RATHBONES | Incorporating Investec Wealth & Investment (UK)

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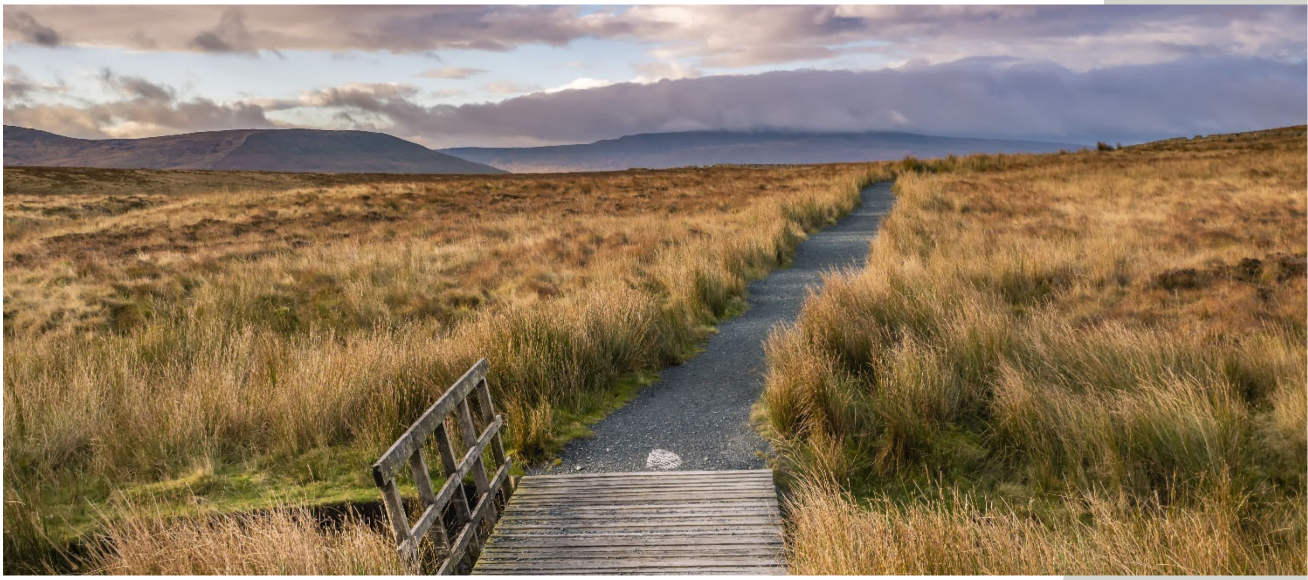
Market reflection



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Head of Investment Strategy

Overview

The positive performance of equity markets during August overall betrays none of the volatility experienced in the first few days. Investors had already been questioning the sustainability of market leadership, concentrated as it had been in so few companies and with the dominant theme being the adoption of generative artificial intelligence.

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Concerns were heightened by a weak US July employment report, increasing fears of a recession. Bad news for the economy became bad news for the stock market as the prospect of job cuts and earnings downgrades overwhelmed the potentially positive effect of expected lower interest rates. The final straw came in the form of a small, but unexpected, increase in interest rates by the Bank of Japan. This triggered a jump in the yen which forced certain investors who had been borrowing cheap yen to fund trades in assets ranging from high-yielding emerging market currencies to US technology giants to sell their positions. Other technical factors, including a reversal of momentum trades and a broad reduction in risk appetite, exacerbated by thin summer holiday market liquidity, saw global equities fall by 6.4% in six trading days, while the VIX volatility index shot up at one stage from 16 to 66, the biggest such move in its history. However, calmer heads soon prevailed. The forced selling was taken into account and investors also started to price in even more interest rate cuts. Their sangfroid was rewarded when Federal Reserve Chairman Powell, during his speech at the Jackson Hole symposium for central bankers, effectively "promised" that the Fed's interest rate cutting cycle would begin at its September meeting. The next leg of performance will be largely dependent on the fate of the US economy, which continues to transmit mixed signals. We continue to hold some insurance against a weaker outcome.

• The Bloomberg consensus for World GDP growth in 2024 has risen to 3.1%, up from 2.6% in January. The forecast for 2025 is also 3.1%. The debate about whether or not the US will fall into a recession rumbles on, while parts of Europe, especially Germany, remain weak. China's economy continues to be very disappointing, with consumers displaying no confidence in the outlook.

• Government bonds benefited from the expectation of lower interest rates, with the Bloomberg Global Aggregate index gaining almost 3%, taking it into positive territory for the year, underlining their current "safety net" role in portfolios.

• The Labour government is getting settled in, and the Prime Minister and the Chancellor have voiced increasing concern about the poor state of the UK's finances. This lays the ground for Rachel Reeves's first Budget on October 30th, an event which seems to guarantee increased taxes, with the potential for much of the burden to be placed on investors (via higher CGT rates and/or less generous pension contribution treatment, if reports are to be believed).

• There have been no further surprises in the US election race following the dramatic turn of events in July. The selection of the Vice-Presidential candidates, Tim Walz and JD Vance for the Democrats and Republicans respectively, illustrates the desire by both parties to increase support in a handful of crucial swing states which will define the result. We continue to be of the opinion that the knife-edge nature of the election makes it difficult to make strong directional investments at this moment.

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