Summer 2024

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?

Hopes for significant rate cuts fade.

While global equity markets rise, especially in the US, fund managers now agree that interest rates will stay higher for longer. It was hoped that rates would fall steadily this year with the US Federal Reserve (Fed) expected to make several cuts, but it now accepts that they must remain elevated and has delayed reductions.

In Europe, with growth improving, inflation above target, and record low unemployment, the European Central Bank (ECB) became the first major western bank to cut rates in June but stressed that this does not herald a series of sharp reductions. The same comments are likely if the Fed eases rates later this year.

"US Employment data and financial stability suggest rate cuts may happen later this year."

As well as using interest rates to control inflation, central banks also manage employment and financial stability, and these are likely to be behind the greater caution. Although US inflation doesn't prompt immediate reductions, employment data and financial stability suggest rate cuts may happen later this year.

Confidence is growing that the global economy can expand but difficulties include the geopolitical balance as almost half the world's population face elections this year.

US and China trade remains strained, and Russia still faces sanctions as the Ukraine conflict continues.

The momentum in equities has continued, led by a relatively narrow, but gradually widening, band of dynamic stocks, but it wouldn't take much to dampen investors' mood and drag markets down from current highs.

The asset classes – a quick round-up

EQUITY MARKETS

Equity markets have been the main boost to investor returns. The focus remains on the US tech giants, but this has broadened to include some mid and small cap stocks.

Investors must consider if this momentum can be maintained. The US and Japanese markets are the strongest with Japan slightly ahead of the US in local currency terms. The US remains driven by global tech companies, including the 'fab five' of Alphabet, Amazon, Apple, Microsoft and Meta, and Japan by an improving economy, rising inflation, and a more competitive currency which benefits exporters.

Meanwhile in the UK interest rates remained at 5.25% after inflation fell to 2% in June. In Europe inflation increased to 2.6% in May and interest rates were lowered to 3.75%. Equity markets still rose but were 7-9% behind the US and Japan, in local currency terms.

Asia has lagged for some time, based on China's economic difficulties but these are now being addressed and this is improving market confidence and valuations and lifting returns from emerging market equities.

FIXED INTEREST

Returns have risen and fallen due to changing expectations about interest rate cuts although investors now seem to accept that the number of US rate reductions has reduced, possibly to none.

As always, attention is on the Fed which favoured rate cuts in January then adopted a tougher stance, but most economic forecasts still expect one or two US reductions before the year end.

Returns on government bonds have fluctuated around 4% for ten-year bonds in the UK and 4.5% in the US. This is still seen as positive, even if there is limited capital appreciation, as investors want to 'lock-in' yields at relatively high levels in anticipation of them falling during the rest of the year.

If interest rates start to drop in 2024/25, bonds will become more attractive in terms of their market value and several fund managers predict that this may be a rare opportunity to capitalise as rates edge lower. However, higher-for-longer interest rates could lead to bond market volatility created by investor jitters about the size and timing of any US interest rate cuts.

ALTERNATIVE INVESTMENTS

Delays in expected interest rate cuts have affected rate-sensitive assets, such as property and infrastructure, and dampened momentum generated from the end of 2023. In property, warehousing and logistics have been resilient while offices struggle to recover from changes such as remote working.

Continuing e-commerce growth is driving logistics. Retailer demand is expected to creep up when warehouse space acquired during the pandemic is filled and online sales continue to increase.

Lower interest rates would boost the property and infrastructure sectors and could lead to a decent recovery.

Commodities rebounded from the previous quarter led by industrial metals such as copper, which benefitted from hoarding, and expansion in emerging markets, although it has fallen recently due to weaker electric vehicle (EV) sales and falling demand for construction in China. The shift to low carbon economies is important for many industrial metals and supplying this transition should keep prices competitive.

Gold has remained strong, helped by central bank buying while oil has benefited from relatively stable prices and a fall in production levels.

Investors assessing the commodities market for the rest of the year should consider energy transition, bad weather, inflation, central bank policies, and US dollar values.

RSMR Global round-up

- Japan's economy has renewed optimism, backed by a weaker yen and higher inflation.
- US stocks hit record highs, up about 14% this year.

- Germany faces commercial difficulties and is expected to grow by only around 1.4% in 2024.
- Indonesia has been forced to raise interest rates to defend the rupiah.
- Countries including Chile, Hungary and Brazil which have cut rates have seen currency weakness.
- Chinese mainland equities and those listed in Hong Kong have rallied.
- Mexico benefitted from being close to the US as multi-nationals reduce supply chain dependency on China.
- The ECB's interest rate cut helped investors by lowering borrowing costs for individuals and companies.
- The Fed's rate cuts delay affected emerging currencies in Latin America and Asia which may suffer their worst first half of the year since 2020.

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SO, WHAT’S NEXT?

Much depends on when central banks cut interest rates. In doing so, the ECB identified that more consistent economic data is needed before the next reduction while Fed cuts have been delayed until later this year, or possibly, even 2025.

This is the overriding view of central banks as, even if headline inflation falls, some elements remain too high, especially in service sectors. The timing of cuts still dominates much market volatility, and this will continue until a Fed cut happens.

As a result, markets have persevered rather than surged but global economic growth shows signs of improvement, and the UK looks to have emerged from recession. The pattern across Europe is mixed but heading in the right direction.

The US remains the strongest western economy with high employment and wage growth, but there is concern that this may be weakening as consumers exhaust pandemic savings and inflationary pressures hit lower income households. If this affects consumer demand the Fed may lower rates as early as September.

Europe’s geopolitical changes, such as this month’s snap French election, may have far reaching consequences while November’s US election result will have global implications.

Equity market momentum continues to focus on technology and large and mega cap stocks in the US, but this could change and the need for diversified portfolios is as relevant as ever.

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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