CARTLIDGE MORLAND

INDIVIDUAL WEALTH MANAGEMENT

INVESTMENT COMMENTARY

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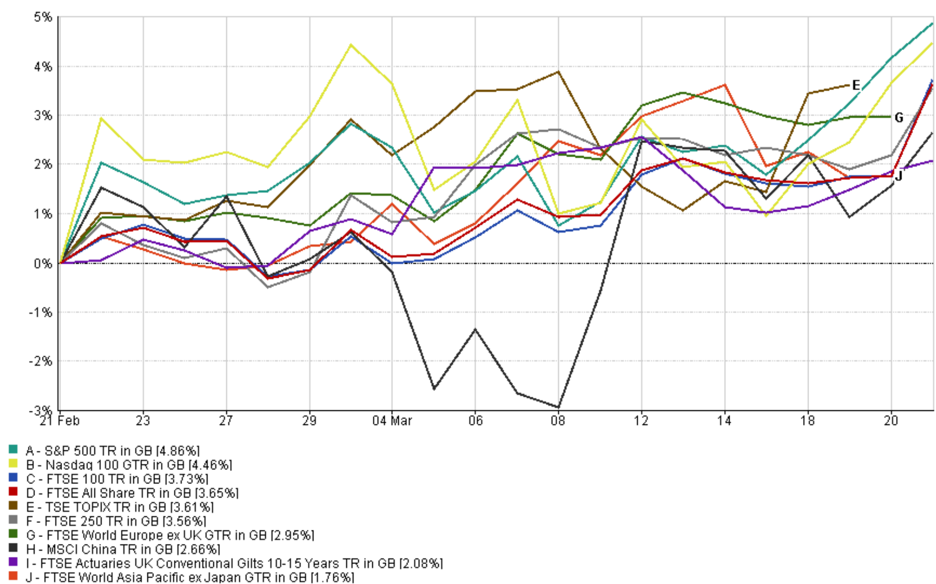
OVERVIEW

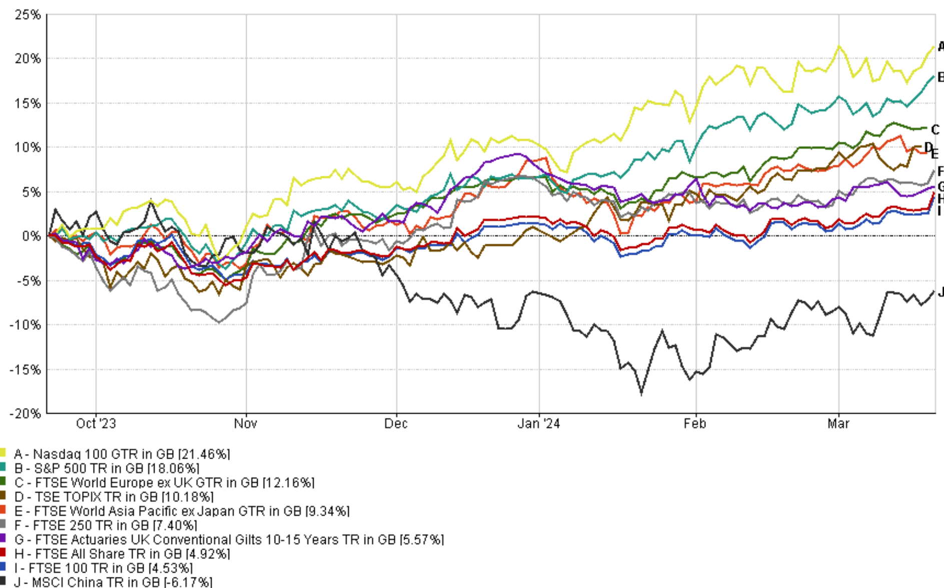
The main equity markets have seen positive returns in sterling terms over the past month with interest rate cuts expected at some point in 2024, perhaps starting in June. Investors have continued to pay close attention to the monetary policy decisions of the major central banks. The expected significant rate cuts during 2024 from the US Federal Reserve (Fed), the Bank of England (BoE) and the European Central Bank (ECB), have not yet been forthcoming as inflation has remained stickier than predicted. Consequently, it appeared that markets had paused for breath to some extent since the beginning of the year. However, the Fed's indication, following its March meeting, that it would cut interest rates three times this year saw gains across equity markets. The Bank of Japan (BoJ) has recently moved in the opposite direction to the other main central banks in increasing its main interest rate for the first time since 1992, having had to cope with decades of deflation.

ONE MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



21/02/2024 - 21/03/2024 Data from FE fundinfo2024

SIX MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



21/09/2023 - 21/03/2024 Data from FE fundinfo2024

Whilst inflation rates, as measured by consumer price indices (CPI) across most developed economies have fallen dramatically from the recent highs experienced in mid/late 2022, the final push to achieve 2.0% targets has been harder than perhaps expected. In the US, CPI unexpectedly rose to 3.2% in February 2024 (from 3.1% in January 2024). The level of core inflation (excluding food and energy costs) remains elevated at 3.8% although slightly down in February. Another inflation indicator of producer prices (PPI), which measures the prices of goods sold by their manufacturers, is also coming in above estimates. The concern is that the manufacturers will pass on these higher prices to consumers, so stoking CPI further.

In the UK, CPI fell to 3.4% pa in February 2024 from 4.2% pa in January 2024, the lowest rate in over two years and coming in at below expectations. Core inflation fell to 4.5% pa in February from 5.1% pa in January. CPI is predicted to fall to 2% pa (the target rate) in the next quarter as energy costs are due to fall by 12% in April. The BoE is closely watching labour market indicators; annual wage growth, one of the key drivers of inflationary pressures, has slowed to 6.1% pa in the three months to January 2024 but still remains at an elevated level.

The ECB has forecast that the eurozone inflation rate is likely to fall to 2.3% in 2024 and reach its 2.0% target next year. It is currently at a level of 2.6%. It appears that wage increases are also more subdued at around 4.5%.

The question is when will the Fed, BoE and ECB start to cut interest rates?

The Fed indicated at its March meeting that they are still expecting to cut interest rates three times this year – reducing the current rate range of 5.25%-5.55% by 0.75% in total. Jay Powell, Chair of the Fed, commented that the US economy is performing well and expects GDP to expand by 2.1% this year. However, he said that headline inflation is expected to be 2.4% this year and core inflation 2.6% so still above target. Against this backdrop, interest rate cuts are not likely to be any deeper or faster with the Fed taking into account data as it looks set to gradually reduce interest rates. It is highly probable that the first rate cut will be in June.

At its March meeting, the Monetary Policy Committee (MPC) of the BoE also left Bank Rate on hold for the fifth consecutive time at 5.25%. Again investors were looking for indicators as to when the MPC would start to cut rates. The Governor of the Bank of England, commented after the meeting, “We are not yet at the point where we can cut interest rates but things are moving in the right direction.” Interestingly, two MPC members who had previously voted for higher interest rates, changed their votes this time to maintain the current rate therefore going with the majority (8-1). The BoE said that in future meetings the MPC would “continue to consider the degree of restrictiveness of policy”. Traders now believe that there will be three cuts in UK interest rates in 2024, perhaps starting in June.

Whilst maintaining its key deposit rate at 4.0% at its March meeting, the ECB had signalled that June would be the earliest point at which a rate cut would be considered. Christine Lagarde, President of the ECB, has reiterated that any move in interest rates would be data dependent in that inflation is heading towards target and that wage growth is at such a level – around 3.0% - that it will not stoke inflation.

Economic growth across Europe and the UK flat-lined in 2023 so any cuts in interest rates should be supportive of future growth. Recent data points to the UK beginning to grow modestly once again with the economy expanding by 0.2% in January 2024. The US has experienced a more robust level of economic growth in 2023 of 3.1%. Despite fears that the US economy would experience a recession after the Fed aggressively raised interest rates to combat inflation, a tight jobs market is keeping wages relatively high, which in turn is supporting consumer spending.

At its recent March meeting, the BoJ ended its negative interest rate policy coinciding with the announcement of the highest average wage rises for members of Japan's labour unions since the early 1990s. The benchmark interest rate increased from -0.10% to a range of 0 to 0.1%. The rate had not been changed since April 2016, whilst the last time it was raised was 1995! For many decades, the BoJ has had to cope with deflation. Now inflation stands at 2.2% pa. The BoJ commented that the Japanese economy is recovering moderately and had in fact avoided a technical recession in the final quarter of 2023. Quarter 4 2023 GDP was revised up to 0.1% compared with an earlier release suggesting the economy had contracted -0.1%. The BoJ also announced that it would stop buying ETFs and REITs through its asset purchase programme, but would continue to buy $40bn of Japanese Government Bonds to support the economy. The Governor of BoJ signalled that monetary policy would remain accommodative until inflation expectations were secured at 2.0%. A weak yen has contributed to the strength in the Japanese equity market as the goods of exporting companies are competitive in world markets.

The Chinese equity market has been weak until very recently, plagued by lacklustre domestic demand and an ailing property market. Lately investor sentiment has become less negative, particularly in the wake of the recent annual National People's Congress. The Chinese authorities confirmed that China's annual economic growth target would be 5.0% once again. To achieve this relatively ambitious target (there is no post-lockdown rebound this year), various stimulus measures have been announced to support growth including more borrowing, government financed housing construction, investment in technologies so that China becomes more self-reliant and a spending plan to encourage consumers and businesses to replace old equipment and goods. China has been experiencing deflation since August 2023 but CPI in February rose by 0.7% pa reversing the decline of -0.8% in January 2024. However, PPI fell by 2.7%, far greater than expected. The concern is that deflation in manufacturing prices will then impact negatively on CPI.

OUR VIEW

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Nobody ever expected an entirely smooth downward pathway for inflation in the developed economies, for all it is expected to move closer to its 2.0% pa target over the course of 2024. Some commentators are already pointing to deflation as the greater risk – suggesting the central banks' objective will shortly become one of encouraging economic expansion, in preference to stagnation. Despite central bank independence, there are definite political imperatives too, as elections loom in the US and UK. We have had mixed views as to which central bank would be the first to cut rates. We had thought that the ECB would act first to support the eurozone economy but it now appears that we may see the Fed, the ECB and BoE all start to cut interest rates in June. Continued robust growth/employment in the US provided the Fed with reason to maintain rates at its March Open Market Committee (FOMC) meeting and possibly will do so at its next. Undoubtedly investment markets will be disappointed if now widely expected rate cuts are not forthcoming by July following Jay Powell's comments after the latest FOMC meeting.

The performance of the European equity market has been driven by the shares of eleven key companies which in some ways is reminiscent of the incredible performance of the so-called 'Magnificent Seven' in the US equity market. These eleven companies have been dubbed the 'Granolas' by Goldman Sachs. They are drawn from a diverse range sectors – pharmaceutical/healthcare (Novartis, NovoNordisk, GSK, Roche, Sanofi, AstraZeneca), technology (ASML, SAP), food and beverages (Nestle), cosmetics (L'Oreal) and luxury goods (LVMH). The combined market cap of these companies is around $3trn so they are dwarfed in size by their US 'Magnificent Seven'" peers. Both sets of companies are seen as having strong balance sheets and good margins. We believe that it is important to hold such high quality companies in our portfolios through both passive and actively managed funds. Indeed, these funds have supported our returns of late. However, it would be imprudent to overlook funds offering exposure to companies of varying sizes which offer attractive longer term growth potential and/or value. Once we start to see a reduction in interest rates and improvement in economic growth, we expect to see other areas of equity markets to which our portfolios have maintained exposure perform.

If you have any queries

please do not hesitate

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