Spring 2024

market outlook.

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contents.

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The UK Economy

The FTSE 100 reached new all-time highs over the period, whilst a strong US dollar has provided a significant boost to international and large-cap companies. Mid and small-cap indices have also shown promising upward trends; however, they are yet to bridge the gap to reach all-time highs. Against this backdrop, mergers and acquisitions are on the rise, buoyed by attractive valuations of UK companies. We have witnessed noteworthy acquisition approaches for FTSE 100 firms like Anglo American and DS Smith.

The current economic landscape presents a stable backdrop with promising signs of recovery, akin to green shoots emerging for consumers. Average weekly earnings continue to demonstrate strength, bolstering consumer confidence and spending power. This trend is expected to persist, buoyed further by impending minimum wage increases, providing additional support to household income. However, the labour market shows signs of loosening with declining job vacancies, indicating a potential slowdown in hiring activity and a slight uptick in unemployment. As we get closer to a general election, with the latest possible date set for January 2025, we expect the incumbent to ramp up fiscal giveaways to bolster their chances of re-election. Regardless of the election outcome, the impact upon businesses is likely to be minimal due to the diminishing policy divergence among political parties.

Inflation has undergone a swift decline, with energy costs serving as the primary factor offering relief to UK consumers. Despite this positive development, inflation still hovers above the Bank of England's 2% target and interest rates remain elevated at 5.25%. While higher rates stand to benefit household income, particularly for those in a net savings position, we are cognisant that elevated mortgage rates are exerting downward pressure on housing transactions and property prices.

Interest rate cuts are still on the horizon for this year. However, it's important to manage expectations regarding the pace and magnitude of these cuts. Unless there's a notable deterioration in the overall economic backdrop—which, as of now, is not the primary scenario being considered— interest rates are not heading back to the extreme lows witnessed since the financial crisis.

The European Economy

European Central Bank President Christine Lagarde's recent announcement that rate cuts are less imminent than anticipated has stirred unease among market participants. This shift in expectations could gradually lead to an overdue correction in the market potentially unveiling compelling buying opportunities, as countries look to address/fund their debt burdens causing short-term stresses.

Concerns surrounding rising debt-to-GDP ratios have the potential to induce market sensitivity, as demonstrated by France's recent consideration for a credit rating downgrade. While the subsequent decision to maintain its rating offered temporary respite, it underscores the fragility of market sentiment in the face of fiscal challenges.

The emergence of far-right political movements ahead of imminent EU elections introduces an additional layer of uncertainty for European markets. The potential for shifts in policy direction and geopolitical dynamics could exacerbate short-term volatility.

The US election brings about uncertainty regarding possible policy changes with a new administration, especially considering the strained US-Europe relations during the Trump era. While President Trump has typically favoured a pro-business approach, past conflicts over policies and trade disputes could lead to market volatility during the election period, until we get more certainty on Trump's approach to the special relationship.

The US Economy

In the midst of fluctuating interest rate expectations, the Federal Reserve remains steadfast in its commitment to data-driven decision-making. We have taken advantage of distortions in markets as a result of misinterpretations of Federal Reserve narrative. Given the global nature of commodity pressures and the divergent economic support between emerging markets and developed economies, the coordination among central banks may grow increasingly vital. The Fed, in particular, may need to consider global currency dynamics and trade implications before implementing any rate adjustments.

The US presidential election campaign has thus far been relatively subdued, with candidates sidestepping contentious domestic issues that could potentially damage their electoral prospects. During this period, intermittent tensions between the US and China may arise, potentially leading to short-term fluctuations in the market. However, amidst this uncertainty, there could emerge valuable buying opportunities as the temporary disturbances subside.

Recent commentary from Federal Reserve officials have sparked apprehension among investors regarding the future trajectory of interest rates. This uncertainty has again brought technology and growth stocks into focus, presenting them as key alternatives to traditional bonds for investors seeking to hedge against fluctuations in interest rate expectations. As earnings season approaches, market volatility is anticipated to intensify. However, rather than being deterred by fluctuations, we may recognise these downturns as favourable entry points for long-term investment.

Market valuations have been influenced by the significant weighting of mega-cap stocks, leading to skewed metrics. Nevertheless, opportunities persist within the region, particularly for small-cap companies poised to benefit from electoral outcomes and attractive valuations. In addition, the uncertainty surrounding the yield curve may once again underscore the importance of value and growth positioning in investment strategies.

The Japanese Economy

The Bank of Japan(BoJ) implemented its first-rate hike in 17 years in March, marking a significant shift in monetary policy. However, BoJ's narratives and actions suggest recent tightening is not indicative of a full cycle but rather a recalibration away from negative rates.

Following the March rate hike we have seen a decrease in the value of the Yen relative to the US dollar. Consequently, policymakers are preparing to adopt a cautious strategy, likely monitoring actions of the Federal Reserve in the US. This prudent approach aims to navigate potential fluctuations in the currency market and maintain stability in the Yen's value. As a result, it is unlikely that the currency will experience further significant weakening.

While the long-term investment prospects remain favourable for small-cap stocks, the current market dynamics are being heavily influenced by the price-to-book rules introduced by Tokyo's Stock Exchange and as such large and mega-cap companies are poised to maintain their strength in the market until 2025 when the stock exchange will "name and shame" any companies with a price-to-book of less than 1.

The potential for inflationary pressures continues to be a significant consideration for investors and policymakers alike. This year's wage negotiations have resulted in strong announcements, but concerns persist regarding inflation, especially with external pressures. The true level of domestically driven inflation could be lower than anticipated, with imported inflation a key component to current headline levels.

Emerging Markets & Asia Economy

We have seen China’s economic momentum start to gain pace in 2024. Policymakers have introduced a wealth of new fiscal and monetary stimulus measures to drive growth, such as the ‘Project Whitelist’ initiative (aiding struggling property developers) and the cutting of a key mortgage reference rate to boost the property sector. Following the Lunar New Year, there have also been notable upticks in travel and retail sectors, indicating consumers are gaining confidence which will continue to climb. We have witnessed an uptick in the domestic A Share market whilst the Hang Seng has further proven fruitful over the quarter, rebounding into positive territory – a clear sign of the resiliency of the market.

The US election may indicate the direction that US/China relations will take going forward. We anticipate some noise in markets as the election gets underway but maintain that China could stand to benefit from either party being appointed in office. Currently, President Biden is making a concerted effort to thaw the US’ relationship with China and, while the market is negative on Trump being re-elected, Trump is very pro-business (and even forged a trade agreement with China before he stepped down from office during his last term). Moreover, other tensions, such as those developing within the Middle East, could create pockets of volatility in markets that breed opportunities in the Emerging Market space as these regions look to capitalise on pressures within the commodity market.

India had one of the strongest markets in 2023. Investors may be forgiven for cashing in on gains from this region, given that 2024 introduces some uncertainty as another political election looms. Prime Minister Modi is running for office again and is a candidate who caters to the majority of the population by supporting agriculture which, although constituting a small portion of GDP, is indicative of his efforts to garner votes. The turnout for voting has been volatile - mirrored by market movements - in wait for India’s next leader. Post-election, we anticipate that there will be greater clarity on the political landscape, as well as market stabilisation.

The Latin America region was proven to be a strong performer over 2022-23, driven by the commodity cycle and a favourable election in Brazil. However, it is also the year in which an election is occurring in Mexico, which may cause temporary disruption in markets. Various pressures on commodities may prompt a revaluation within the Brazilian market, considering its significant weighting to commodity and banking sectors, both of which seem somewhat vulnerable at present. Nonetheless, there persists a convincing argument for long-term investment. While opportunities found elsewhere in the Emerging Market region perhaps present stronger risk return opportunities, we still endorse that the region has a strong long-term investment case.

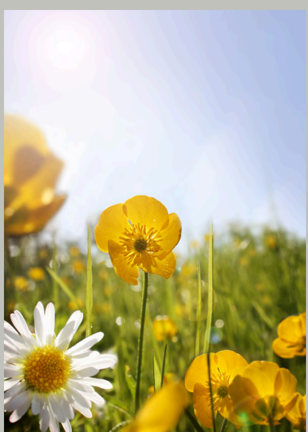
Fixed Interest

Government bond yields generally moved higher over the quarter driven by market expectations of rate cuts in 2024.

Spreads remain tight relative to long run averages, suggesting that investors have confidence in the creditworthiness of issuers.

Investment grade companies remain well positioned to weather potential economic downturns, with strong balance sheets (i.e. ample cash, healthy assets, and appropriate amounts of debt).

A mix of core yields and their spread component make all-in yields quite attractive.



If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on 0800 049 2011, Monday to Friday 9am-5pm or you can email us at affinity.advise@wealthatwork.co.uk

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