Winter 2024

market outlook.

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contents.

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The UK Economy

The FTSE 100 delivered a Total Return of 6.47% in 2023, the Mid 250 Cap Index achieved a similar result of 6.45%. However, their paths to achieve these results were markedly different. Nearing the end of October, Mid-Caps experienced a notable dip of around 10%, while large-cap stocks maintained a steadier, relatively flat course. Domestically focused stocks surged in Q4 fuelled by signs that the Bank of England's interest rates may have hit their ceiling and as the UK shed its label as an outlier with sustained falls in inflation.

The Bank of England has paused monetary tightening post-August's meeting. Interest rates, which stood at a modest 3.5% at the beginning of 2023, now stand at 5.25%. Markets initially priced in a 25-basis point cut in May 2024, but have since pared back expectations, eyeing a cut in June. Wages are finally showing signs of aligning with inflation's downward trend. Data is indicating that current rates are contractionary, suggesting we have hit peak rates; however, we don't expect a sudden cutting cycle to the ultra-low rates of yesteryears, as borrowing costs are expected to settle at a higher ground, barring economic collapse.

With inclement weather conditions over the period, consumers have been less enthusiastic about hitting the high streets, leading to disappointing retail sales over the Christmas period and a challenging start to the new year for retailers. Nonetheless, consumer confidence is picking up with wages outpacing inflation, purchasing power is slowly creeping back into the pockets of the consumer. The economic climate remains uncertain with the effects of higher rates yet to fully filter through the economy, with more refinancing on the cards in 2024, including mortgages and car loans.

2024 is likely to be an election year for the UK. So far, the policy divergence between major parties appears to be narrower than we've seen in previous years, which means we might expect a smoother than usual transition of power, no matter the outcome. The UK market remains relatively undervalued compared to its international counterparts. A large proportion of the market is comprised of global businesses with multinational revenue streams providing a shield against domestic economic headwinds.

The Japanese Economy

Companies not meeting the Tokyo Stock Exchange's rule on price-to-book ratio may face delisting by 2026, urging corporations to enhance return on equity and manage cash, boosting Japan's appeal for foreign investment. A significant number of companies are currently trading below book value, harbouring potential for strong performance in 2024 driven by market flows betting on expectations.

We continue to explore opportunities in the under-researched small-cap space where mispricing is common, leading to attractive valuations. Large caps could see pockets of good performance on the expectation that markets will continue to respond positively to corporate efforts to improve shareholder value.

The era of the negative interest rate, a hallmark of Japan's battle against deflation, might be drawing to a close. Bank of Japan's governor Ueda has hinted at eliminating negative short-term interest rates however due to the exogenous nature of inflation, further evidence is needed to convince the Bank of Japan as to its durability and signs of sustained wage growth. We could see some volatility driven by speculation of the possible shift in policy.

Over the period the Yen has reached multi-decade lows at ¥148 against the USD. The Yen's weakness reflects the disparity between Japan's ultra-loose monetary policy and that of other major economies. However, with the major central banks (e.g. Federal Reserve in the US) expected to cut rates this year the Yen is unlikely to weaken further. A weaker Yen has played a key role in driving equity markets higher increasing the competitiveness of Japan's exports. These trends align with policies emphasising market reform, aiming to position Japan as a more competitive and appealing destination for foreign investment. However, one must not forget that Japan's economic backdrop and in particular labour market/wage data remains unable to stand alone without policy.

The Emerging Markets & Asia Economy

China's valuations have become some of the most attractive globally, with Chinese markets nearing the lows experienced during the Global Financial Crisis. Despite global uncertainties, China achieved a commendable growth rate, exceeding 5% in 2023, significantly outpacing other major economies. In the property sector, China is pulling the levers of support, looking to stabilise and inject confidence into the market. The government has been conservative thus far with regard to monetary policy – possibly waiting for policy normalisation in the West to make its next move - a strategic consideration to manage the currency impact. Looking ahead, we could expect to see interest rate cuts and a further decrease in banks' reserve requirements from the People's Bank of China to counteract deflationary pressures and maintain the momentum of growth.

2024 is an election year in India, with Prime Minister Narendra Modi predicted to return for a third term. Markets have been performing well, reflecting confidence in the continuity of current policies and economic reforms. After a strong 2023 one would be forgiven for taking profits from the region given strong valuations, however, one could look towards election data, results and policy over the coming months for an entry point, as 2024 could potentially be another strong year for the region's markets.

Markets closely monitored Taiwan's election in January given the island's strategic significance and its delicate ties with China. The incumbent Democratic Progressive Party secured victory whilst gains made by the pro-China Kuomintang (KMT) party suggest a desire for a balanced approach in cross-strait relations. In essence, the election has kept the geopolitical boat steady reassuring investors and maintaining market stability for now.

Latin America remains an attractive market. In Brazil, while the top names may sway with commodity prices, Mexico's upcoming election brews a fresh sense of optimism for investors and businesses. With President AMLO's tenure drawing to a close – noted for his anti-business stance and constitutionally barred from re-election – the changing political climate could signal a more favourable environment for business and investment in the near future.

The US Economy

Market expectations of impending interest rate cuts may pose challenges for the banking sector, affecting margins and profitability. We don't envisage a swift cycle of rate cuts is necessary or likely. Amidst investor speculation, it's worth noting that the Federal Reserve has consistently shown a data-driven approach. Contrary to the market's interpretation, consecutive policy pauses do not necessarily equate to impending rate cuts. In fact, this misinterpretation by the market could present a strategic buying opportunity, especially for value-based investments.

The countdown to the US election has begun and regardless of a potential Trump comeback or a Biden continuity, a common narrative emerges. The US is expected to persist as a safe haven for investors, possibly through bond proxies, exemplified by big tech, and the dollar is anticipated to remain more stable than market forecasts indicate. Trump's pro-business approach historically supports growth and investor confidence, while a second term for Biden could bring policy continuity, viewed as a stabilising force for the economy.

Recent disruptions in Red Sea shipping lanes have caused ripples in the global supply chain, elevating freight costs as vessels take longer, more expensive routes. This new challenge comes at a time when oil prices had been sailing in relatively calm waters with prices trading within a predictable range. This period of uncertainty may continue to generate noise in markets but could open the doors for buying opportunities for strategic investors, particularly in a region that is self-sustaining.

The rising tide of US debt has become a focal point in economic discourses, as the figure touches $34 trillion. However, the US has so far maintained its ability to honour its financial commitments and given the profound ramifications for global financial markets, such an event is viewed as highly improbable. However, it is this market volatility driven by these such events that present buying opportunities for long-term investors.

The European Economy

European Central Bank President Christine Lagarde, after consecutive pauses in monetary policy, has signalled a cautious approach, emphasising the importance of incoming data, especially wage growth, tempering expectations of rate cuts in 2024. This mirrors the Federal Reserve's recent sentiment, putting March rate cuts off the table. Although the market perceives this as less supportive, it could contribute to making the region appear more attractive.

The region navigates the fine line between growth and recession, investors face a landscape marked by pronounced economic headwinds. High government debt and restrictive interest rates are casting long shadows over the market's potential. Despite the uncertainty, there are pockets of attractive valuations out there, however, the market awaits a catalyst or overdue correction to arguably prompt a true buying opportunity.

Despite Europe's longstanding relationship with China, the rise of China's automotive sector represents a new frontier of competition, particularly in the realm of electric vehicles (EVs). In response to this surging competition, Europe is considering duties on electric vehicle imports to safeguard the domestic industry. Yet, in this dance of competition and collaboration, Europe continues to value China's vast consumer market, especially for the luxury segment. With China working to stimulate its economy, this could spell good news for European luxury brands, potentially driving up the performance of their stocks as the Chinese consumer begins to start spending.

The US election outcome raises concerns for Europe. The potential return of Republican Donald Trump prompts apprehensions for Europe with the previous term marked by distancing from multilateral engagement—exits from UNESCO, WHO and the Paris Climate Agreement, and various security accords have not been forgotten. Whilst Trump is largely pro-business, the possibility of a Trump Presidency could cause some short-term noise in the region.

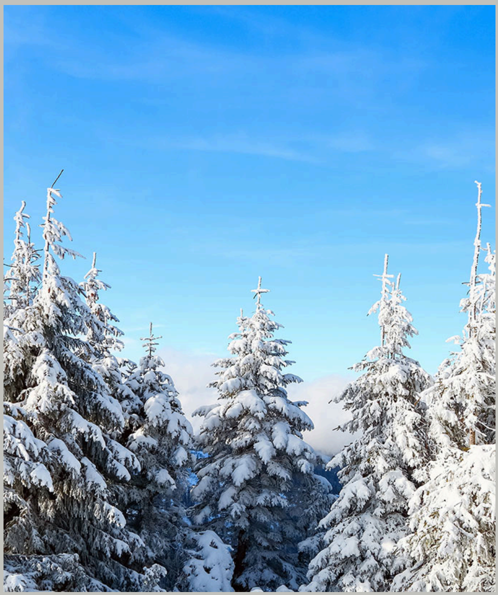
Fixed Interest

The recent quarter has witnessed a rally in government and corporate bonds, meaning that longer-duration assets were an attractive option for investors. However, government bond curves remain inverted due to the market projecting a series of rate cuts in 2024.

We have experienced robust total returns in recent months off the back of strong economic data; however, it's important to note that this has resulted in lower yields. Relatedly, weaker economic performance could lead to a sell-off across corporate bonds.

Investment-grade companies have balance sheets that remain particularly strong and have ample liquidity. Such companies are well-positioned to deal with any short-term economic turbulence.

Regardless of the extent to which central banks ease, it is anticipated that government debt issuance will persist at elevated levels.



If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on 0800 028 3200, Monday to Friday 9am-5pm or you can email us at mywealth@wealthatwork.co.uk

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