Market View
A look back at the quarter

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Author Sanjay Rijhsinghani

At a glance

- Stronger than expected inflation slowed down the expected pace of interest rate cuts. Whilst the European Central Bank, Sweden, Switzerland and Canada did lower their rates, the US and UK remain more cautious about reducing rates.

- US stock markets hit new highs, mainly due to big increases in tech companies such as Nvidia, Apple and Microsoft. Most market growth came from these companies.
- Snap elections in the UK and France created some market uncertainty. Asia saw more negative economic results, with China's property market struggling and Japan's currency weakening.

Markets have generally slowed down expectations of the pace of rate cuts as data had continued to signal stronger than expected inflation. However, the Fed did indicate earlier this week that inflation is coming down. Despite pushing back expected rate cuts, equity markets continued to push towards all-time highs in the second quarter, buoyed by US technology companies and the ongoing exuberance surrounding artificial intelligence (AI).

Although the European Central Bank (ECB) lowering interest rates in its June meeting was expected, it is noteworthy that interest rate cutting in individual countries is also underway, with central banks in Sweden, Switzerland and Canada all cutting rates.

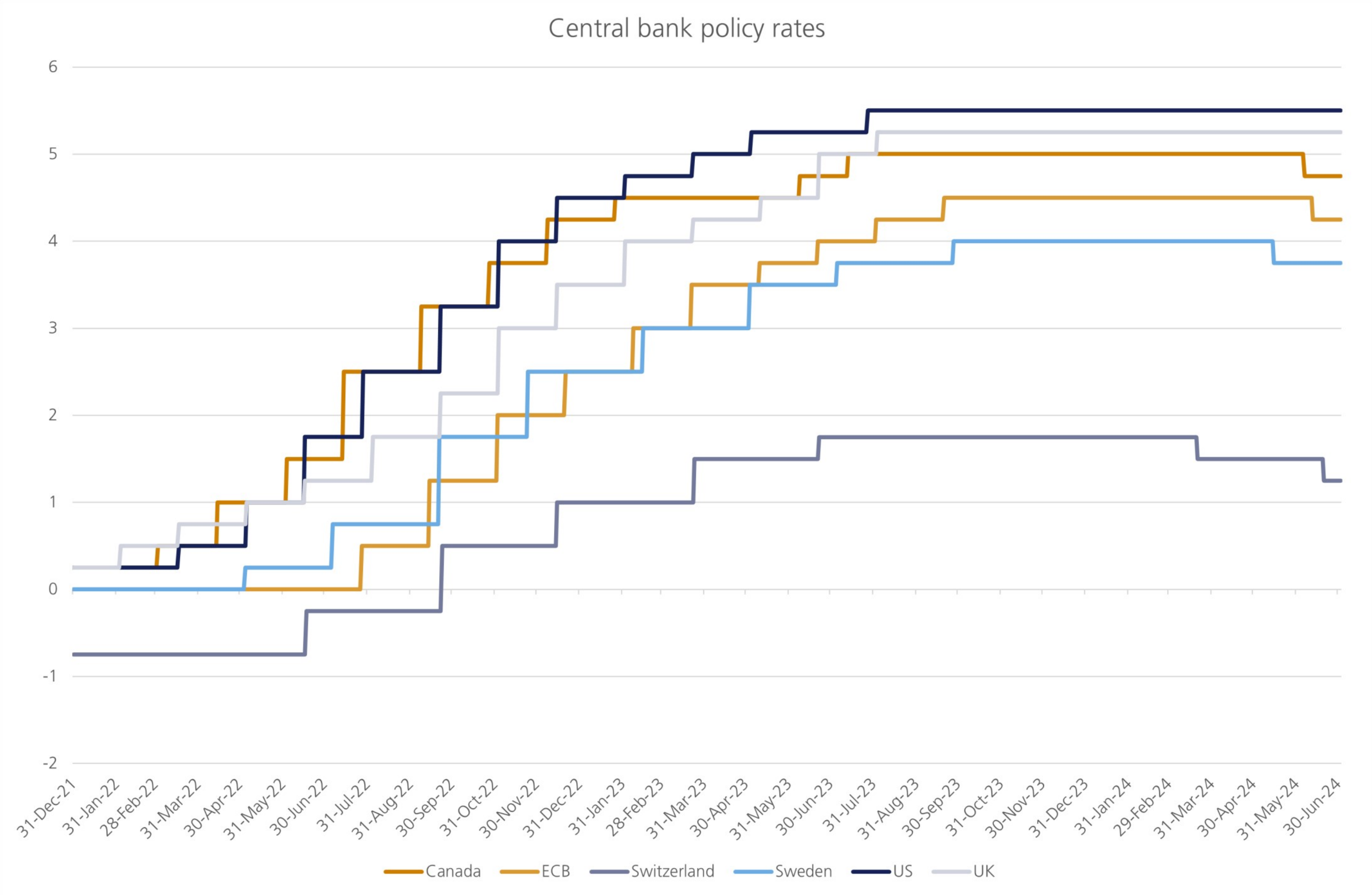
On the political front, the UK and France saw both leaders call snap elections, with the Labour party securing a landslide victory this morning in the UK’s general election.

Glacial pace

Markets have gyrated between one Fed rate cut and two this year. Although the Fed indicated it is on the right path towards disinflation, rate cuts remain unlikely anytime soon given ongoing price pressure concerns and the robust jobs market. This glacial pace of cuts means timing remains uncertain. The Bank of England (BoE) indicated in June it is more comfortable cutting rates and will likely start in August.

Regional differences will widen the gap between central banks. The Fed has significant influence, so it is likely central banks elsewhere will be more cautious and favour ambiguity over clear guidance.

The ECB had been signalling for months it was due to cut interest rates amid declining inflation and a sluggish economy. Consequently, it opted to cut rates by 0.25% to 3.75% in June.



Source: Bloomberg

Although the ECB became the first major developed market central bank to lower rates, the number of future rate cuts remains uncertain. The ECB will rely on data and analyse the inflation outlook before proceeding with future cuts. Europe's economic recovery has been uneven, with southern European nations outperforming industrialised northern countries.

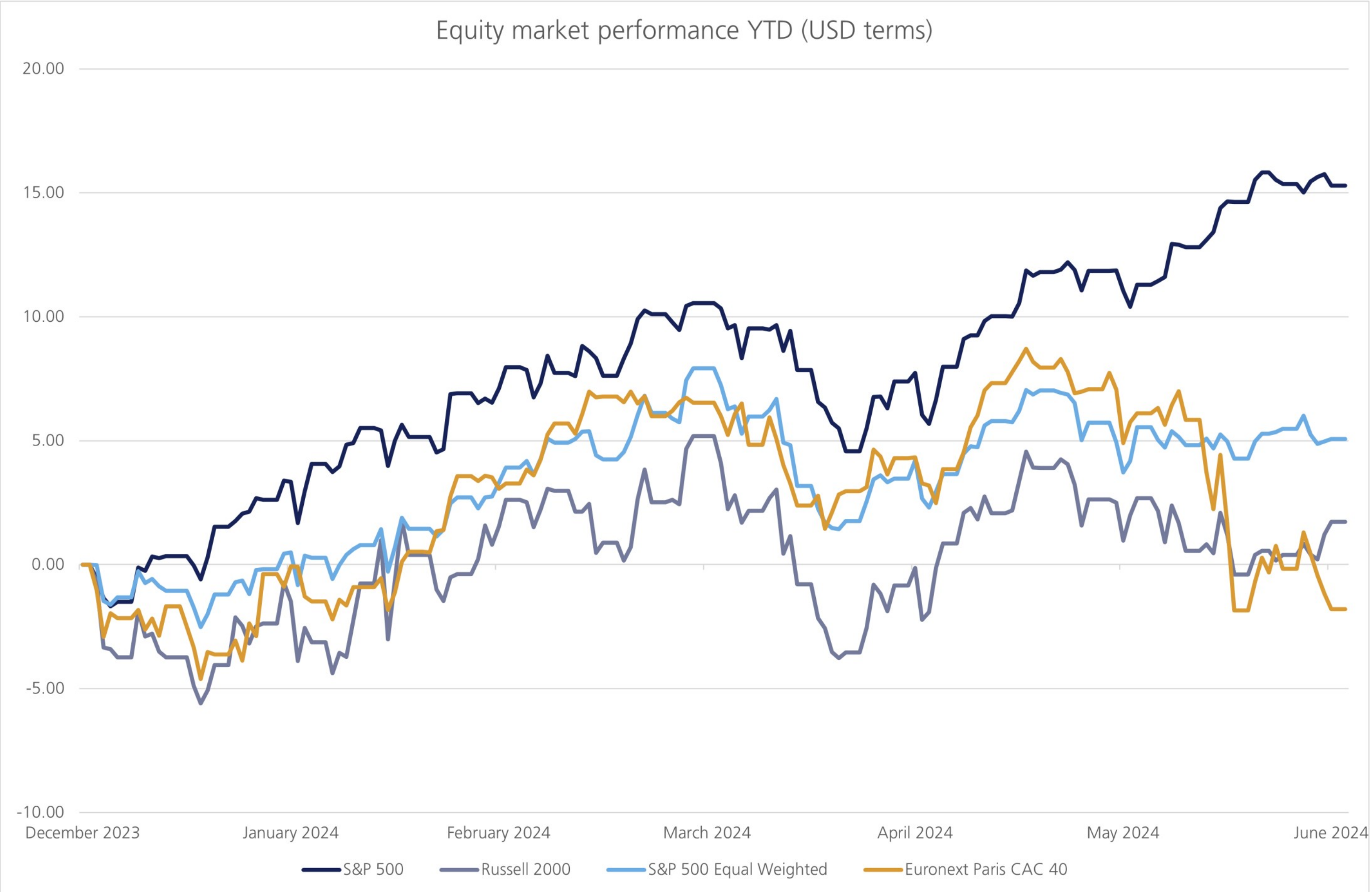
New records

After a surprise increase in April, the US Consumer Price Index (CPI) moderated,[1] indicating inflation is headed in the right direction. Bond yields followed suit, with 10-year Treasuries reaching 4.7% early in the quarter before falling to 4.4% by quarter-end. Despite positive CPI developments, the Fed indicated markets should only expect one cut this year.

After a slight pullback in May, US equity markets continued to hit record highs, lifted by Nvidia, Apple and Microsoft, with Nvidia briefly overtaking Microsoft in June to become the world's most valuable company with a market capitalisation of $3.3 trillion.[2]

The small number of companies with high levels of growth in the markets was even more pronounced this quarter, as Nvidia rose 37% while the S&P 500 gained 4.3%. Nvidia is responsible for some 35% of the S&P 500's gains since the start of this year. Keeping with technology and AI-related themes, Apple and Microsoft also rose 23% and 6% respectively in the quarter, further boosting the S&P 500's returns. In comparison, the equal weighted S&P 500 index, meaning that stocks are weighted according to their total market capitalisation (or size), fell 2.6% in the quarter, clearly indicating a handful of companies continue to drive the indices.

We expect something is likely to give in coming quarters. History tells us that hot sectors should not be chased at any price, but we do believe there is a place for these companies, albeit in a well-diversified, high-quality portfolio comprising of different asset classes. The Small Cap index, as measured by the Russell 2000, fell 3.3% over the quarter, further highlighting the narrowness in the markets.



Source: Bloomberg

The season for snap elections

UK Prime Minister Rishi Sunak's decision to bring forward the general election to 4th July stunned market participants. Labour won the general election by a landslide, but markets showed limited reaction to the news, as polls predicted the Labour victory for months and with limited fiscal headroom, policy changes are likely to be marginal. In the US, the first presidential debate brought forth fresh concerns over President Joe Biden's health.

In early June, the European Parliamentary elections showed surging support for right-leaning parties, with President Emmanuel Macron calling a snap national election in France. The French CAC 40 fell over 6% following Macron's announcement and spreads on French and German bonds reached levels not seen since 2017.[3] In the first round of the French parliamentary election on 30th June, Marine Le Pen's National Rally party secured approximately 34% of the vote, with Macron trailing in third place. However, she is not projected to win an absolute majority, which brought relief to investors ahead of the second round on 7th July.[4]

Cobbling together a coalition

In India, Prime Minister Narendra Modi lost his outright majority for the first time in a decade, and will now focus on forming a coalition government, which means passing important reforms will likely be more challenging. In Mexico, Claudia Sheinbaum's landslide victory sent the peso and Mexican equities falling, as markets feared more extreme policies.[5]

Attempts to boost growth in Asia
The Hang Seng Index's April rally quickly fizzled out, but it still finished the three-month period up 9%. China unveiled wide-ranging measures to stimulate its ailing property market, but this is not expected to be sufficient to boost the economy materially.[6] The Shanghai Composite fell 1.3% over the quarter, while Japan's equity market paused for breath. The Bank of Japan (BoJ)'s reluctance to take material action resulted in the yen falling 5.9% against the dollar in the quarter to reach the weakest level since 1986. This puts further onus on the BoJ to raise rates sooner.

A stable horizon?

As elections conclude and global governments take office and form post-election policies, this should help settle the tone and provide clarity around the evolving political landscape in the second half of the year. That said, the US election is not until November, so uncertainty will remain.

In the post-pandemic world, markets are increasingly influenced by fiscal policies. Consequently, we remain attuned to political risks while constructing portfolios. We continue to monitor these developments closely, but our focus is on quality companies that can withstand political turbulence and deliver solid returns over the medium to long term.

[1] Bureau for Labor Statistics

[2] Bloomberg

[3] Bloomberg

[4] Times, https://www.thetimes.com/article/16dcbb9e-7e64-4e7d-8e39-3a596ab04864?shareToken=0bc21bb3ab5227d79a2114d174ccc1b6

[5] Reuters, https://www.reuters.com/markets/currencies/mexico-peso-drops-nearly-3-sheinbaum-landslide-raises-reform-worry-2024-06-03/

[6] CNN, https://edition.cnn.com/2024/06/17/business/china-property-price-record-slump-intl-hnk/index.html