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2024 Q1 INVESTMENT REVIEW

Introduction

A busy start to the year at FPC has caused a slight delay to our 2023 review and outlook for the current year, so we will also cover what's happened to markets so far this year.

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- This investment commentary review contains information and opinion on current economic and political positions and does not constitute advice.
- The information is provided in good faith and is believed to be accurate, but as some data is provided by third parties this cannot be guaranteed.
- Past returns should not be seen as predictors of future returns.

Market Data

(ranked by full year return, in £):

Asset Class	Index	Q4 2023	Full Year 2023
European Shares	Euro STOXX 50	8.4%	19.4%
North America Shares	S&P 500	6.8%	18.6%
World Shares	FTSE World ex UK	7.1%	17.6%
Japanese Shares	TSE Topix	3.4%	12.8%
Corporate Bonds	Bloomberg Sterling Aggregate Corporate	8.5%	9.8%
UK Shares	FTSE All Share	3.2%	7.9%
Gold	S&P GSCI Gold Spot	6.6%	6.5%
Emerging Market Shares	MSCI Emerging Markets	3.3%	3.6%
UK Gilts	Bloomberg Sterling Gilts	8.6%	3.6%
Asia Pacific Shares	MSCI AC Asia Pacific ex Japan	3.3%	1.3%
UK Commercial Property	FE UK Property Proxy	-0.4%	-0.3%
Hedge Funds	HFRX Global Hedge Fund	-2.6%	-2.7%
Commodities	S&P GSCI Commodities	-14.5%	-9.7%

Performance Data: FE Analytics in GBP to 29/12/2023

2023 Review

For a while, it appeared we might have to report to clients on another year of challenging performance in 2023, especially for those taking lower risk, but a significant positive change in market sentiment occurred in October and values rallied broadly.

The year started with an acute banking crisis in the US and a hasty high profile weekend rescue of Credit Suisse by UBS. These events sat on top of continued inflation pressure and rising interest rates, which gave an economic backdrop not experienced for almost two decades. Nonetheless, asset prices rose broadly in Q1 as economic data showed strength in most economies and full employment reduced fears of recession.

Progressing through the year, the euphoria around Artificial Intelligence (AI) helped technology heavy stock markets such as the US S&P 500 rise in value, though gains were very sector specific and not displayed more broadly. The dominance of these AI linked companies is striking and their run up in performance does make the US market appear relatively expensive.

When the top ten largest stocks are removed from the data the US is trading at around its long-term average valuation.

Fixed interest markets were very volatile, as surprisingly resistant inflation data disappointed markets. However, as the year went on it became clearer that inflation was easing, albeit the mood tempered by signs of continued wage growth, concerning economists due to the lagging effect on prices.

Global central banks started to change their language around the potential for interest rate cuts, but the market as ever was looking ahead and rapidly started to price in a reduction in rates. This led to a sharp rise in fixed interest capital values and a drop in yields from mid-October.

This offered relief for investors in this asset class who had suffered falls over the past couple of years. One of our core bond funds, Janus Henderson Strategic, rose 12% in price over a couple of months, equivalent to over two years of interest earned on cash. It will however take time for the sector's total return to offset falls incurred in 2021 and patience is needed.

Global economic progress was slow, with the UK hardly growing at an estimated 0.1% pace in 2023. The US bucked the trend and delivered annualised growth of 3.1% thanks to investment in new housing, manufacturing, and infrastructure.

The US consumer was also stronger than expected, though data is distorted by Covid support money sitting in individual deposit accounts.

China, approximately 18% of world GDP, is contending with deflation at the moment with CPI -0.8% year on year. The great re-opening that was expected as the country emerged from its brutal series of COVID lockdowns failed to appear. The economy is stuttering with falling property values and weak consumer confidence, even though the economy moves forward at an official annual rate of 5%.

The year ended with double digit gains in most major stock markets in £ terms, except Asia and Emerging Markets exposed to China. The UK returned a respectable +7.9% total return. Corporate bonds once again outpaced UK gilts +9.8% to +3.6% respectively.

2024 Outlook

The growing impression is that major world economies have avoided any sort of deep contraction, despite the increase in borrowing costs and impact on indebted households and businesses. But, in most cases we remain in the slowdown phase. The data is confirming that position, with the UK now entering 'Rishi's recession', given two consecutive quarters of negative growth in 2023.

It is an important year for politics of course. In the UK the general election is likely to be called later in the year and must be before the fifth anniversary of the government (17th December) plus 25 working days, so it could fall into 2025.

The Conservatives are behind in the polls and have continuously lost by-elections throughout this parliament. The Financial Times poll tracker projects a Labour victory.

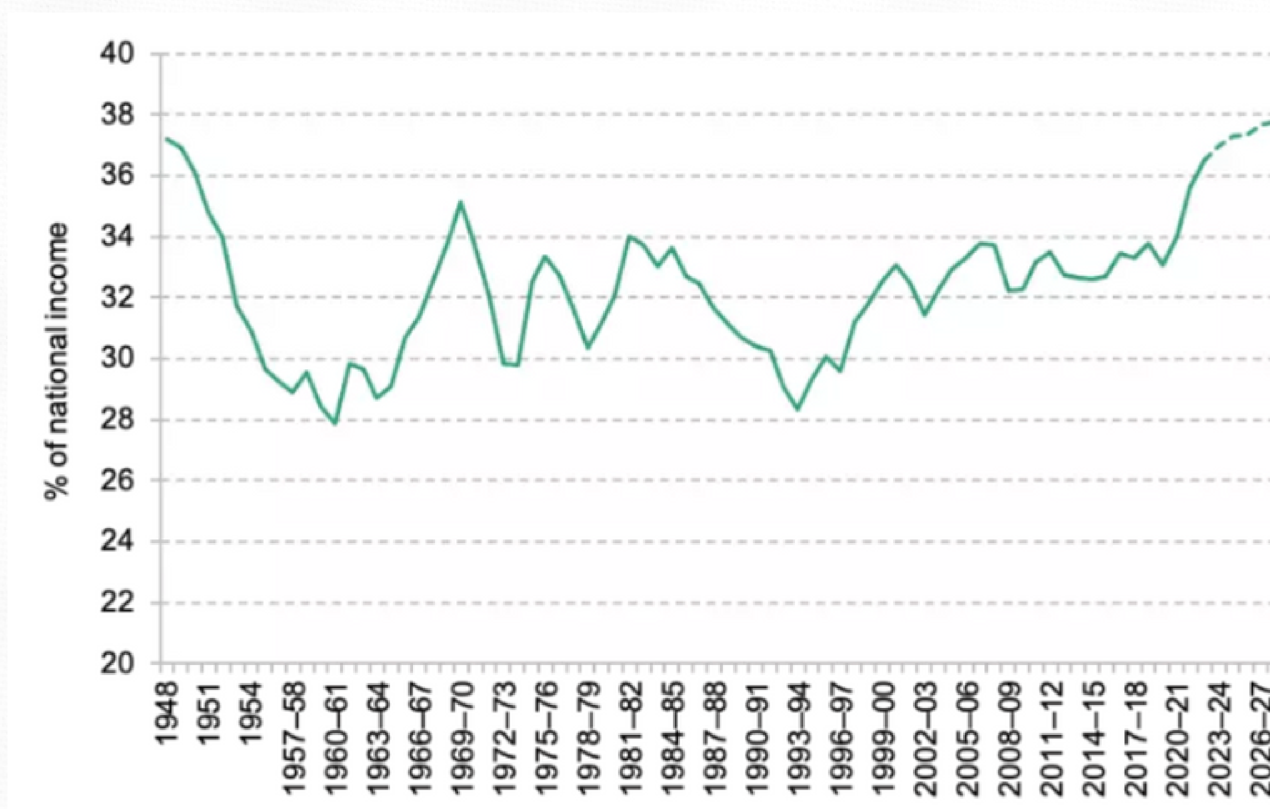
Support for Labour has drifted from its high point in September 2022 following the poorly received Conservative mini-budget, but not because of Conservative gains, which remain at the lowest point during this parliament. It appears to be Labour's election to lose.

As standard in an election year, the Conservatives are thought to be planning further tax cuts in the budget next month, funded through public sector efficiencies. There remains a big voting gap to fill and the public sector desperately needs funding.

Should Labour get into power they have promised an economic revival through the reform of building planning requirements and green infrastructure investment. They will have no additional financial flexibility to the Conservatives of course and have already said they won't subject tax rises on working people, so they'll have to find the money somewhere.

This suggests either, or both, a review of capital and estate taxes or additional borrowing by way of relaxing some of the fiscal rules governing national debt. The latter seems more likely and palatable given the tax taken from national income is at the highest level post-war as shown in the Institute of Fiscal Studies (IFS) chart below:

Figure 1. UK tax revenues as a percentage of national income



The potential implication of higher and/or longer national borrowing is the level of interest rate on the national debt. UK 10-year government gilts currently yield 4.1%, having peaked at 4.7% in October. This is compared to the current Bank of England (BoE) base rate at 5.25%.

It seems a sustained fall below the current gilt yield is not on the cards, unless the current recession turns into something more sinister and the BoE is forced to act. More likely is a stable, or even higher yield, with further pressure on gilt values. This is not the view held by markets that are hoping for a downward move in yields. We do not hold direct exposure to UK gilts presently in client portfolios and still prefer corporate bonds.

Over the pond the Americans will also be staring down the ballot box in November. It is likely to be the first candidate re-match in 70 years says The Economist, with their poll indicating Republican Mr Trump holding a short lead over current Democrat President Biden. There remain several milestones along the way, including criminal charges for Mr Trump, and much can change.

Still, the apparent tailwind in the US is similar to that of the UK. The Brooking Institute (Back to the future: It's the economy, stupid) suggests amongst the growing politically engaged young adult population, who previously supported the Democrats, that there was increased support for Mr Trump due to their own worsening economic position. The importance of the economy above and beyond social priorities is growing, as soaring house and cost of living prices meet with a disappointing competitive jobs market.

Turning back to markets, there is a general expectation that central banks will cut rates moving into the summer months, but they are in no rush. There will be gentle encouragement from the government to do so no doubt. The current base rate of 5.25% might seem high but try arguing to anyone who had borrowings in the period 1970-2000.

More often than not, fixed interest investments tend to be negatively correlated with stock markets and move in different directions. If interest rates are falling, which benefits the value of fixed interest, it could be because the economy is stalling and hence company profit growth and share prices are falling, and vice versa.

It is worth again reiterating that for many years prior to 2022, due to the printing of money otherwise known as quantitative easing (QE), investors became used to both fixed interest and stock markets, as well as other asset values, moving positively in the same direction.

This unusual period of ultra-low interest rates is unlikely to occur in the foreseeable future and investors should no longer have that expectation for 'a rising tide raising all ships'.

There is however reason to be optimistic for 2024. Returns on cash and fixed interest investments remain attractive, corporate profitability is steady pointing to earnings growth, inflation is expected to slow further, and 'real' wage growth is putting more money into consumers' pockets, relatively speaking.

How the year has started

At the time of writing, it feels much of the same going into the year. The US and Japanese markets lead the way, with the S&P 500 +6.4% and TOPIX +5.4% respectively in pounds. The broad-based UK FTSE All Share is trading -0.1%.

The main story so far is a dampening of hopes for how soon rate cuts will be seen, as the market got too excited last year. January core CPI numbers came in flat on December with UK core CPI +5.1% and US +3.9% year on year. For the moment, these numbers are not sufficient to warrant rate cuts.

As a result, fixed interest values have given back some of the gains achieved in the final quarter with UK gilts under pressure -4.3% and corporate bonds only marginally stronger -2%.

The bounce back in fixed interest values is likely complete for now and most returns will come via interest. Stock markets continue to be the place to protect against inflation, especially as a deep recession appears avoided.

FPC process update

As our clients will know, we have used the fund research services of Square Mile Research since 2020. The company was acquired by Titan Wealth last year as a complementary offering to its existing financial services businesses. Going forward it will be business as usual, with Square Mile continuing to operate under its own brand but with additional investment available to enhance its research capabilities.

FPC has in fact recently made additional commitment with partner company Square Mile Investment Consulting to provide enhanced asset allocation support for our clients' investment portfolios. We are confident that the depth of research available will add to the rigorousness and rationale of our investment process.

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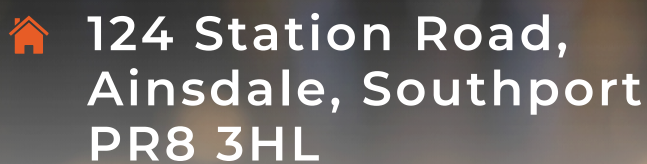
Contact Information



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