Summer 2024

market outlook.

Brought to you by the Investment Management Team

affinity financial awareness
part of the Wealth at Work group

contents.

Written by:

The Investment Management Team

affinity financial awareness

part of the Wealth at Work group

The UK Economy

The UK market has held its ground, performing in the middle of the global pack, despite a protracted period of downbeat sentiment driven by subdued economic growth, elevated inflation, Brexit-related challenges and political uncertainty. This has led to discounted valuations for internationally competitive businesses simply because they are listed in the UK, offering attractive prospects for investors.

The UK's economic landscape has seen significant improvements this quarter. Investors hope for greater political stability from the new Labour government and await details of their policies which are due to be outlined in the Autumn Budget. We have also witnessed inflation easing, rising disposable income, and increased confidence in the market. Recent returns in the UK have been relatively attractive and valuations suggest there is still substantial potential for continued growth. Despite current expectations remaining relatively modest, the improving economic outlook provides fertile ground for long-term investment opportunities.

Despite challenges such as the lingering effects of the pandemic, supply chain disruptions, and elevated interest rates, the case for long-term investment in the market remains compelling. Adopting a long-term investment strategy and looking beyond short-term noise is crucial. Rising confidence is evident from a stronger Sterling, an increase in takeovers, and a resurgence of IPOs, signalling the potential for a market re-rating.

Nonetheless, caution is warranted due to elevated interest rates and conservative consumer behaviour, with many opting to save rather than spend their disposable income gains. Excess consumption during the pandemic has also led to extended replacement cycles and a reduced appetite for big-ticket items. After holding rates steady since August 2023, the Bank of England's recent 0.25% cut, bringing rates to 5.00%, signals a positive shift in policy. While a rate cutting cycle or a swift return to near-zero rates remains unlikely in the near term, this supportive monetary adjustment is expected to boost consumer and business confidence and create a more favourable environment for economic growth throughout the year.

The European Economy

Over the quarter, the European Central Bank (ECB) cut interest rates by 0.25%, leading Western banks with this policy shift. This move underscores the ECB's data-driven approach and willingness to adapt to economic conditions. While Eurozone economic data is mixed, the rate cut signals the ECB's commitment to growth and inflation stabilisation. However, as highlighted by President Christine Lagarde it doesn’t mark the beginning of a rate-cutting cycle particularly given that inflation remains above the 2% target. Policymakers will continue to assess economic conditions before further action. We maintain a cautiously optimistic view on Europe’s outlook, supported by relatively modest valuations and the ECB's more accommodative stance, which is likely to ease the debt burdens for households and companies.

French political uncertainty, sparked by President Macron's dissolution of Parliament after his party's EU defeat, has led to market volatility and concerns about a potential far-right government. The snap elections saw a Leftist alliance win, with Macron's centrist group second and Marine Le Pen’s far right third, but no party secured a majority. With the Paris Olympics underway, Macron has called a political truce, leaving the landscape fragmented and uncertain. Markets reacted positively to the stalemate, as it limits drastic fiscal changes. Short-term disruptions, particularly in the aftermath of the Olympics, may occur as coalition talks begin, but they are unlikely to have a lasting negative impact on the European economy.

Over the quarter, Europe's relationship with China, a major trading partner, has been in focus. Following a surge in Chinese electric vehicle exports to Europe, the EU proposed a 37.6% tariff on these vehicles to protect its automotive industry. While the tariff is still pending approval from all member countries, the tariffs have sparked discussions on the potential impact on European car manufactures and consumers. China has responded with anti-dumping investigations into European pork and brandy. Although these measures might initially seem contentious, they could actually serve as a catalyst for renewed trade talks. By directly addressing these trade imbalances, Europe and China may find opportunities to rebalance their economic relationship and explore new areas of strategic cooperation.

The potential return of Donald Trump as US President could have significant implications for Europe. His previous administration created tensions over trade policies, NATO contributions, and diplomatic relations, which introduced uncertainty into transatlantic ties. A Trump presidency might revive these challenges, particularly regarding trade tariffs and defence, including support for Ukraine. However, Trump's emphasis on deregulation and tax cuts could benefit certain European industries with strong connections to the US.

The US Economy

xpectations surrounding interest rates continue to be a significant driver in the markets. Despite other major central banks implementing rate cuts the Federal Reserve has opted to hold rates steady over the quarter at 5.25-5.5%, underscoring their commitment to data-driven decisions. Fed policymakers are closely monitoring economic trends rather than reacting to isolated data points. CPI and other inflation measures have trended modestly lower, with inflation falling to 3% in June 2024, an encouraging sign that the Fed may be ready to initiate a rate cut in September.

Recent market dynamics have been significantly shaped by investor expectations regarding US Federal Reserve policy. Weak manufacturing PMI and signs of a cooling labour market, following the Federal Open Market Committee's July meeting, led investors to believe that policymakers might be falling behind the curve, which triggered a global market sell-off. However, this viewpoint is not novel and has been proven wrong several times before. The Fed continues to be data-dependent, as it always has been, making decisions based on a comprehensive analysis of economic indicators and trends rather than reacting to a single set of data. In this context, the market fluctuations could present opportunities for long-term investors, particularly when trading volumes stabilize.

The recent market selloff caused a long-overdue correction in highly valued mega-cap stocks. We mitigated the impact of this correction by employing ETFs and thematic investments. We are aware that these mega-cap stocks have been used by the market as bond proxies, which provide stability in times of uncertainty. However, we have also focused on small and mid-cap equities (which are more sensitive to interest rate changes) along with income and value-oriented strategies. Nevertheless, many US corporations remain fundamentally strong, making the recent market selloff an opportunity to acquire high-quality assets at more attractive prices.

President Joe Biden's withdrawal from the November election has shifted the political landscape, prompted by concerns about his campaign's viability and the belief that Trump's survival of an assassination attempt might bolster his re-election chances. With Biden out, Vice President Kamala Harris has emerged as the Democratic candidate, likely continuing Biden's policies and alleviating some policy uncertainty. As the election approaches, Harris has managed to reverse Trump's growing lead. Market reactions have been relatively subdued, with investors having familiarity with the policies of both administrations. One should anticipate some noise and volatility as the election draws closer, which could present potential buying opportunities.

The Japanese Economy

During the quarter, the depreciation of the yen has slowed, with the currency even strengthening nearly 1% to 148.51 per dollar by the end of July. A strengthening of the currency could offer several positive outcomes for the region, including reduced import costs for domestic businesses (thus decreasing expenses and enhancing consumer purchasing power), alleviating inflationary pressures, and lowering the costs associated with foreign investments.

In July, the Bank of Japan adopted a hawkish stance, implementing an interest rate hike that increased rates to approximately 0.25%. This is only the second interest rate hike in 2024, as policymakers must limit monetary tightening to ensure consumer demand - and spending - is maintained. Without such measures, there is a risk that inflation will stagnate, potentially leading to deflation, a condition the region has historically experienced and tried to reverse. In June 2024, core inflation (excluding fresh food) rose by 2.6% year-on-year. However, economic data indicating growth for the region remains inconsistent, with indicators such as employment, retail sales, and wage growth showing significant variability.

Despite the Bank of Japan's exit from negative interest rate territory in March 2024, along with other monetary easing measures such as the termination of yield curve control, the spectre of low inflation continues to hang over Japan. As the year progresses, policymakers may consider implementing further monetary easing measures, but will likely strategically position these efforts behind Federal Reserve rate cuts to avoid an appreciation of the yen.

Investors' capacity to purchase Yen at low rates and subsequently invest in high-growth assets such as the "Magnificent Seven" over the past quarter indicates Japan's involvement in a carry trade. In the wake of the Bank of Japan's recent interest rate increase in July, coupled with the potential for further hikes, traders began to sell-off their assets. While this sell-off alarmed even those market participants not engaged in the carry trade, leading to a brief period of market volatility, it was non-fundamental in nature and ultimately presented investors with a buying opportunity and a valuable entry point into the market.

Emerging Markets & Asia Economy

As anticipated, India's Prime Minister Modi was re-elected for a third consecutive term, offering markets a sense of stability and continuity. Although he did not secure a landslide victory, Modi successfully retained his position without resorting to major political manoeuvres, such as substantial monetary investment in agriculture (which constitutes approximately 70% of the population but only approximately 16% of GDP). This strategic approach has enabled Modi to concentrate on enhancing India’s infrastructure, increasing employment opportunities, and reforming welfare initiatives - thereby fostering economic growth.

China's property sector challenges have been largely addressed by policies aimed at boosting housing demand, such as government purchases of unsold properties and lower mortgage rates. These measures are expected to gradually restore market confidence. Despite concerns about a potential Trump presidency and his controversial statements, China's performance under his administration might exceed market expectations. Historically, Trump successfully negotiated a trade deal with China (aside from COVID-19 disruptions), suggesting he may be inclined to collaborate with China to advance his business growth agenda.

Over the quarter, the Latin American region has experienced a pullback mainly driven by issues in Brazil and Mexico, namely surrounding the potential for Mexico’s new government to implement contentious law reforms and a moderation of prices in the global commodity market. However, the recent recognition of the essential role of fossil fuels, both in the development of renewable energy systems and in its more standardised usage, positions Brazil (as a major producer of commodities like oil and the largest producer of gas in Latin America) as an appealing opportunity for investors. Additionally, Mexico's new president, Dr. Claudia Sheinbaum, is determined to chart her own course rather than continuing the policies of her predecessor, AMLO. Her administration may also stand to benefit from a potential second term of Trump, given his administration's emphasis on maximizing opportunities for, and advantages of, trade.

The United States imposed restrictions on chip-making exports to China to prevent the latter from achieving self-reliance in supercomputing and developing AI for the benefit of their military. Consequently, China in part shifted its focus to the utilisation and development of legacy chips, which are older chips used in household appliances and electric vehicles. Despite these US blockades, however, China's ambition to advance in the technology sector remains undeterred. The country has recently established its largest semiconductor investment fund in pursuit of self-sufficiency in the industry.

Fixed Interest

Over the quarter, government bond yields have moved lower, resulting in positive returns.

Credit spreads continue to be tight relative to historical averages, reflecting that economic data has remained relatively supportive alongside company fundamentals and strong technicals.

Investment grade companies possess strong balance sheets that will position them appropriately to withstand times of economic volatility.

All-in yields continue to look attractive to investors.

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

affinity financial awareness
part of the Wealth at Work group