Market View
An early Santa rally

Investor activity tends to fall off as we approach the holiday season at the end of the year. As such, liquidity tends to be more challenging, with investors looking to position themselves for the new year. This combination tends to push markets up and as such, has been dubbed the Santa rally.

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As temperatures dropped and the weather turned frosty, Santa appears to have come early this year. The S&P 500 registered its strongest month of the year, ending November up 9.1%.

This rally gained momentum earlier last month as weaker US jobs and economic indicators combined with lower-than-expected Consumer Price Index (CPI) data in the US and UK reaffirmed that not only are the Federal Reserve (Fed) and the Bank of England (BoE) likely finished with their rate hiking cycles, but also put rate cuts on the agenda.

Digging deeper into the data, the ISM surveys pointed towards US economic momentum slowing. Non-farm payrolls rose by only 150,000 in October, roughly half the jobs added the prior month. This pushed the unemployment rate to 3.9%, the highest level since January 2022. US core CPI – which excludes food and energy – came in at 0.2% against forecasts of 0.3% month-on-month. The annual core CPI figure registered at 4%, down from 4.1%. The lower-than-expected CPI reading sent bond yields lower with ten-year Treasuries falling 0.6% to end the month at 4.33%. Markets are also now aggressively pricing in rate cuts, with futures markets pricing four rate cuts by year-end 2024.

Initially central banks expressed concern over these sharp movements following the CPI reports, prompting some members to reiterate the "higher for longer" narrative. However, several Fed governors expressed confidence that the current monetary policy stance is appropriate to bring inflation down to 2%. Some even suggested cuts could come in the first half of the year.

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The dollar index fell by 3% as US inflation cooled, which helped the pound strengthen from 1.22 to 1.26 by month-end.

Looking ahead to 2024, the US faces a heavily controversial election, with the UK also going to the polls. Over the past month we have seen some surprising election results globally. Populist leader Geert Wilders's party caused a dramatic upset by winning more seats in the Netherlands general election. Although Wilders's Freedom party (PVV) needs the backing of other major parties before he can become prime minister, the victory sent shock waves throughout Europe. Further afield in Argentina, Javier Milei, a politician known for his radical and provocative policy proposals, won by a landslide in the country's run-off presidential election on 19 November. Milei is talking of a bold plan to dollarisze the economy by scrapping the Argentine Central Bank to stop hyper-inflation, a tall order indeed. It is unclear if the Dutch and Argentine elections represent isolated events or show trends that could spill over to the US and UK.

There was positive geopolitical movement earlier last month when Presidents Joe Biden and Xi Jinping met in California. The pair agreed to reopen military communications, discussed climate change, AI and the upcoming Taiwanese election. While nothing major came out of the meeting, it represented a positive step at a time when tensions between the two superpowers have been simmering for months. China is still relying on incremental fiscal policy loosening to bolster its growth prospects as the economy continues to stutter.

As it stands, in the Eurozone, the trade-off between growth and inflation is most evident. Recent data showed inflation cooling rapidly to 2.4% year-on-year and the German economy shrunk in the third quarter with a recession looking likely. Even though the Eurozone's fight against inflation appears successful, downbeat growth prospects bolsters the view that the European Central Bank (ECB) will be the first central bank to cuts rates.

Markets bounced sharply amid softening inflation and slower economic activity. In all likelihood, the rate hiking cycle is over but the hurdle to cut rates remains high given the risks surrounding inflation. As such, we retain a preference for quality business that are not overly indebted and can compound returns over time.

Sources:

Performance - Bloomberg
Non-farm payrolls and CPI- Bureau of Labour Statistics
Eurozone CPI- Eurostat

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