NORTH CAPITAL

Ongoing cycle, broadening growth

Mid-Year Investment Outlook 2024

July 2024

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Ongoing cycle, broadening growth

- Markets faced many challenges during the first half of 2024 – rate cuts did not materialise as expected, geopolitical tensions remained high, and elections generated volatility. Despite this, economies proved resilient with strong corporate earnings and, as such, many equity markets have hit record highs.
- Uncertainty is likely to continue over the remainder of 2024 with more elections, most notably in the US, and ongoing geopolitical risks.
- Looking through the noise, we remain optimistic for asset returns as policymakers lean towards interest rate cuts, fiscal spending continues, and global trade continues to rise.
- In equities, we think ongoing economic health supports an overweight position. Broadening growth, bolstered by rising global trade and corporate activity, favour overweight positions in the UK and Japan.
- In bonds, the backdrop of rate cuts underpins short-dated bonds while fluctuations in the prevailing market narrative create a good environment for active managers.

Asset		YTD Change/ Value at 28 June
Equities		
UK	↑	7.82%
Europe	↑	8.72%
US	↑	14.64%
Emerging Markets	↑	11.00%
Japan	↑	21.25%
Bonds/Rates *Absolute change (%)		
UK Base Rates	–	0.00%
		5.25%
Fed Funds Rate	–	0.00%
		5.50%
UK 10-Year Yield	↑	0.64%
		4.18%
US 10-Year Yield	↑	0.51%
		4.37%
Currencies		
GBP/USD	↓	-0.82%
		1.26
GBP/EUR	↑	2.23%
		1.18
DXY (USD Index)	↑	4.47%
		105.87
Commodities		
Gold	↑	12.81%
		2,326.96
Oil (Brent)	↑	12.16%
		86.41

2024 H1 Review and H2 Outlook

Over the first half of 2024, many equity markets reached new highs – the US, Europe and various Emerging Market regions to name a few. The outlook for economic growth remains healthy as businesses and consumers are reassured by the pause in interest rate hikes (and, in some cases, commencement of rate cuts) alongside falling inflation. Corporate results have impressed investors and equities have re-rated in anticipation of further strong earnings. Stock buybacks and US government spending are also underpinning returns. US stocks have been the star performer as AI enthusiasm continues amid record-breaking earnings.

The World Trade Organisation are forecasting a rebound in global trade this year and next after a slowdown in 2023. Concerns about prices and interest rates weighed on trade in 2023 but, with these worries greatly reduced, 2024 and 2025 are expected to be more buoyant. As a result, the World Bank have revised up their global growth expectations for this year (to 2.6%) and next (to 2.7%). This coincides with our view that this cycle will continue, in the absence of a significant shock. This bodes well for a broadening of equity market performance across a greater number of regions and industries.

Contrastingly, many bonds have underperformed (yields have risen) as inflation declined more slowly than the market expected at the start of the year. A large part of the drop in inflation is linked to food and energy prices stabilising. Underlying inflation (excluding the volatile effects of food and energy) is proving stickier. Robust wage growth may restrict further declines but a worrying re-acceleration in inflation seems unlikely as supply disruptions have unwound and unemployment has started to rise, albeit gradually, in the US and UK.

The upcoming US election presents some risks with the potential for inflationary policies, such as higher tariffs. However, given recent experiences of extremely high inflation at its peak (9% in the US and 11% in the UK), we do expect that central banks will tolerate inflation a little above target to enable ongoing growth. Therefore, looking forward, we do not expect inflation be a significant concern for equity investors.

Our base case is for resilient growth - global manufacturing indices are picking up, an encouraging sign for global trade, while the stance from central banks is generally supportive and government spending remains elevated. This is a backdrop that we think bodes well for equities with broadening participation across regions. We also foresee modest positive returns for bonds as supportive central banks keep yields capped (and bond prices underpinned), with short-dated bonds most favourable.

Nonetheless, we are mindful of risks. It is possible that economies slip into recession as prior policy tightening has a greater impact on firms and consumers or political turmoil hurts confidence. Alternatively, it is also possible that inflation accelerates again – perhaps triggered by geopolitics (e.g. tariffs or a re-emergence of supply disruptions). The risk of alternative scenarios serves as a reminder of the importance of diversified multi-asset portfolios.

North Capital portfolio positioning: Defensive Assets

We started the year with a neutral stance between defensive and growth assets. Within fixed income we held an overweight position in government inflation-linked bonds and, across fixed income, we tilted our exposure towards short-dated bonds to restrict exposure to the longer end of the curve with more expensive valuations. Inflation has continued to fall but less rapidly than investors expected at the end of last year; therefore, inflation-linked bonds have performed similarly to equivalent conventional bonds.

During the first half of 2024, we reduced our exposure to fixed income, as we expect returns to be limited, in favour of equities and gold. Rates cuts are materialising more slowly than the market anticipated and we think valuations may be challenged by heavy bond supply (resulting from high levels of government spending). We have also increased our allocation to active managers as we expect ongoing fluctuations in the prevailing narrative to provide compelling opportunities for additional returns.

	Asset Class	Tactical Conviction					Rationale
		-2	-1	0	1	2	
	Overall Risk				●		**We are modestly overweight risk.**
	Defensive Assets		●				**We are underweight Defensive Assets as we lean towards alternative forms of diversification in the current environment, such as listed infrastructure and gold.**
Defensive Assets	**Cash**			●			**We remain neutral on cash.**
Defensive Assets	**Fixed Income**	●					**We are underweight Fixed Income relative to Real Return. Our bias remains to short duration bonds.**
Defensive Assets	Sovereign Bonds	●					Central banks have paused interest rate hiking cycles and are expected to cut rates, providing support to short-dated bonds. Meanwhile longer duration bonds have lower yeilds and inflation is still above target. We have a preference towards active funds because ongoing fluctuations in investor expectations for growth provides ample opportunities for strong managers.
Defensive Assets	Investment Grade Corporate Bonds			●			
Defensive Assets	Tactical Fixed Income			●			
Defensive Assets	**Real Return**				●		**Defensive Real Return assets offer good value, as inflation pricing remains subdued while prevailing inflation is still above target.**
Defensive Assets	Inflation-Linked Bonds				●		Real yields (nominal bond yield minus the expected inflation rate) are now positive, presenting value to investors.
Defensive Assets	Tactical Real Return			●			
	Growth Assets				●		**We are overweight Growth Assets as economies prove resilient to past increases in interest rates, fiscal spending remains high and the decline in inflation enables central banks to provide support.**
Growth Assets	**Equities**					●	**We are overweight Equities. The backdrop supports ongoing earnings growth, thus making Equities attractive. There are opportunities between regions and styles.**
Growth Assets	UK Equities				●		Economic cycles tend to move slowly in the absence of significant shocks and we expect interest rate cuts to support economies for longer. Rising global trade should provide support broadly across the globe. High cash rates mean that returns on capital invested need to be greater and we expect this will lead to dispersion, a good environment for strong active managers. We hold selective exposure to high quality Global and Emerging Markets active managers. Within equity styles, we favour smaller companies, which offer an attractive entry point for long-term investors. Within regions we favour Japan, where corporate reforms are encouraging investment and buybacks, and the UK, where the pause in rate hikes and reduction in political upheaval are expected to provide a good environment for earnings and merger and acquisition activity.
Growth Assets	Europe Ex UK Equities			●			
Growth Assets	US Equities			●			
Growth Assets	Japan Equities				●		
Growth Assets	EM Equities			●			
Growth Assets	Global Equities			●			
Growth Assets	**Real Assets**		●				**We are underweight Real Assets, via property, in favour of Equities.**
Growth Assets	Infrastructure/Clean Energy				●		We are underweight property as we see high rates as unfavourable. We are overweight infrastructure. We anticipate ongoing investment due to rising populations, the need for AI grid capacity and energy transition. This sector also has a low colleration with other growth assets. We are neutral commodities - geographical tensions favour commodities but this is balanced by the potential for greater supply. We have added gold, which tends to perform well in recession and stagnation scenarios, for diversification.
Growth Assets	Property	●					
Growth Assets	Gold			●			
Growth Assets	Broad Commodities			●			

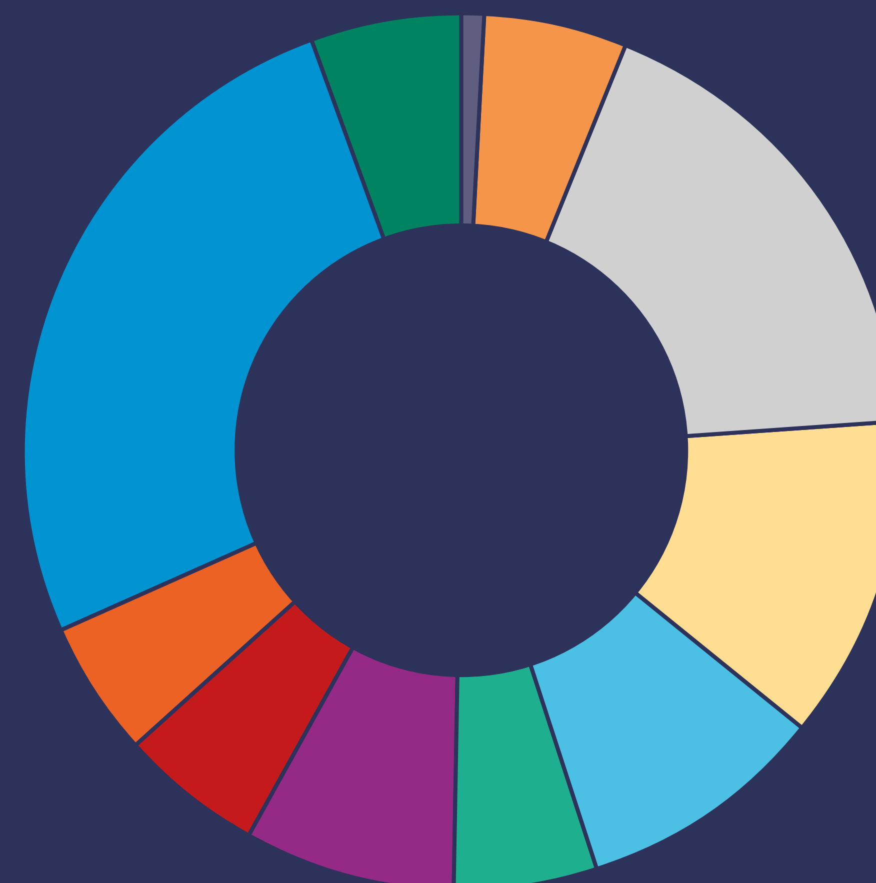
North Capital portfolio positioning: Growth Assets

Within equities, we started the year underweight European equities to fund our overweight in Japan. We expected slower growth in China to weigh on trade with Europe while Japan could continue to benefit from corporate reforms. However, we subsequently increased European equities to a neutral weighting in the first quarter as economic data improved and the ECB President started guiding investors towards rate cuts. Additionally, we recognised that stimulus in China may help lift sentiment from extremely depressed levels. We continue to hold an overweight in Japan. As well as corporate reforms, we expect Japan to benefit from rising global trade given its heavy weighting to sectors poised to benefit, such as industrials and technology. Japan has a mild inflation backdrop, supporting wages and corporate pricing power. We have also added to our exposure in UK Equities where confidence is returning amongst businesses and consumers. Attractive valuations are triggering more merger and acquisition activity, and political uncertainty is fading following the election. The UK market also has the advantage of being heavily weighted in sectors with defensive qualities, such as consumer staples and healthcare, thus providing some diversification against other allocations.

The weight of US equities in global indices has continued to grow as the region has outperformed and a key risk to our positive overall outlook for returns is US valuations. US equities, and the technology sector in particular, have performed very strongly year to date due to the insatiable demand for AI, concerns overseas (for example regarding growth in China or politics in France) and robust corporate earnings. Valuations now screen expensively and suggest that, over the long-term, US equity dominance can fade. However, with the US election approaching later in the year, and both presidential candidates emphasising the importance of a strong economy, at this stage it seems likely that US equities can continue to find support. We have a neutral US allocation but are positioned for more sectors, as well as smaller companies, to participate.

We maintain some exposure to infrastructure and commodities which offer attractive diversification. We further reduced our allocation to property to fund allocations to equities and gold. As it is supply constrained, gold offers inflation-protection but has also proved itself as a safe-haven asset in recessionary scenarios.

Balanced Portfolio Allocation



Defensive	
Cash	1.00%
Sovereign Bonds	5.35%
Corporate Bonds	17.65%
Sovereign Inflation-Linked Bonds	12.00%

Growth	
UK Equities	9.25%
Europe ex-UK Equities	5.25%
US Equities	7.75%
Japan Equities	5.25%
EM Equities	5.00%
Global Equities	26.00%
Real Assets	5.50%

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NORTH CAPITAL

58 North Castle Street, Edinburgh EH2 3LU

+44 (0) 131 285 0860   info@northcapital.co.uk

northcapital.co.uk

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