

INVESTOR INSIGHT

A look at the markets by RSMR

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Welcome to the latest edition of our 'Investor Insight' which provides high-level commentary on the global markets and how these might be affecting your investments.

Ken Rayner, CEO, RSMR

The global economy: What's going on?

Confidence rises as inflation eases.

The now familiar themes of inflation, interest rate speculation and international upheaval dominated investor confidence and market volatility during 2023.

Despite how these factors influence market valuations, the US technology sector performed very strongly and the so-called 'Magnificent Seven' large cap stocks now represent 26% of all global equities (FT Dec 2023). This created a US-led global equities rally reaching close to all-time highs by December. Bonds also did well as yields fell in anticipation of interest rates cuts.

Perhaps the biggest disappointment in 2023 was the economic performance of Asia which, apart from India, struggled after a hopeful start when China reversed its strict post-Covid conditions and reopened its economy.

Most economic forecasts for 2024 focus on inflation which is now thought to have peaked, leading to hopes of earlier-than-expected interest rate cuts.

This was confirmed by the US Federal Reserve (Fed) in December when it indicated a less aggressive stance on interest rates, with official predictions showing a larger number of reductions.

The US economy may have grown around 2.5% during 2023 which contrasts with the latest Office for National Statistics (ONS) UK figures which confirm stagnation with Gross Domestic Product (GDP) contracting by 0.3% in the third quarter.



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The asset classes – a quick round-up

EQUITY MARKETS

Western equity markets soared following Fed statements indicating that interest rates are likely to be cut earlier than expected due to falling inflation.

This, combined with increasing confidence that the US economy is heading for a soft landing rather than recession, led to a global equities rally.

Valuations of growth stocks now look inflated as sectors such as technology and luxury consumer goods have benefitted from this confidence but the question for 2024 is if this rally is sustainable.

The fact that the rally has included bond markets fuels some investors concerns as falling yields signal recession while rising equities indicate strong earnings growth and both are unlikely to be true at the same time.

There are also geopolitical concerns with a record number of countries holding elections in 2024, including the US, UK, Russia and Taiwan.

The UK stock market had a reasonable 2023 with an end of year rally, mainly in large cap stocks, while mid and small cap stocks struggled, reflecting the weak domestic economy.

In spite of the difficult conditions, the UK has not fallen into recession, which shows how robust it has been. A smooth recovery in the US and Europe would help the UK economy get stronger, faster this year.

FIXED INTEREST

Although, following significant rate rises, 2023 was expected to be the year for bonds, it did not turn out that way with yields stubbornly high until an improvement in the autumn.

Interest rates have been stable for several months and, with declining inflation, are expected to fall in 2024. Central banks' rhetoric for much of 2023 that inflation was not conquered has changed following recent falls, creating an equities and bonds rally in anticipation of rate cuts earlier in 2024.

The consensus is that interest rates have peaked and, even if inflation rises, a further rise is unlikely and would be only temporary.

Even so, the 'higher-for-longer' policy could cause residual problems. Central banks do not appear keen to start lowering rates and there will be considerable difficulty reducing inflation to the 2% target although this is not impossible given the right conditions.

Bond markets have accounted for future interest rate cuts, but the question for investors is how quickly they will come in reality.

If rates are reduced in 2024 bonds will become more attractive, and several managers predict this may be a rare opportunity to capitalise as rates fall. Emerging market debt may also offer opportunities as several countries have already started to lower rates.

Volatility is likely, caused by investors moving assets from cash into other vehicles to maintain returns. There are also several geopolitical factors to consider including the Middle East and Ukraine conflicts and many national elections.

ALTERNATIVE INVESTMENTS

Expectations of falling interest rates are driving once-cautious investors towards alternative markets, particularly property which has had a difficult 18 months.

However, changing lifestyles and work patterns, such as flexible office attendance and the online economy, are putting pressure on office and retail space. Distribution hubs, supermarkets and data centres have met investor needs for several years but this declined in 2023. Values have fallen and could fall further if there is a recession.

If interest rates are cut in 2024, it will boost the property and infrastructure sectors and help stimulate a decent recovery.

We are in the early stages of growth, driven by economic, regulatory, and social changes that could generate very attractive long-term returns for property investors in life sciences, Build to-Rent (BTR) and care homes.

Commodities struggled in 2023 as oil prices fell, which drove down inflation faster than expected. Oil may well be a barometer for commodity growth in 2024 as will weaker GDP data from China, which heavily influences industrial metal prices including copper, aluminium and nickel.

The transition to net zero is also encouraging for commodities as huge amounts will be needed for the renewable energy infrastructure, which is also the most likely source of inflation in 2024.

RSMR Global round-up

- The US has been the strongest western economy with robust growth and employment data throughout 2023.

- European economists do not expect a rapid Eurozone recovery, but it should avoid recession.

- In contrast to the US where growth exceeded expectations, China has been the major economic disappointment of 2023.

- According to Purchasing Managers Index (PMI) data, business activity worsened in Germany for the seventh consecutive month.



- India has boomed 2023 with its economic and business foundations remaining positive.
- UK inflation fell to 3.9%, surprising many observers, while interest rates remained at 5.25%
- Brazil is likely to see GDP growth in 2023 of around 2.5%-3.0%.
- Mexico is benefitting from moving its global supply chains away from China.
- In local currency terms, the Japanese stock market rose more than 25%.



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“ A smooth recovery in the US and Europe would help the UK economy to get stronger faster in 2024. ”

SO, WHAT'S NEXT?

Investor confidence has transformed from a year ago following falls in inflation and talk of US and UK interest rate cuts.

However, interest rate rises usually have a delayed reaction, which could still cause recession in the west, although most observers now feel there will be a smooth landing in the US even if recovery elsewhere, including the UK, is tougher.

If apparent recovery is not a mirage, there are still risks, including that economies continue to weaken as consumers and businesses gradually refinance their debt at higher rates; rising unemployment eventually bears down on wage inflation, bond yields drop, and stock and credit markets suffer due to earnings downgrades and corporate defaults.

If interest rates fall, corporate and consumer refinancing will not be necessary, but nothing is certain and, if Tump wins the US election in November, the country may follow very different political and economic agendas.

Even so, we start on a high, as confidence that inflation and interest rates have peaked has led to the surge in markets.

This should present a more benign backdrop for investors as we enter 2024 with some of the conditions which have inhibited progress starting to fade.

About RSMR

Independent specialist research.

RSMR was formed in 2004 to meet a growing demand from financial advisers for specialist and impartial investment research.

The RSMR team is made up of individuals with expertise from across all areas of the financial industry – from asset management, strategy and fund research through to business development, strategic planning and market research.

We are best known within the financial industry for our 'R' fund ratings – this rating is given to investment funds that meet our stringent research criteria. We don't limit ourselves to just looking at performance

– we also look carefully at the people, processes and capabilities that are required to make effective investment decisions.

We work in partnership with your financial adviser, providing the benefit of our broad industry insight and rigorous research. This quarterly market summary is designed as a 'snapshot' of the more thorough and lengthy commentary that we provide to your adviser on a quarterly basis.

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