MONTHLY UPDATE

Latest views from the investment team

Oceans Apart

November was an eventful month in politics, economics, and asset markets with divergent outcomes between the US and Europe. The US election set the tone as expectations for US tax cuts, deregulation, and even higher government spending pushed up US stocks and the USD. Meanwhile, fears over US import tariffs and escalating geopolitical tensions weighed on stocks and currencies in other regions, relative to the US. However, evidence of weakening economic data in the UK and Europe spurred expectations of more rate cuts, helping stocks and bonds recover from adverse moves earlier in the month.

US sentiment has been buoyed by the Republican's 'pro-business' policies, as described in our flash update The US Turns Red. However, consequences have also been felt elsewhere. Most notable perhaps has been the Euro falling around 3% against the USD. Investor sentiment was already cautious on Europe for many reasons - Germany's manufacturing sector lacking competitiveness against China, fewer highly innovative companies relative to the US, and the vulnerability of Europe's energy supply due to its heavy reliance on imports. This already weak narrative has taken another hit from the threat of higher US tariffs following the US election. Additionally, European gas prices hit their highest level in a year in November as Russia-Ukraine tensions increased, creating concern over potential disruption to supplies. Some European countries still receive gas from Russia via a Ukraine transit route and prices increased over 20% in November. These headwinds, as well as ongoing political volatility, have weighed on European business surveys, with indicators of private sector activity pointing towards contraction. Equity indices lagged but expectations of further rate cuts from the European Central Bank have been bolstered, leading to positive returns for European bonds.

In the UK, there is evidence that the new government is losing favour. Gilt yields initially jumped following the budget, business confidence has dropped, and surveys are indicating stagnation in both manufacturing and service sectors. With this backdrop, GBP has also fallen against the USD. Therefore, despite inflation jumping up to 2.3% from 1.7%, largely due to last year's energy price cap being removed, investors are expecting the Bank of England to cut rates again soon and this has helped UK stocks recover from a decline earlier in the month.

Contrastingly, business optimism increased in the US in November, indicating a positive reaction to the election, and pushing up stocks and the USD. In particular – small caps, financials and energy stocks have been boosted by expectations of a more relaxed regulatory environment and greater oil production. Headlines over who will be part of Trump's cabinet when the Republicans take office in January have been eagerly followed throughout the month. The planned Department of Government Efficiency, which will be led by billionaire businessmen, Elon Musk and Vivek Ramaswamy, has perhaps attracted most attention. While it sounds sensible to cut wasteful expenditures and bureaucracy, this will likely mean job cuts which could be detrimental unless the private sector remains strong enough to absorb the additional workers. At present, there is still an excess demand for workers over supply, but the margin has narrowed this year and, so, should be monitored closely. In any case, friction due to policy changes seems likely. The US Treasury Secretary, responsible for advising the President on spending and taxes, has been announced as Scott Bessent, a former hedge fund manager. He is being viewed as a sensible choice by investors because he views aggressive tariff rhetoric as a starting point for negotiations, rather than a definitive outcome which may result in lower global trade volumes and worsening global relations.

Bottom Line

There are some signs of weakness in European and UK economic data but, as interest rates are still quite high, there is scope for central banks to provide support. This contrasts with resilience being demonstrated in the US which is playing out in the USD and stock prices. Differences between asset returns across regions and sectors was large in November, highlighting the potential benefits of active asset allocation.

NORTH CAPITAL

Month in Numbers

Change in various markets over the month:

ASSET NAME		CHANGE / VALUE
EQUITIES — Local Currency		
United Kingdom	▲	2.18%
Europe (ex UK)	▼	-0.48%
United States	▲	5.73%
Emerging Markets	▼	-2.81%
Japan	▼	-2.23%
BONDS/RATES — Absolute change (%)		
Bank of England Base Rate	▼	-0.25%
		4.75%
Federal Reserve Funds Rate	▼	-0.25%
		4.75%
UK 10-Year Gilt Yield	▼	-0.20%
		4.25%
US 10-Year Treasury Yield	▼	-0.09%
		4.19%
CURRENCIES		
GBP/USD	▼	-1.24%
		$1.27
GBP/EUR	▲	1.62%
		€1.20
DXY (USD Index)	▲	1.69%
		105.74
COMMODITIES		
Gold (USD/ Troy Oz)	▼	-2.97%
		$2,659.45
Brent Crude Oil (USD/Barrel)	▲	0.01%
		$73.20
NOTEWORTHY		
Tesla Inc	▲	38.15%

December 2024

As of 30 November 2024

Q&A

Shake up for the Dow Jones

The Dow Jones Industrial Average (Dow) is a stock market index tracking 30 major publicly traded US. companies. Created in 1896 by Charles Dow, it is one of the oldest and most widely quoted indices, often seen as a barometer for US economic health. Unlike the S&P 500, which is market-capitalization-weighted, the Dow is price-weighted, meaning companies with higher stock prices have more influence on the index, regardless of their overall market value. As a result, companies like UnitedHealth Group, Goldman Sachs, and Home Depot, with higher stock prices, hold the largest weights in the Dow. In contrast, in the market-cap-weighted S&P 500, firms like Apple, Microsoft, and Nvidia dominate due to their massive valuations. Despite being symbolic, this approach is arguably less valid and representative than the value weighted approach of the S&P 500.

The Dow's composition is determined by a committee, which selects its 30 constituents based on qualitative criteria. These include a company's reputation, financial stability, and ability to represent a broad cross-section of the US economy. This also makes the Dow less comprehensive than the S&P 500 which includes the largest 500 companies listed on the US market. It was therefore significant last month that the committee made the decision to drop Intel from the index and replace it with Nvidia. This shift underscores the evolving dynamics of the semiconductor industry and the broader technology sector. Intel, once the undisputed leader in the chip-making space, has faced mounting challenges in recent years, including increased competition, strategic missteps, and delays in key technological advancements. As a result, its dominance in the sector has waned, making way for Nvidia, which has become a market darling due to its meteoric rise and leadership in the artificial intelligence space.

Why is Bitcoin surging?

Bitcoin and Ethereum have been making waves recently, and it's clear the crypto market is watching these giants closely. Bitcoin surged past $98,000 for the first time, largely thanks to strong inflows into spot ETFs and optimism around potential Federal Reserve rate cuts. It's a reminder that, even with global economic uncertainty, institutional investors see Bitcoin as a solid long-term play. Ethereum isn't far behind, climbing to trade near $3,600, its highest level in almost three years. The boost came from growing interest in Ethereum-focused ETFs and its increasing role in blockchain-based solutions. Both cryptos are signalling resilience, even as broader market participation remains somewhat cautious. Interestingly, the US election is adding a new layer of intrigue as the potential for a pro-crypto administration has caused further enthusiasm in the market. There's speculation about regulatory shifts that could further legitimise cryptocurrencies, especially if new leadership reshapes the regulator's stance.

Is the Santa Rally real?

The "Santa Rally" is a stock market trend where prices often rise during the final five trading days of December and the first two trading days of January. Historically, the S&P 500 has experienced gains during this period about 79% of the time, with an average return of 1.3% since 1970. This pattern is often linked to factors like year-end tax strategies, reinvestment of holiday bonuses, and reduced institutional trading activity during the holiday.

However, the rally is not guaranteed. For instance, in 2015, the S&P 500 dropped 2.3% during this period (December 24 to January 3), demonstrating that market conditions can override seasonal trends. While the Santa Rally is a notable historical trend, investors are best served by focusing on long-term strategies rather than short-term anomalies.