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2024 Q2 INVESTMENT REVIEW

Introduction

A strong period of market returns has provided client portfolios with healthy gains after a fragile couple of years. With the announcement of the 4th July general election, a potential change of government could have an impact, but the limited difference in fiscal management policies from each party suggests UK asset prices will be more swayed by the outlook for interest rates.

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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 return to 24th May, in GBP)

Asset Class	Index	Q1 2024	Year to 24th May
Gold	S&P GSCI Gold Spot	8.4%	12.9%
North American Shares	S&P 500	11.5%	11.7%
European Shares	Euro STOXX 50	11.3%	11.4%
Commodities	S&P GSCI Commodities	11.4%	11.0%
World Shares	FTSE World ex UK	9.8%	9.8%
UK Shares	FTSE All Share	3.6%	9.1%
Asia Pacific Shares	MSCI AC Asia Pacific ex Japan	3.0%	7.1%
Emerging Market Shares	MSCI Emerging Markets	3.3%	6.7%
Japanese Shares	TSE Topix	10.9%	5.0%
Hedge Funds	HFRX Global Hedge Fund	3.5%	3.0%
UK Commercial Property	FE UK Property Proxy	-0.1%	0.5%
Corporate Bonds	Bloomberg Sterling Aggregate Corporate	0.1%	-0.9%
UK Gilts	Bloomberg Sterling Gilts	-1.8%	-3.9%

Performance Data: FE Analytics in GBP to 24/05/2024

Q1 Market Review

It does finally feel like the investor sentiment clouds have lifted in relation to investor sentiment, following a fragile past couple of years, as evidenced by an extremely positive return on growth assets over Q1 that has extended into Q2. Double digit returns from North American and European shares, closely followed by the UK, have powered client portfolios higher this year.

It would be far reaching to suggest that economic sentiment has turned positive, but it is certainly less negative than it has been. The broadly held opinion that the world was on the cusp of a significant downturn, given rampant inflation growth and corresponding interest rate rises, did not come to pass. In the UK, the technical recession that was entered into during Q4 2023 following two consecutive quarters of negative growth, ended in Q1, as the ONS confirmed positive real gross domestic product (GDP) growth of +0.6%.

As the majority of FPC client portfolio gains continue to be driven by the North American stock market, it is worth a check-in on the current dynamics and what continues to drive the market higher.

The technology sector now makes up 29% of the S&P 500 index, but that does not include some large companies that might be considered technology, but sit within communication services, such as Meta (Facebook) and Alphabet (Google). Presently the entire market value of the index is $44.4tn, with the top ten holdings accounting for 32% of the total. The top three holdings Microsoft, Apple and Nvidia (computer processing hardware producer) are presently valued at $3.2tn, $2.9tn, and $2.6tn respectively. Combined, these three companies make up 20% of the entire market value.

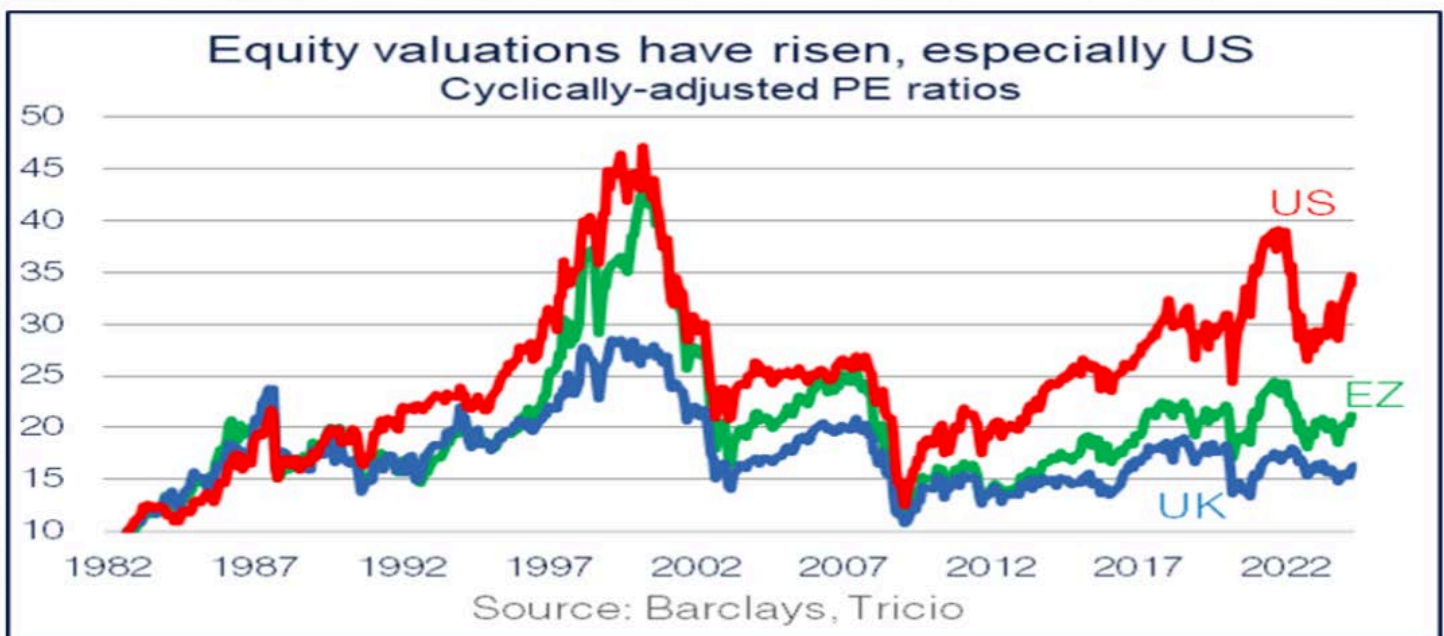
There is broad commentary on the future profit potential of these companies, and justification of the current high stock prices, but few people if any, know how detached from reality current valuations are. Investors should be mindful of this level of concentration and the relatively high stock prices being paid for company earnings, which might be considered ‘priced for perfection’. Any minor failure could disappoint and a re-balancing of portfolios is likely sensible.

Top 10 Constituents By Index Weight

CONSTITUENT	SYMBOL	SECTOR*
Microsoft Corp	MSFT	Information Technology
Apple Inc.	AAPL	Information Technology
Nvidia Corp	NVDA	Information Technology
Amazon.com Inc	AMZN	Consumer Discretionary
Alphabet Inc A	GOOGL	Communication Services
Meta Platforms, Inc. Class A	META	Communication Services
Alphabet Inc C	GOOG	Communication Services
Berkshire Hathaway B	BRK.B	Financials
Eli Lilly & Co	LLY	Health Care
Broadcom Inc	AVGO	Information Technology

*Based on GICS® sectors

It is positive to finally see that UK stock markets have been recharged recently. In fact, since the end of Q1 the FTSE All-Share has returned +9.4% as compared to +4% for the S&P 500 in sterling terms - just at the point of commentators calling the UK stock market dead. It has long been highlighted that the UK market is relatively 'cheap' and that the absence of a large technology sector has held back growth in the index value in recent years. This can be seen on the chart below, showing the price to earnings valuation for the US, Europe and UK stock markets. However, we may be at a turning point in the economic cycle as interest rates fall and real incomes begin to grow, which could favour the industrial production and consumer discretionary sectors. The relatively low market valuations have also encouraged corporate activity, with mining company Anglo American, packaging company DS Smith, and Royal Mail owner IDS all receiving takeover approaches recently.



We suggested in our last review that it was probable fixed interest investments had seen the best of the recovery in capital values, following the lows seen last Autumn. Year to date values have been flat to negative as market expectations of significant interest rate cuts were proven wrong due to stubborn inflation and reduced recession risk. The benchmark 10-year UK gilt yield is currently trading at 4.2% having hit a low of 3.4% back in December, demonstrating how market expectations for the speed of rate cuts has changed.

The Bank of England has now held the official rate at 5.25% for nine months, and whilst a summer interest rate cut is likely, governor Andrew Bailey has stated the need for more evidence of falling inflation at the next meeting on 20th June before reversing course. The path however is now lower, save for a global risk event that might cause commodity input prices to spike and inflation to climb once more. This is a tail-risk always present in financial markets, which should be respected, hence the need for diversification in portfolios.

On the matter of diversification, it may have been noticed that one of the strongest asset class performers year to date is gold, supposedly due to central bank buying and inflation protection. The gold council stated that emerging market central bank demand in Q1 was the strongest of any year on record. However, the utility of gold as an investment is always questioned and to paraphrase Warren Buffet's speech in Harvard in 1998 "It gets dug out of the ground, melted down, buried again, and people are paid to guard it. Anyone watching from Mars would be scratching their head".

The most significant event of course in recent weeks has been the general election announcement due on 4th July. Financial markets would not be surprised to see a change of government, and even if it was more in doubt, both parties' fiscal policies are very similar: a commitment to not raise taxes or national insurance on working people, and to have the public deficit falling as a ratio of debt to GDP. The Institute for Fiscal Studies (IFS) highlights that over the next parliament, UK growth is forecast to be lower, and debt interest payments higher, than average, such that the task of achieving a lower debt ratio will prove extremely difficult.

Having already announced that tax rises are unlikely, it seems the path of least resistance could be to allow borrowing to increase and relax the rules on the debt to GDP ratio, perhaps in hope of stimulating economic growth. This adjustment could be seen as the most digestible, and masked under an urgent need to get the UK growing again.

This is something we have mentioned previously with a consequence being higher than expected government borrowing yields. For investors, this suggests returns on UK gilts will primarily come from interest payments, rather than capital growth from falling yields.

For those who think they could do a better job than either party, the IFS has launched a 'Be the Chancellor' tool on their website, allowing you to make the big calls on tax and spending and see the impact on the current deficit and government borrowing. Whoever has power following the election there are few additional levers that can be pulled to boost the UK economy, improve public services, and increase the standard of living in the short term. The market is unlikely to react with any great surprise as to the result.

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