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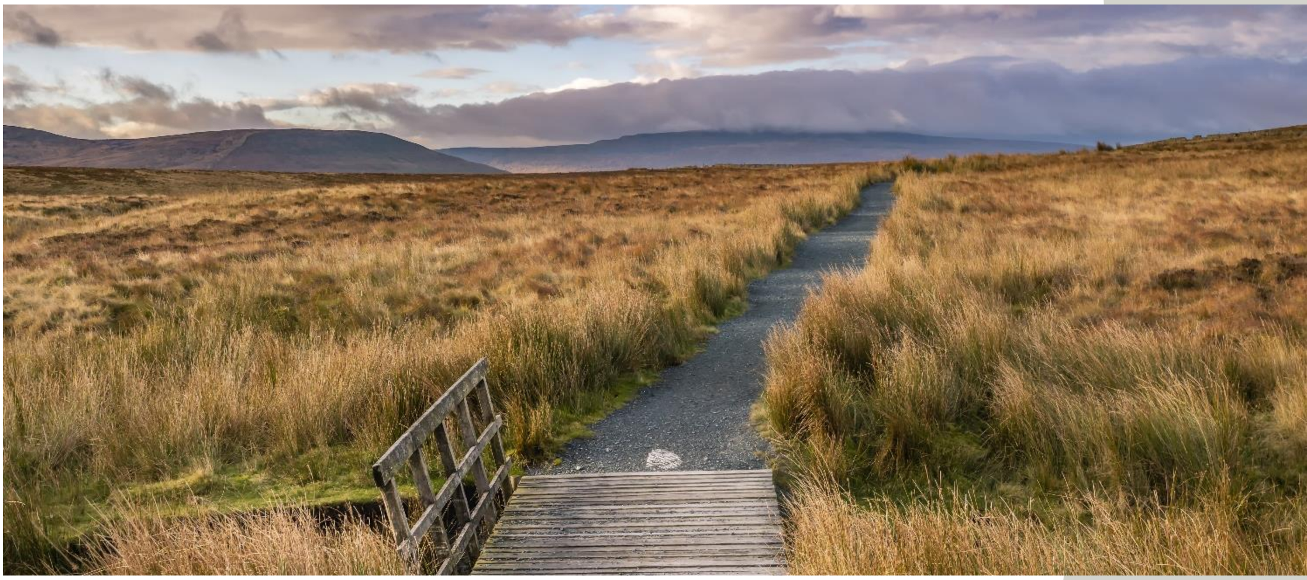
08 January 2024

Market reflection



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Overview

The final two months of the year finally rewarded investors’ patience. Global equities, as measured by the MSCI World Index, gained more than 15% in dollar terms, although gains for UK investors were diluted by a weak dollar. Sterling gained around six cents vs the US currency to end the year at $1.27.

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Gains in equities and other risk assets were triggered by a strong recovery in government bond markets. These, in turn, were the result of a combination of weaker-than-expected inflation data and a shift in the US Federal Reserve's attitude towards interest rates. Having previously leaned against the possibility of interest rate cuts, its December survey of members suggested as many as three quarter-point reductions over the course of 2024. Futures markets are currently pricing in six cuts, which seems a little optimistic, although, more encouragingly, it is now clear that we have passed the peak of the current interest rate cycle.

The main reason to expect deeper rate cuts would be a weaker economy. Economists are currently evenly split on the probability of a US recession developing in 2024. Despite a more hawkish tone being maintained by the Bank of England and the European Central Bank, rate expectations also tumbled on this side of the Atlantic, where GDP growth has been negligible over the last year. While we retain some caution heading into the New Year based on the lagged effect of past interest rate rises, lower bond yields and the prospect of interest rate cuts now provide much better support for financial assets.

We note that smaller companies have rallied strongly on the outlook for lower interest rates. While we believe that the "Magnificent 7" US companies have led indices higher with some justification owing to their high profitability and growth rates, broader participation is healthier for the overall market.

• The Bloomberg consensus for World GDP growth in 2023 has risen from a low of 2.1% in February to a current 2.9%. The much-anticipated US recession never materialised and flat economies in the UK and Europe also managed to beat more pessimistic expectations. The outlook for 2024 continues to suggest slower progress next year, with consensus estimates at 2.6%, as the lagging effect of higher interest rates continues to bite.

• The Bloomberg Global Aggregate Index of investment grade bonds gained almost 10% from its late October lows, dragging itself back into positive territory for the year and avoiding a third consecutive year of negative total returns.

• The US 10-year Treasury bond yield fell from a peak of 4.99% to 3.82%. The 10-year Gilt yield dropped from 4.67% to 3.5%. Such falls are also good news for governments as the cost of financing still-large fiscal deficits is reduced.

• The weaker dollar helped Gold to trade at a new all-time high in dollar terms of $2,077. The price continues to be supported by central bank buying, especially in emerging economies. The freezing of Russia's dollar assets following its invasion of Ukraine has motivated many countries to diversify their reserves away from dollars.

• Despite further disruption in the Middle East, notably to shipping in the Red Sea, the oil price remains relatively subdued. It remains lower than it was before Russia's invasion of Ukraine. There seems to be no shortage of supply, with almost all of Russia's production heading to China and India to be refined.

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