MONTHLY UPDATE

Latest views from the investment team

No summer lull

There was little evidence in July of a summer lull. Events in focus have been many and varied – the Labour party achieved a landslide victory in the UK election, the French election resulted in no overall majority, US Republican candidate Trump was the target of an attempted assassination, US President Biden stepped down from being the Democrat's election candidate, and hopes for US rate cuts were bolstered by soft inflation data. As a result, movements in asset prices have been diverse and volatile, but with modest gains in the end for UK and US equities.

Recent US political events may be included in future history books. These events contributed to volatility in asset markets in July which we summarised in our Spotlight article 'US Election'. Away from politics, July brought a reassuring inflation print showing ongoing moderation in US price pressures and raising hopes for rate cuts soon. In markets, rather than this catalysing broad support for US stocks as one might expect, instead, there was an acute rotation. Small cap stocks, which have underperformed large caps for some time, increased sharply. Smaller companies generally have higher levels of debt so should benefit disproportionately from lower rates. Stocks in sectors such as financials and healthcare, with steady profits, and that pay dividends also fared well. Meanwhile, technology stocks suffered after dominating returns in the first half of the year. Growing confidence about rate cuts has made dividend payments attractive while concerns over US restrictions on chip exports to China, as well as the unwinding of heavy investor positioning in technology stocks, have driven this rotation. On the day US consumer price inflation data was released, small caps outperformed indices for the technology sector by the most for over forty years.

Many central bank meetings hit the headlines over the month, with varying outcomes. The Bank of Canada followed up on its June rate cut with another in July. Although Canadian inflation remains a little higher than desired at 2.7%, further slowing is expected, and policymakers have chosen to focus also on signs of softening in the jobs market – a theme that is becoming common across developed markets. The European Central Bank held rates steady following June's cut but pointed towards a possible September reduction. The Bank of Japan, which is moving policy in the opposite direction, raised interest rates by 0.15% to "around 0.25%", the highest level since 2008. The slow approach to lifting rates is aimed at not choking off improvements in confidence and preventing inflation from slipping back towards the extremely low levels of the recent past. The rate increase was welcomed by the Japanese Yen and is one of the reasons we favour Japanese equities. Finally, at their meeting at the end of July, the US Federal Reserve left policy rates unchanged. Chair Powell acknowledged that, at current levels, rates are restrictive. He noted broad softening in inflation, and signalled increasing attention is being paid to both sides of their dual mandate – ie unemployment as well as inflation. With unemployment having risen modestly over recent months, September is the focus for the first US rate cut.

Bottom line

There has been a lot for investors to navigate in July. Looking through the noise, the outlook for earnings in the UK and US remains robust with falling inflation, growing economies and a supportive tone from central banks. Recent volatility and variation between regions and styles highlight the benefits of a diversified multi-asset portfolio and a long-term outlook.

Month by numbers

Change in various markets over the month:

Asset	Change	Value
Equities		
UK	↑	2.55%
Europe	↑	0.57%
US	↑	1.23%
Emerging Markets	↑	0.60%
Japan	↓	-1.04%
Bonds/Rates *Absolute change (%)		
UK Base Rates	-	0.00%
		5.25%
Fed Funds Rate	-	0.00%
		5.50%
UK 10-Year Yield	↓	-0.21%
		3.97%
US 10-Year Yield	↓	-0.32%
		4.06%
Currencies		
GBP/USD	↑	1.47%
		1.28
GBP/EUR	↑	0.64%
		1.19
DXY (USD Index)	↓	-1.67%
		104.10
Commodities		
Gold	↑	5.22%
		$2448.46
Oil (Brent)	↓	-6.58%
		$80.72
Noteworthy		
CrowdStrike Inc	↓	-40.85%

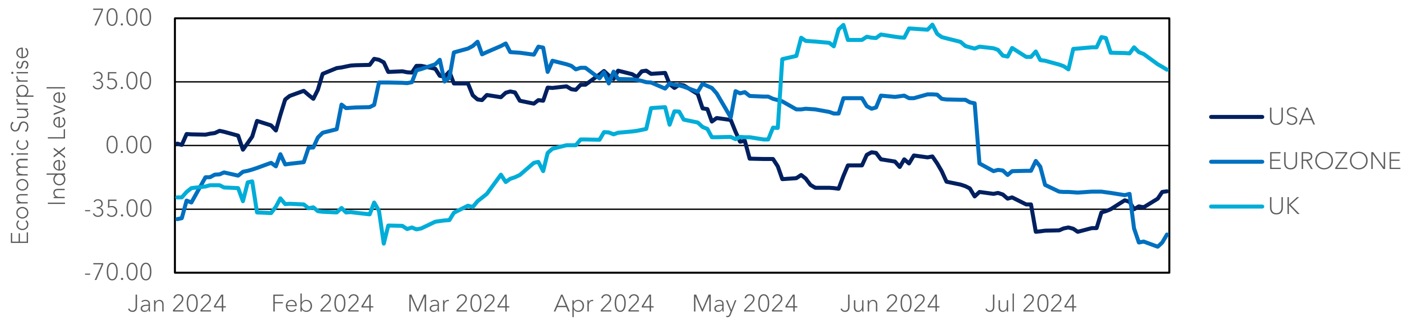
August 2024

As of 31 July 2024

Q&A

Things are OK in the UK!

July brought a long-expected change of government in the UK as the Labour Party secured a landslide victory in the July General Election. This new stability follows several years of political volatility in the UK and comes as the economic picture in the UK is showing improvement. Headline inflation is back at the 2.0% target, the rate of GDP growth exceeded expectations, and consumer sentiment is at a three year high. Meanwhile, the Bank of England seems to be on the cusp of a rate cutting cycle, offering an additional stimulus. All this comes as the economies across the Channel and across the Atlantic endure more uncertainty. Indeed, economic surprise indices (which represent differences between actual economic results and forecasts) show a positive score for the UK whilst the Eurozone and US have been deteriorating. This stability and good news could be a catalyst for a more constructive period in UK assets, especially among foreign investors who have persisted with their structurally low UK allocation in recent years. Against this backdrop, the UK equity index has been one of the strongest performing markets in July and we maintain our decision to move overweight, especially in UK smaller companies which typically have a more domestically focus. We do, however, acknowledge that challenges remain such as weak productivity growth, worker shortages, and fiscal constraints for the new Government.



What's happening with Q2 Earnings?

As we reach the mid-point of the second quarter earnings season, we have seen a continuation of strong earnings growth. At the time of writing 78% of companies in the US have reported results which beat estimates, slightly more than the ten-year average of 74%. Similarly, performance in the UK and Europe has been equally robust. Despite these strong results, the market has been less inclined to reward companies with robust earnings. On the other hand, earnings misses have been harshly punished, with average declines of 3.8% in the days following the announcements. This is not entirely unexpected and highlights the fact that much of the 'good news' was already priced in. There have been pockets of weakness, particularly among consumer-facing companies like Procter & Gamble, Diageo, and McDonald's. Each warned that customers are cutting back spending, noting that consumers across income levels are feeling financially squeezed.

For more information, please contact your adviser.