MONTHLY UPDATE

Latest views from the investment team

The Recession That Never Came

No previous Federal Reserve hiking cycle (of the current magnitude) failed to trigger a recession. But the chances of this rate hiking cycle bucking this 60-year trend has risen, and markets have reacted accordingly – with a strong rally in both equities and bonds in the final quarter of the year. Relief has come for investors as inflation appears to be coming under control, meaning that we have likely reached peak interest rates in the current cycle, and that rate cuts may be on the horizon.

US growth has been much more resilient in 2023 than many had expected - above 2% for each of the last five quarters. Key to this has been a strong jobs market, with low unemployment and robust wage growth – underpinning retail sales and the service sector. The UK has been more sensitive to higher interest rates than the US. This is likely to be, at least in part, due to the shorter nature of mortgages in the UK compared with the US, where typical mortgages are fixed for at least 20 years. UK savings rates are above pre-Covid norms, another indication of weak confidence amongst consumers. On a more positive note, wage growth remains strong in the UK.

The path of inflation was the big unknown coming into 2023. At the year end, the outlook is that inflation has declined a long way (3.1% US CPI, 3.9% UK CPI) – driven by falls in energy costs and goods prices while the services sector has proven stickier. This has built expectations of interest rate cuts beginning in the first half of 2024 and provided support to both stock and bond markets. Economic cycles tend to move slowly and the recent improvement in asset prices is likely to boost confidence and lengthen this one.

Some US and European indices have increased to new highs over the last month. In the case of Europe, the move has largely been driven by Southern countries with Italy and Spain leading the move. These markets had been trading cheaply on various metrics, as they are viewed as more sensitive to economic uncertainty. Smaller companies' stocks, which have similarly been factoring in a lot of pessimism, have also outperformed over the last month but are still behind large companies for the year. Over 2023 US, European and Japanese equity markets have all delivered double digit returns, far superior to that of the UK. However, it is emerging market stocks that have trailed the most. In particular - Chinese stocks lagged significantly in 2023, delivering a third straight year of losses. The reopening bounce in activity has been disappointing and an overhang of debt in the real estate market has been detrimental. Even the recent market optimism across much of the globe has not been felt in Chinese equity markets.

Bottom Line

Restrictive interest rates and asset price declines that would often kick off a slowing economy have been reversed in recent weeks. The fall in inflation has led to expectations of policy rate cuts in 2024 – something that seemed very far away a year ago – and boosted global equities, with some markets even making new all-time highs. This will likely help to improve confidence and extend the economic cycle, providing a good backdrop for economies in 2024.

Month by numbers

Change in various markets over the month:

Asset		Change / Value
Equities		
UK	↑	3.79%
Europe	↑	3.85%
US	↑	4.67%
Emerging Markets	↑	3.14%
Japan	↓	-0.47%
Bonds / Rates		** Absolute change (%)*
UK Base Rates	–	0.00% / 5.25%
Fed Funds Rate	–	0.00% / 5.50%
UK 10-Year Yield	↓	-0.64% / 3.54%
US 10-Year Yield	↓	-0.47% / 3.87%
Currencies		
GBP / USD	↑	0.72% / $1.27
GBP / EUR	↓	-0.53% / €1.15
DXY (USD Index)	↓	-2.09% / 101.33
Commodities		
Gold	↑	1.31% / $2062.80
Oil (Brent)	↓	-6.99% / $77.04
Noteworthy		
US Small Caps	↑	11.44%

January 2024

All data as of 31 December 2023

Q&A

What's on your mind?

What is going on in the Red Sea?

Trouble is brewing in the Red Sea, one of the world's most important shipping lanes. Members of the Iran-backed Yemeni Houthi militant group are attacking vessels to show their support for Hamas in its conflict with Israel – the group are targeting vessels they believe are heading to and from Israel. The route is used to access the Suez Canal by around 15% of the world's shipping traffic. It is estimated that avoiding the Red Sea adds approximately 10 days onto a journey from Asia to North Europe, an increase of nearly a third. Some of the world's largest companies have stopped sailing through the Red Sea for safety and now retailers are warning of product delays as a result. While this is unlikely to impact the holiday season as products are already at their country of destination, we may see longer-term disruptions.

What's happened to Rishi Sunak's pledges?

At the beginning of 2023 Rishi Sunak made five pledges – to halve inflation, grow the economy, cut debt, reduce illegal migration, and cut hospital waiting lists. At year end it seems that only the halving of inflation has been achieved. Revised data shows that the UK economy shrank in the third quarter by 0.1% and was flat in the second quarter. Public sector net debt now totals £2.7 trillion, about 97% of GDP. This is the highest level since the early 1960s and, with higher interest rates than a few years ago, interest payable on the debt is rising – Fitch Ratings has estimated that UK interest costs are over 10% of total government revenue, the highest in the developed world. Meanwhile, hospital waiting lists have risen and migrant boats continue to cross the English Channel. These are all topics that are likely to dominate election debates in 2024.

Are cryptocurrencies becoming a mainstream investment?

Cryptocurrencies caught plenty of flak in 2023 - prices were crushed by higher interest rates in 2022 and the founders of the two largest cryptocurrency exchanges await sentencing for financial crimes. Despite this, bitcoin climbed more than 150% in 2023. There are many useful features – transactions are quick and low cost, a growing list of vendors accept cryptocurrency payments, and it is impossible for governments to tax or confiscate tokens without the owner's cooperation. Unlike fiat currencies, there is a limited supply and, therefore, investors view the tokens as a solid, long-term store of value. For now, the market is volatile and directed by speculative trading, but, cryptocurrency may be proving itself as a serious asset - Blackrock and Fidelity have applied to launch cryptocurrency exchange traded funds in the US – making it more accessible for pension funds and investment portfolios – a decision is expected in January.

For more information, please contact your adviser.