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Investment Management

Window on the world

APRIL 2024

Introduction

With the on-going cost of living crisis, the war in Ukraine, and the situation in Gaza, the world seems quite an unsettled place right now, so it’s perhaps a surprise to see that the first quarter of 2024 has been a positive one for equities, with some markets rallying to new all-time highs.

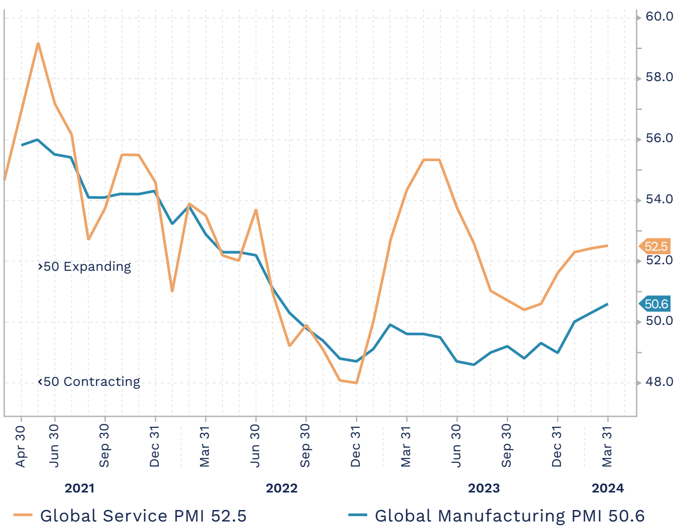
The main reason for this has been better than anticipated economic performance and consequentially a growing optimism that there won’t be a global recession let alone a major one. The question that investors have been asking for some time therefore is when will central banks cut interest rates? Opinion on this has ebbed and flowed with each new economic release or comment from the US Federal Reserve. As we stand today, the good news about the economy probably means that interest rates won’t be cut as soon as some investors had hoped for because inflation may prove to be stickier than initially thought.

Economic Conditions

Economic conditions remain broadly robust as global manufacturing picks up.

Robust economic data in the US was a key theme in 2023, and this has very much remained the case this year. Encouragingly, there is also evidence of improving economic conditions in other regions. The backbone of many economies is the manufacturing sector, and this is showing signs of picking up as global demand increases – which is good news as it’s been in the doldrums for 18 months. We can see this because a survey called the Purchasing Manager Index (PMI) provides a useful and reliable economic guide for assessing activity in coming months. The chart below shows the global manufacturing PMI (the blue line) has been steadily improving since December and is now above 50 which is a sign the manufacturing sector is expanding rather than contracting.

GLOBAL MANUFACTURING AND SERVICE PURCHASING MANAGER INDEX SURVEYS ARE SIGNALLING EXPANSION IN BOTH AREAS



Source: Bloomberg. The Purchasing Managers’ Index is an index of the prevailing direction of economic trends in the manufacturing and service sectors. A reading above 50 represents an expansion; a reading below 50 represents a contraction.

When you delve into the figures in more detail it shows that the US, China, and the UK are all above 50, whilst the picture is more mixed in Europe; where Germany, often seen as the powerhouse of the continent, continues to lag behind France and Italy. However, we expect to see a continuation of this improvement which will benefit regions such as Asia and Europe, where economies are more cyclical in nature.

The other part of the global economy is services and as the chart shows the global services industry (orange line) remains in good health. It’s because the services industry has been robust globally, following the end of COVID-19 restrictions, that certain economies, particularly the US, has so far avoided recession, which has been a welcome surprise given the large rise in US interest rates.

A key factor behind this has been the strength of the consumer, helped by tight labour markets and more recently rising real wages. The US has been a key beneficiary of the latter, and we expect this to now broaden out to the UK and Europe. The official unemployment rates in the US remains very low at 3.9%, and labour market data continues to suggest a healthy level of job creation and new openings, which is positive news for the economy.

The cost-of-living crisis has been headline news in the UK for quite some time, and although the rate of inflation has slowed considerably, prices are a lot higher today than they were only 12 months ago. The recently announced cuts in National Insurance rates will help consumers and is estimated to be worth between up to 0.3% of Gross Domestic Product (GDP). At the end of 2023 the UK was technically in a recession (defined as two consecutive quarters of negative GDP growth) but more recent GDP data indicates the economy is expanding again, suggesting the threat of recession has passed. Another positive note is house prices and retail sales, both of which have recently surprised to the upside, so with the prospect of rising real incomes (with wage growth outstripping inflation) and supportive fiscal measures the foundations for a further pick-up in the UK economy are in place as we move through 2024.

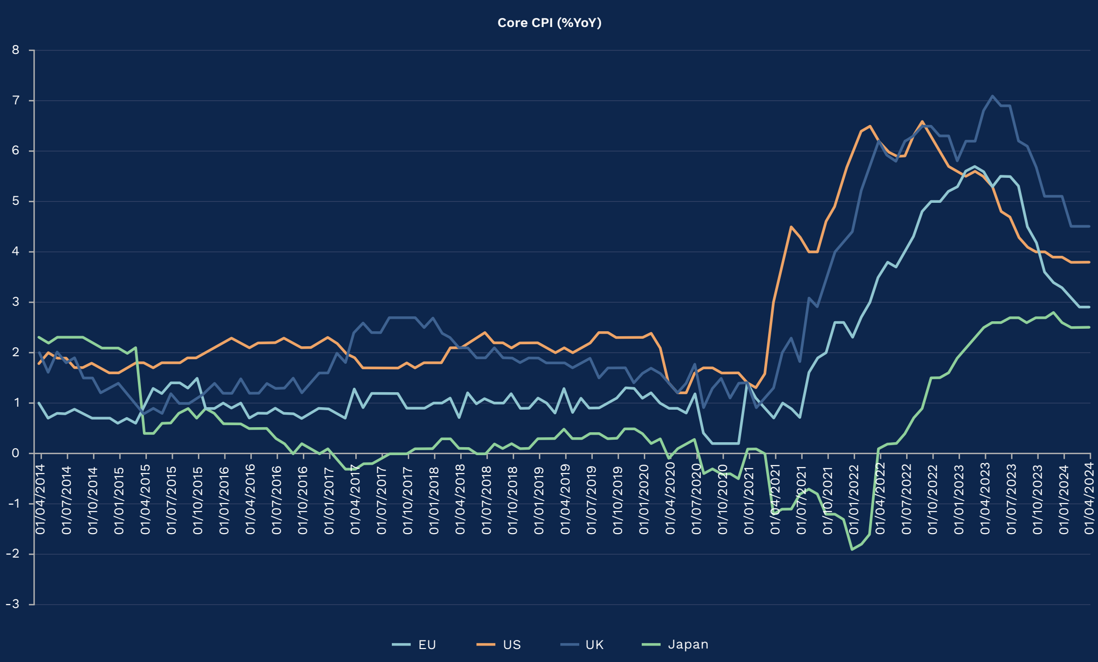
Elsewhere, China whose economy has been in the doldrums continues to improve. Retail sales grew at 5.5% in February, and industrial production picked up by 7.0%, its highest year-on-year change in two years. And in Japan the economy avoided recession in 2023, and despite household spending remaining weak the stock market has performed very well this year.

Central Banks

Central Banks remain a focal point, as does inflation.

Inflation is the key to when interest rates start to fall and whilst inflationary pressures have been easing in both the UK and Europe, where core Consumer Price Index has continued its decline, in the US the last two US inflation readings have been more sticky. On the other side of the world Japan finds itself further behind in the inflation cycle, with it remaining at elevated levels relative to its history which not been helped by a weak Yen which has imported inflation.

/ INFLATION HAS REMAINED ON A DOWNWARD TRAJECTORY IN MOST DEVELOPED MARKETS



Source: Bloomberg.

It's worth having a closer look at why US inflation has been sticky. There has been an across the board rise in a range of areas – shelter, gasoline, used cars, clothing and airfares – and whilst some may be partly attributable to seasonal factors in all likelihood it should continue to fall. However, we have to watch the oil price carefully which has risen sharply this year as have some other commodities all of which inevitably leads to an uptick in inflation.

This has meant that most central banks (with the exception of Japan) have kept interest rates on hold during the quarter, while investors remain focused on when interest rates cuts will start. Market expectations for the number of rate cuts from the Federal Reserve, Bank of England and European Central Bank have come down from an optimistic six to seven at the end of 2023, to two or three cuts this year, which is probably a much more realistic path for interest rates to follow.

Whilst there's an element of disappointment that rate cuts won't happen until later in the year and that they'll be less than expected only a short while back, it shouldn't be forgotten that it's a lot to do with the resilience and improvement in economic data which is positive, even with inflation remaining sticky – it wasn't so long ago that the major concern was recession and how deep it would be!

Monetary policy therefore remains tight, but we expect the first cuts will be this summer – it's also looking likely that the UK and Europe may cut rates sooner than the US, something that doesn't happen very often!

Capital Markets

As we said at the beginning of this article equity markets have rallied on the back of robust economic data in the first quarter of 2024, amidst growing optimism that a soft landing remains in sight. US equities once again led the way, with strong performances from two large technology companies – Nvidia and Meta – acting as the driving force, although there were also strong showings from financials, energy, industrials, and materials. Investor sentiment towards Japan remains strong, driving the market higher, despite the authorities tightening monetary policy.

European equities were also higher, driven by strong performances from two key large cap companies – semiconductor equipment company ASML and software provider SAP and also European Banks. UK and emerging market equities lagged, with China weighing on the former in January, whilst UK underperformance primarily relates to a relative lack of high growth companies.

Government bonds and fixed interest in general declined marginally during the first quarter, as yields rose as the expectation of interest rate cuts faded. Despite this the case for fixed income remains strong supported by yields that haven't been seen for many years.

	Total Return (%)			
	1 Month	3 Month	12 Month	YTD
UK Equities	4.8	4.0	8.1	4.0
US Equities	3.2	11.8	27.0	11.8
European Equities	4.3	11.4	18.3	11.4
Japanese Equities	3.4	11.1	21.2	11.1
Emerging Market Equities	2.5	3.6	6.2	3.6
UK Gilts	1.8	-1.8	-0.5	-1.8
UK Corporate Bonds	1.9	0.2	7.4	0.2
UK High Yield Bonds	0.5	2.8	14.7	2.8

Source: Bloomberg, as of end March 2023. Total returns in Sterling terms.

We remain positive on fixed income as an asset class with yields at 15 year highs.

Activity and Positioning

As yields rose in fixed income assets we took this opportunity to increase the duration of our fixed income positions across our bond and multi-asset strategies, which we expect to pay off as interest rate cuts eventually come through.

Within equities, we have added further to UK and European equities, at the expense of US equities (which are expensive), and we also added further to small caps positions where we see some very cheap stocks.

Looking forward, we remain positive on fixed income as an asset class with yields at 15 year highs. Whilst in equities, we are positive on the UK, Europe and emerging markets.

We think these will benefit from a broadening out in equity investor focus, as the current market leadership fades, helped by the recovery in global manufacturing and their lower valuations which makes them appealing. Given the strong rally in markets over the past five months, some pull-back cannot be ruled out, but we'd see this as both healthy and a buying opportunity.

In summary, the first quarter of 2024 has been good for investors despite a range of global geopolitical issues, and we are positive on the outlook for the rest of the year. No doubt there'll be some surprises, positive or negative, but our portfolios are well diversified, carefully managed, and are well positioned for the months ahead.

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