Q2 Market Commentary 2024

After the positive returns that investors enjoyed during the final quarter of 2023, there was increased optimism as the new year started that investments globally could continue to grow.

As we moved into the new year, investors were pricing in up to seven interest rate cuts from the major central banks of Europe, the US and UK. This view reflected the fact that inflation was moving lower, towards central bank target levels, without creating a hard landing for their underlying economies to endure.

The issue that markets faced in the first quarter was that inflation, even though it was falling, was not going to fall quick enough to allow central banks to cut interest rates as much as first predicted. This meant that markets had to reassess their interest rate cut predictions, which have now moved from seven cuts down to a more achievable number of around three rate cuts over the year.

This caused bond yields to rise from their lows at the end of 2023 and provided a headwind to more interest rate sensitive areas of the global market. However, this volatility abated as we moved through the quarter as central bankers in the US and UK highlighted to the market that interest rate cuts were still likely to happen, but inflation data would need to continue to show signs of moving lower and continuing to stay low over time.

We think that now the market is moving more in line with central bank predictions, there should be a more positive backdrop for investors over the shorter to medium term.

However, we still believe that the market is being far too short term in its thinking, with sentiment driving positioning over fundamentals. Even though the market has moved more in line with central bank predictions in interest rate cuts, there is still far too much focus on when the first-rate cut will be.

We are instead focusing on when interest rate cuts may end and where this will leave them, as well as yields, inflation, and growth for the longer term. We think this is far more important for return prospects over time. We believe the prospects of a softer landing impacting the global economy, should provide a positive backdrop for the themes and allocations within our portfolios over the coming quarters and years.

Britain first?

During the quarter, one of the major headlines out of the UK was the UK Government's yearly budget announcement. The Chancellor of the Exchequer set out his aims to stimulate growth, reduce inflation and increase spending. There was the added focus for this budget on greater investment in UK businesses, in an attempt to reverse the lack of focus on UK stocks from both UK and overseas investors.

From an economic perspective, the UK has improved moving into 2024. In previous years, inflation was an outlier compared to other developed nations, with both core and headline inflation far higher than areas such as the US and Europe. However, UK inflation has fallen to levels in line, if not lower than many other developed economies. UK inflation is also predicted to fall further to the central bank's target of 2% in the coming months, which is before other markets are predicted to reach their targets.

Interest rates should then be cut as the Bank of England will look to stimulate growth from its current low level. This would boost spending and provide a positive backdrop for UK growth to pick up materially.

Sentiment from businesses and some investors is starting to shift. Economic indicators are showing that the consumer is more positive on the economy, wages are now growing more than inflation, business sentiment is improving, which should all lead to better growth opportunities over time.

Underlying companies in the UK are also more positive on their own prospects moving forward and some are undertaking a large amount of share buybacks as their stock is currently so cheap. In addition, some overseas companies and private equity houses are purchasing UK businesses at undervalued levels.

What are the current opportunities in UK investments?

Looking at valuations of the FTSE 100 compared to other global indices, the UK holdings are undervalued compared to many of these markets, not just on an index level but also sector by sector as well. Some discount will always be present due to the makeup of the UK market, but the discount has widened to levels that are not currently justified by the underlying businesses constituting the index.

Looking at specific businesses like BP and Shell, these oil majors trade on a large discount to their global peers who have similar business models. We think this should not be the case and so these discounts should narrow over time. It is not just oil companies where these differences occur, the same can be seen in miners, global banks & financial, utilities and consumer discretionary and consumer service stocks.

Moving down the market cap spectrum the medium and small companies based in the UK are even cheaper based on historic metrics. There have been reasons for this as higher inflation and slower growth provided a headwind for smaller companies, who tend to have higher debt costs and have a greater link to the domestic economy.

As the economy is now turning and interest rates could be cut in the coming months, the picture for these businesses is far rosier. Add into this the discounts that these businesses sit on compared to their large cap peers, both in the UK and abroad, there is a huge opportunity for UK small and mid-caps to perform well moving forward.

What about the future?

For the team here, having a healthy weighting to the UK seems like a fantastic opportunity with where valuations currently are. Other areas like Europe and Emerging Markets equities, value style equities and small and mid-cap equities also have these positive valuation metrics, with large discounts to peers and to their own history. This is where we believe sustainable long-term returns will come from.

The prospect of interest rate cuts, means fixed income is providing investors with both the opportunity for positive capital return, and positive real yields that are above inflation. Our blend of funds within fixed interest should enable us to benefit from the current high yields available, together with increasing capital returns as and when interest rate cuts commence.

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