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# Q2 Market Update

As at 28th June 2024

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### **Macro Backdrop**

Inflation and interest rates remained at the forefront of investor concerns throughout Q2 2024. However, the news was more optimistic than previous quarters, with inflation rates lowering to be close to central banks' targets. This shift paved the way for a fascinating move: the European Central Bank became the first major central bank to ease monetary policy by lowering its base rate by 0.25% (source: European Central Bank). Whilst a modest step, it signalled a long-awaited change of direction in that the first of the world's major central banks had shifted policy.

Despite this progress, challenges remain. Some measures, particularly wage inflation and job growth, have proven persistent in several economies, despite rising unemployment figures now at around 4% in both the US and UK (source: Capital Economics). This in large part explains the cautious approach of the US Federal Reserve and the Bank of England, both maintaining interest rates at their elevated levels.

The economic growth picture presented a mixed bag. The US economy showed resilience, forecast to grow at 2.1% annualised in Q2 according to the Federal Reserve of Philadelphia. By contrast, the UK, following a mild recession, experienced flat growth in April after a brief period of expansion. This trend mirrored the broader Eurozone. The slowdown in many major economies is a deliberate consequence of rising interest rates, a tool used to curb inflation by reducing demand.

Voters across the United Kingdom will head to the polls on the 4th of July, with widespread dissatisfaction expected to lead to an historic victory for the Labour party over the ruling Conservatives, who have been battered by scandals and policy errors. Markets have shown little reaction however, due to Labour's moderate stance relative to their own recent past, and a general consensus of results already being priced into currency, equity and fixed income markets.

Looking beyond western markets, China's economy, which had been severely weakened in 2023, exhibited strong signs of recovery throughout Q1 and into Q2. A report by Deloitte suggests growth is expected to top 5% this year, fuelled by significant increases in industrial output and rebounds in both trade and consumption. In Japan, a weak yen and renewed investor confidence are also driving markets, though the country is expected to post a contraction of GDP for the quarter.

### **Bond Markets**

Bond markets experienced a volatile Q2, with investors grappling with the uncertainty surrounding future rate cuts and political instability in several major economies. Despite the turbulence, after a period of widening, government bond yields, such as those issued by the US and UK, declined significantly in the later stages of the quarter thanks to easing inflation. The odds of a US rate cut by September are around 66% according to the futures market, whilst the UK seems likely to make its first cut in August following suggestive comments by Andrew Bailey, Governor of the Bank of England. Our underlying actively managed funds navigated this volatility effectively, keeping returns largely flat.

Looking ahead, bonds remain an attractive asset class due to their sensitivity to interest rates. As Jenna Barnard, manager of the Janus Henderson Strategic Bond fund, writes; "with the current outlook for inflation in May/June being a continued step down in the pace of monthly core consumer price index (CPI) and personal consumption expenditure (PCE) prints, we see cause for optimism". However, we have seen at several points over the past few quarters how far markets can move following adverse news around inflation and monetary policy. As such, we retain a moderate overweight to duration, and quality issuers who tend to have lower volatility than riskier issuers.

### **Equity Markets**

Equity markets continued their upward trajectory in Q2, with the UK and US markets gaining around 7% and 6% respectively. The US market was once again led by its dominant tech sector, with companies like Apple and Microsoft maintaining their strong performance. Notably, NVIDIA became the world's largest company, defying expectations with consistently eye-popping earnings growth. Additionally, the previously narrow leadership of the US market by tech giants seems to be broadening, with energy and utilities sectors contributing to further growth in the market, acting as a headwind for those underweight the two sectors, as pointed out recently by the managers of the Guinness Global Equity Income fund.

The UK market offered a more contrasting story. Encouragingly, investor sentiment towards UK equities appears to be on the rise. Economic growth, though muted, seems to be on a positive trajectory. The upcoming general election on July 4th, in the now near-certainty of an historic Labour win, will likely see a stable majority government formed, providing a supportive environment for investors. Combined with declining inflation, this has paved the way for a more optimistic outlook, according to the managers of the Liontrust Special Situations fund. Additionally, as alluded to by Scott McKenzie, manager of Amati UK Smaller Companies, a surge of activity in the UK stock market with new IPOs such as Raspberry Pi and the likely upcoming listing of Shein, coupled with high levels of mergers and acquisitions, is boosting confidence in this undervalued market. Our overweight in UK equities has benefitted from this trend.

European equities had a more subdued quarter, perhaps surprising some after the first rate cut in the region. The market seemingly shrugged off this news, but EU elections in the closing stages caused some jitters as right leaning parties increased their vote share, prompting concerns around stability.

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Most notably, French President Macron's call for an early election raises concerns about a similar shift in power dynamics across one of Europe's major economies.

Looking to more international markets, China's economy, after a turbulent period, responded positively to rate cuts and government stimulus. Export volumes have seen a significant increase this year, fuelled by aggressive pricing strategies and driving economic activity. This resulted in a rebound in investor confidence and corporate earnings, which the managers of the Lazard Emerging Markets fund credit for good performance earlier in the quarter. However, aggressive industrial output has drawn international disapproval, with the EU recently imposing tariffs on Chinese electric vehicle imports. Partly as a consequence of this, and mostly as a consequence of continuing property market maladies, the Chinese market tailed off for most of the quarter.

Japan, a previous investor darling due to its meteoric growth over the past 18 months, experienced a slight contraction. The yen continues to defy economic theory, depreciating against the US Dollar even with rising interest rates. While beneficial for Japanese exporters, it cripples importers. However, economists anticipate this devaluation will stabilise as other economies lower their rates. The broad Japanese economy has contracted for the past two quarters and is expected to do so again this quarter (source: BNP Paribas). This economic weakness is likely a contributing factor to the slight decline in Japanese equities during Q2. However, with wage growth continuing apace the great reflation story of the Japanese economy continues, and it remains a popular story for investors.

### Outlook

The second quarter of 2024 was undeniably marked by volatility, particularly in bond markets and some equity markets. This volatility is likely to persist for the foreseeable future. Elections, ongoing conflicts, and the ever-shifting sentiments around monetary policy continue to exert an outsized influence on short-term market movements. As pointed out by Douglas Charleston, manager of the TwentyFour Monument Bond fund, "The market will remain focused on comments from central bankers and economic data to assess the likely timing of upcoming rate cuts". Predicting these factors with certainty remains a challenging task for the rest of the year.

It is precisely this level of uncertainty that underscores the importance of our diversified approach. While clear paths towards positive returns exist for both fixed income securities and equities, unforeseen economic or geopolitical developments could quickly alter the trajectory. To navigate this uncertain landscape, we retain a healthy exposure to alternative investments and adopt a well-diversified approach. This diversification strategy serves as a hedge against volatility in these highly uncertain times.

Our sizeable allocation to alternative funds, such as Ruffer Diversified Return and TwentyFour Monument Bond, has proven to be a valuable asset this quarter. These funds delivered positive returns and helped mitigate some of the fluctuations within the fixed income portion of our portfolios. By taking a balanced and diversified approach, we aim to navigate the complexities of the current market environment and deliver long-term value for our investors.

**All data is as at 28th June 2024 and has been sourced from FE fundinfo, Square Mile, Lipper, a Refinitiv Company (all rights reserved), European Central Bank, Capital Economics, Deloitte, Janus Henderson, Guinness Global Investors, Liontrust AM, Amati Global Investors, Lazard, BNP Paribas & TwentyFour AM.**

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**Important Information**

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