and AI-exposed stocks, with the larger Asian market weight offsetting weakness in Latin America.

Broad commodities gained over the quarter as industrial metals rallied while agricultural products were weaker. Iron ore strength buoyed the Australian dollar, which outperformed among G10 currencies against the U.S. dollar.

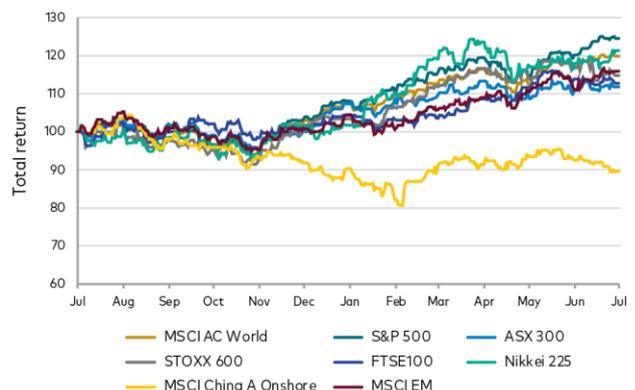
The yen continued to be dragged by its interest rate differential compared with other currencies.

Figure 1. Australian equities lagged



Note: Returns are cumulative total returns denominated in AUD.
Sources: Bloomberg, as of 30 June 2024.

Figure 2. Global equities rally continues with China lagging



Note: Total return indexed to 30 June 2023. Returns are cumulative total returns denominated in local currency of each security's country of domicile.

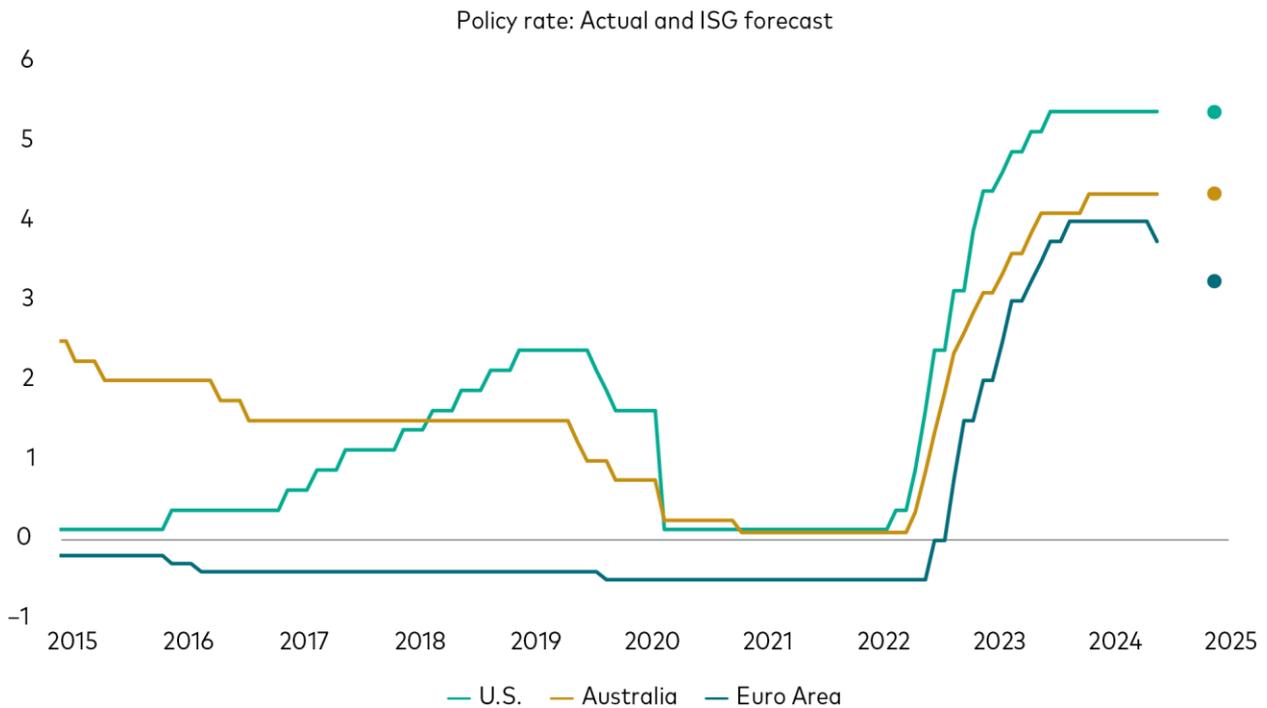
Source: Bloomberg, as of 30 June 2024.

Economic and market outlook

Despite the twist presented by an unexpectedly strong U.S. economy, developments in the first half of 2024 have only strengthened the view that a higher interest rate environment is here to stay (Figure 3). The U.S. economic resilience continues to be supported by supply side forces, with labour productivity still above the pre-COVID trend. Continued economic growth, labour momentum, and stubborn inflation are likely to leave the Federal Reserve without the confidence it needs to cut interest rates this year.

Europe is facing a very different environment than the United States. Both the euro area and the United Kingdom flirted with recession in late 2023 before returning to growth in the first quarter of this year. China still faces deflationary pressures and feels constrained by the U.S. Fed, with depreciation pressure on the renminbi. China's central bank may cut rates, but not by as much as it otherwise might and perhaps later than planned due to the Fed staying on

Figure 3. Monetary policies likely to diverge temporarily



Sources: Vanguard calculations, based on data from Bloomberg as of 30 June 2024.

In Australia, the lacklustre GDP growth in Q1 suggests that prior monetary tightening has begun to curb demand. The softening in demand has been even more stark considering the strength in population growth, which has been supported by the surge in net migration. Meanwhile, the economy's supply side also displays weaknesses. The elevated unit labour costs growth still persists at a rate that is above what is consistent with the RBA's 2%–3% inflation target, which has been supporting sticky inflation. As a result, Australia may end

up being the last developed market to cut rates, as it is increasingly concerned about whether it can bring inflation back to target next year.

At the midpoint of 2024, rates and corporate earnings remain the key areas of focus for equity and bond markets. While markets have broadly rewarded investors staying the course, the key components of the outlook are not significantly changed. It's unlikely that the tailwinds that have driven exceptional

performance over the past decade will continue to the same extent in the decade ahead.

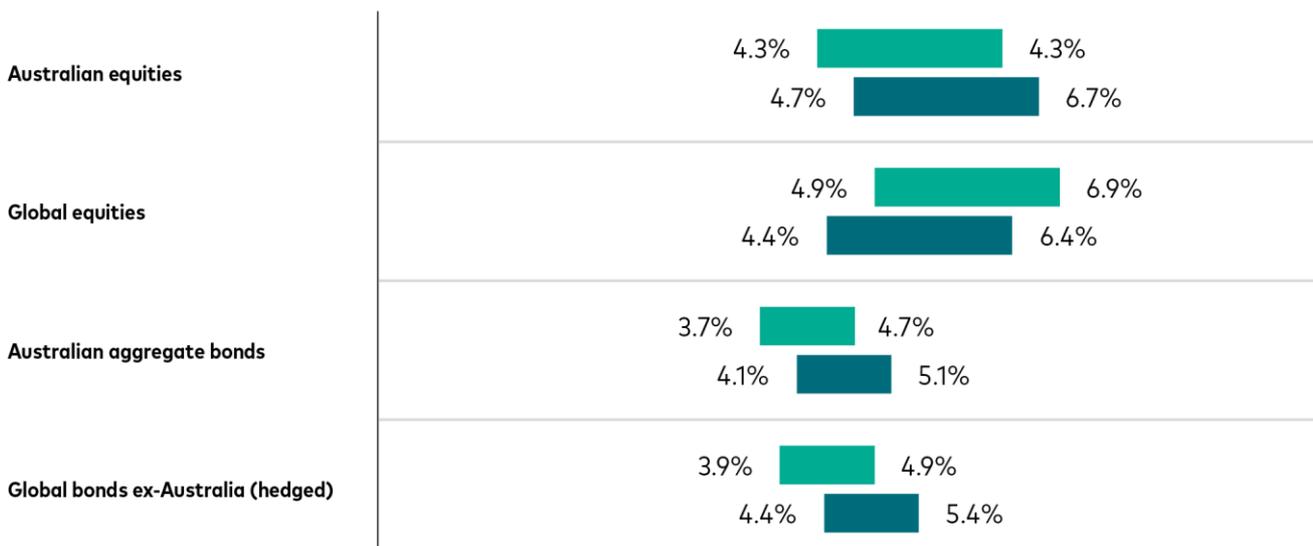
Valuations continue to show a different picture inside and outside of the United States. The broad U.S. equity market remains richly valued, while valuations outside the United States appear more attractive. Although valuations are typically poor indicators for short to medium-term performance, over the long run, stock

market returns are likely to appear more similar across regions and continue to provide a case for diversification.

In bond markets, the long-term outlook continues to be supported by an expectation for higher rates. Sticky inflation in Australia and economic resilience in the United States strengthen the view that higher interest rates are here to stay.

Figure 7. Outlook for the decade ahead

Australian dollar



Forecast ■ 2023 year-end ■ 2024 mid-year

IMPORTANT: The projections and other information generated by the Vanguard Capital Markets Model regarding the likelihood of various investments are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modelled asset class. Simulations as of December 31, 2023, and May 31, 2024. Results from the model may vary with each use and over time. For more information, please see the important information slide.

Note: Figures are based on a 2-point range around the 50th percentile of the distribution of return outcomes for equities and a 1-point range around the 50th percentile for fixed income.

Sources: Vanguard, July 2024 using 31 May 2024 and 31 December 2023 VCMM Simulations.