SUMMER INVESTMENT REVIEW 2024

Introduction

Overall financial markets have continued to provide stability and strength leading up to the half-way mark of 2024, however in recent weeks we have seen a re-emergence of volatility in stock markets, given rising concerns of a global economic slowdown and high company valuations, amplified by lower trading volumes during the quieter summer period.

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August 2024

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- 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

(return to 28th June, in pounds)

Asset Class	Index	Q2 2024	YTD
Asia Pacific Shares	MSCI AC Asia Pacific ex Japan	6.2%	9.4%
Emerging Market Shares	MSCI Emerging Markets	4.9%	8.4%
Gold	S&P GSCI Gold Spot	4.9%	13.6%
North America Shares	S&P 500	4.1%	16.0%
UK Shares	FTSE All Share	3.7%	7.4%
World Shares	FTSE World ex UK	2.7%	12.7%
UK Commercial Property	FE UK Property Proxy	1.2%	1.1%
Commodities	S&P GSCI Commodities	0.6%	12.0%
Hedge Funds	HFRX Global Hedge Fund	0.3%	3.8%
Corporate Bonds	Bloomberg Sterling Aggregate Corporate	-0.5%	-0.3%
UK Gilts	Bloomberg Sterling Gilts	-1.1%	-2.9%
European Shares	Euro STOXX 50	-2.9%	8.1%
Japanese Shares	TSE Topix	-4.4%	6.0%

Q2 Market Review

The Q2 market period to the end of June continued to show positive sentiment overall, but that progress has since been overshadowed by a sudden return of market volatility. Stock markets were led higher by the Asia Pacific ex Japan region rising +6.2%, closely followed by Emerging Markets +4.9% and the US +4.1%.

Defensive fixed interest assets remained flat, with the market having already re-priced to account for expected lower interest rates. The fixed interest market will continue to reward investors primarily by way of income from now on, absent an economic slowdown forcing interest rates lower than currently forecast. Gold continues to 'find a bid' as an alternative defensive asset, notwithstanding there is no cash-flow generated from the asset class.

It is an old story now in some ways that the US technology sector, and specifically the Artificial Intelligence (AI) arms race, has been the only game in town recently for amassing capital gains. We, like many others, question at what point company valuations in this space become detached from the reality of future profits. Given the increased volatility, investors may have decided that has already happened, though the low trading volumes of the summer months do not make it easy to identify a change in trend and, in the long-term, betting against a dynamic economy like the US is a bold move.

However, any sensible investor (and helped by experience) would see the sector concentration in the market as a risk factor, which of course is mitigated by good portfolio management i.e. diversification and the discipline to rebalance. If this is a change of trend and we do see a shift in asset allocation, then that capital has to go somewhere. The implication is that if money does leave the US stock market, then that could cause some pressure on the dollar. In addition, and as suggested by recent weak July employment data, any weakening in US economic growth will also encourage the federal reserve to lower interest rates, in turn making holding the dollar less attractive to overseas investors.

This emerging story does make a case for other stock markets to take the lead after many years of US outperformance, and during Q2 there was a hint that Asia (despite China's current economic issues) and the UK had experienced renewed investor interest. In the case of Asia, and looking a little closer under the bonnet, the region is similarly driven by 'big tech', with Taiwan's Semi-Conductor Manufacturing, China's Tencent Holdings, and Korea's Samsung, making up a combined 20% of the MSCI Asia Pacific Index. In their World Economic Outlook report in July, the International Monetary Fund (IMF) suggested that US growth would fall from 2.6% in 2024 to 1.9% in 2025, whilst the Euro area would grow from 0.9% to 1.5% and within that the UK from 0.7% to 1.5%.

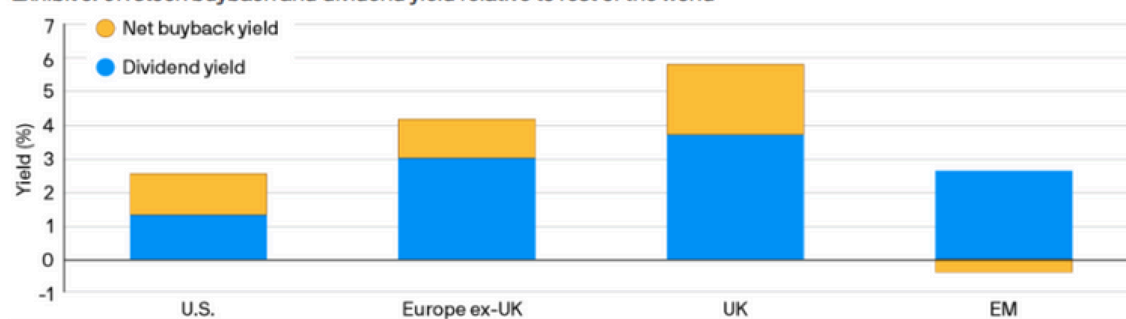
Is the UK market becoming more attractive?

It could be then that the UK has the potential to take up the next leg in terms of relative stock market performance, considering its limited exposure to the technology sector. International investors have shied away from the UK over recent years following the handling of Brexit, other political mishaps and lacklustre growth.

But, what that does is make the UK relatively attractive from a value point of view. Further, research by JP Morgan shows the return to investors by way of dividend yield and share buybacks in the UK is notably above that of other regions, providing a solid, if not exciting, place for investors to pivot themselves at this juncture.

A relatively high shareholder yield is coupled with attractive valuations

Exhibit 3: UK stock buyback and dividend yield relative to rest of the world



Source: JP Morgan: Global Equity Views 6th August 2024.

The Bank of England (BoE) has now finally reduced its main base rate from 5.25% to 5%, citing inflation hitting the 2% target allowing an easing of borrowing costs for the first time in more than four years, but commentary from the bank said it was not a clear decision.

Savers and borrowers can be guided as to where interest rates may get to in the short-term by looking at the two-year gilt yield, which is a market barometer of where rates should be, rather than thinking too much about the hypothesising of the BoE governors. The two-year yield presently sits at 3.6% so the market is saying interest rates are on a firm trajectory downwards from here.

Now that the election is over and a majority Labour government is in place, this offers more stability to UK policy decision-making, which should encourage international confidence back into the UK. The public finances are in poor health, so if the two-year yield does come to pass it will be welcome news to a government that is contending with a large public debt pile and high interest payments whilst also staring at a long shopping list. We will find out more about how the government intends to move forward and shape the investment landscape at the Autumn budget due 30th October.

The clear indication from consistent avoidance of the matter is that the UK capital gains landscape is set to change. An alignment of capital taxes with income tax rates is a popular talking point currently, and that would fit with the nature of some policies announced so far that target wealthier individuals. There are however solid arguments against disincentivising business owners and job creators by taxing more of the value they create. It seems that if the capital gains tax rate is increased, it could be accompanied with more generous allowances than are currently in place both to individuals and business owners. Whilst a rate rise is still a fear and not a fact, those with significant taxable capital gains may wish to review their positions.

Accepting volatility...

Since the quarter end we have seen a surge in volatility in stock markets, especially in the US as noted earlier, but illustrated strongly in Japan.

The Japanese central bank raised interest rates from 0.1% to 0.25%, which seems modest by most benchmarks, but represents a commitment away from holding rates negative as it had for many years. This triggered the largest two-day drop in the domestic Topix index since 1987, with the index falling by over 12%, with a butterfly effect to sentiment globally. Since then the Topix, whilst still at lower levels, has risen by double digits from the low point.

There are a number of core principles that underpin sensible investment management, one of which being the acceptance of short-term volatility in exchange for longer-term rewards. Research by fund management house Schroders found that US investors who moved into cash during the 'Great Crash' of 1929 after the initial 25% market fall (it eventually fell 80%!) had to wait until 1963 to breakeven. Had they remained invested, and withstood further falls, the breakeven date was 1945. Clearly still an extreme period in which to manage cash-flow from lower capital values, but comparably much better. More recently, an investor who took exactly the same action during the financial crisis in 2008, would still be underwater now[1].

As ever, in the absence of pure and consistent luck in moving money in and out of the market, most are best advised remaining largely invested, despite any change in sentiment.

[1] Schroders. 'The data which can help you keep a cool investing head in a crisis'. 9th August 2024.

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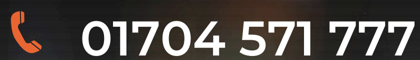

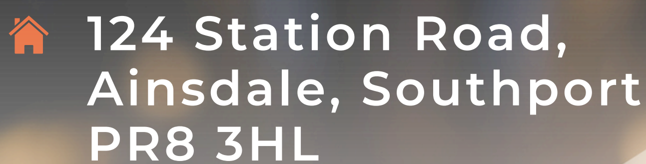

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