Quarterly market and economic update - Q1 2024

defaqto

Financial market background

All of the main equity regions saw strong returns over Q4 2023, with most of these gains coming in November and December. This was mainly due to a growing expectation that central banks would cut interest rates in 2024 sooner than expected. The fear of 'higher for longer' rates abating boosted growth stocks in particular.

North American equities, with its growth tilt, was the best performing of the main equity regions in local currency terms, although the narrow rally dominated by the 'magnificent seven' tech and AI stocks seen through most of the year broadened out over the quarter. Europe ex-UK equities also delivered strong returns and was the best performing equity region in sterling terms.

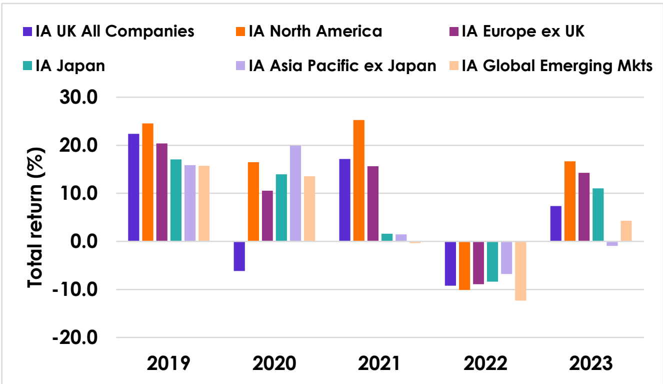
Asia Pacific ex-Japan and Emerging Markets saw the lowest sterling returns (although still positive) over Q4, mostly due to a fall in Chinese equities.

Expectations of earlier interest rate cuts also meant that bonds had a strong quarter. US 10 year government bond yields fell, from 4.53% initially to finish at 3.87%. In the UK, 10 year gilt yields also fell, ending Q4 at 3.54% compared to 4.41% at the start. UK government bonds were in fact the best-performing main sovereign market over the quarter in local currency terms. Spreads also tightened over Q4 and this helped credit. Spreads on high yield and emerging market debt fell as the risk of higher for longer rates reduced.

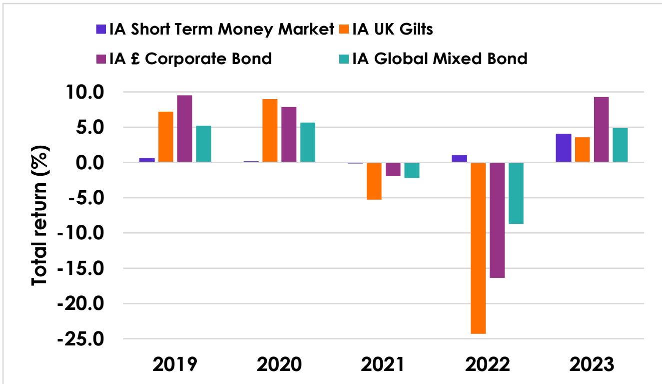
Sterling rose against the US dollar over the quarter. The pound was more volatile versus the euro over Q4 and finished the quarter slightly weaker.

Commodities, unlike most of the other main asset classes, fell over Q4. Infrastructure, however, had a very strong quarter.

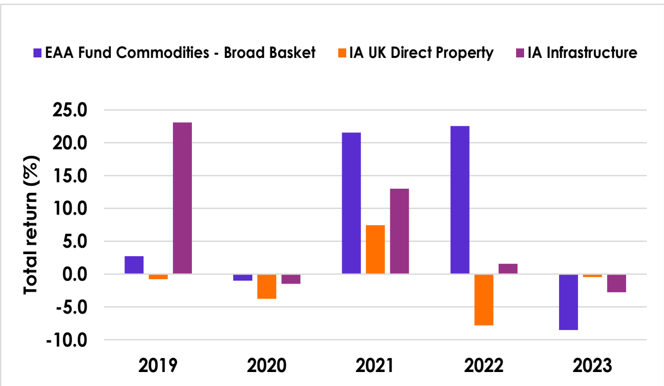
Total returns for the main equity markets



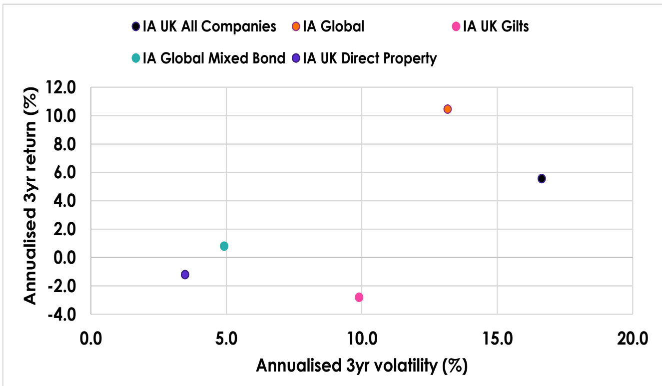
Total returns for fixed interest



Total returns for commodities, property and infrastructure



Three year risk and return for selected asset classes



Source: Morningstar, 31/12/2023

Economic background

Quarterly UK GDP growth was -0.1% in Q3 2023, after no growth in Q2. Eurozone GDP also fell by 0.1% in the third quarter, after 0.1% growth in the previous quarter. US GDP, however, increased at an annual rate of 4.9% in Q3 2023, following an increase of 2.1% in Q2.

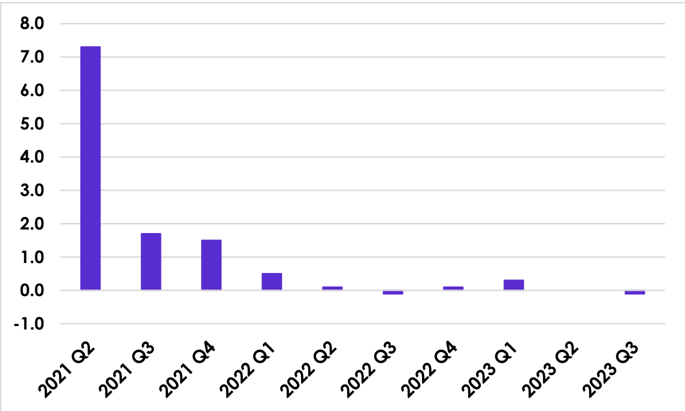
Purchasing Managers' Index (PMI) numbers continue to be stronger for services than manufacturing for the above three economies. Overall, Eurozone PMI data is weaker than that of the US and UK. Latest consumer confidence figures, meanwhile, are in positive territory for the US but negative for the UK and Eurozone.

Headline inflation fell over Q4, largely due to falling energy prices and the continued fixing of supply chains, with rates of 3.9%, 3.1% and 2.4% registered in November in the UK, US and Eurozone respectively. The corresponding core inflation rates were 5.1%, 4.0% and 3.6%. Inflation in Japan was 3.3% but just 1.4% in Switzerland and *minus* 0.5% in China in November.

The Bank of England, Fed and European Central Bank all held interest rates through the quarter, at 5.25%, 5.25-5.5% and 4.5% respectively.

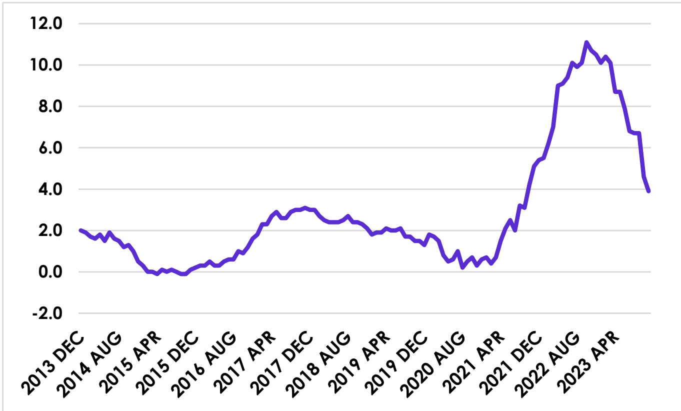
Labour markets generally remain tight, although there are some signs of easing, with modest rises in unemployment in the UK and US. UK wage inflation is about 7.5% but has recently seen a small improvement. US wage inflation is around 5% but falling. Wage growth is slightly lower but accelerating in the Eurozone.

UK quarter on quarter GDP % growth (1955-2023 average = 0.6%)



Source: ONS; chained volume measures, seasonally adjusted

UK CPI annual % rate (all items)



Source: ONS

New FCA SDR rules

At the end of November, the Financial Conduct Authority (FCA) unveiled its final Sustainable Disclosure Requirements (SDR) rules.

Sustainable funds fulfilling the qualifying criteria will be able to use one of four different labels from the end of July - Sustainability Focus, Sustainability Improvers, Sustainability Impact and Sustainability Mixed Goals - with the final label being added following feedback to earlier consultations that multi-asset and blended strategies did not fit into any of the first three categories.

Alongside the four labels, the FCA will also introduce anti-greenwashing as well as naming and marketing rules. The latter will allow firms to promote non-labelled funds with ESG characteristics and was not included in earlier consultations.

The labelling won't apply to overseas funds, model portfolios or pensions, at least to begin with, although all authorised firms will need to comply with the anti-greenwashing rules.

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