

Hymans Robertson Investment Services (HRIS)

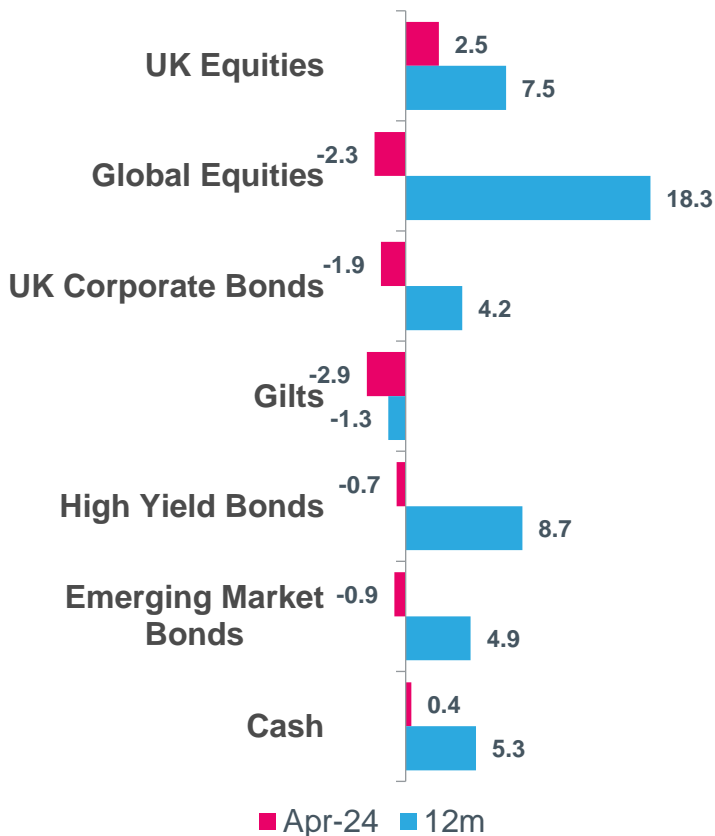
Market Digest

April 2024

Monthly highlights

- Most asset classes fell slightly, after strong performance in the first quarter of 2024.
- All major Western central banks held rates level, as expected, but the Bank of England and European Central Bank look to be approaching a rate cut as inflation moves closer to target. In comparison, the US has experienced some inflationary setbacks.
- UK equities outperformed other markets as higher oil prices helped fossil fuel producers, like BP and Shell.
- On page 3 of this document, we provide market commentary to cover the past year to 31st March 2024.

Asset class returns (%)



Market summary

- Our model portfolios typically invest in a combination of the asset classes shown in the left-hand chart.
- Most asset classes struggled over April as signs of persistence in US inflation data hurt markets.
- Inflation rose for the second consecutive month in the US to 3.5%. In addition, economic data continued to show strong US consumer spending, even if the headline GDP figure slowed. In combination, this further dampened any prospect of imminent interest rate cuts from the Federal Reserve.
- Equity markets suffered as a result, with the interest-rate sensitive US market underperforming. The UK market was an exception, as the high weighting to energy and commodity companies helped to generate returns of 2.5% (see next page for more on the oil market).
- Eroding expectations of interest rate cuts pushed up bond yields, hurting bonds (bond prices fall as yields rise). Although the inflation picture looks better in the UK and Europe, bond yields still tracked the US market higher.
- Shorter-dated bonds like high-yield bonds outperformed other bond asset classes, with only mild losses.
- At a portfolio level, equities and bonds performed similarly, meaning higher and lower risk portfolios generated similar returns over the month.

Source: Morningstar. Figures to 30 April 2024. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

Outlook and topical market themes

- The Bank of England looks to be approaching a first interest rate cut. Further progress with inflation in the April and May data prints may line up a cut in June.
- Oil has risen by almost \$15 since the start of the year, driven by several factors. Persistently high oil prices will cause a headache for central bankers but may be positive for the FTSE.

Interest rate cuts look just around the corner

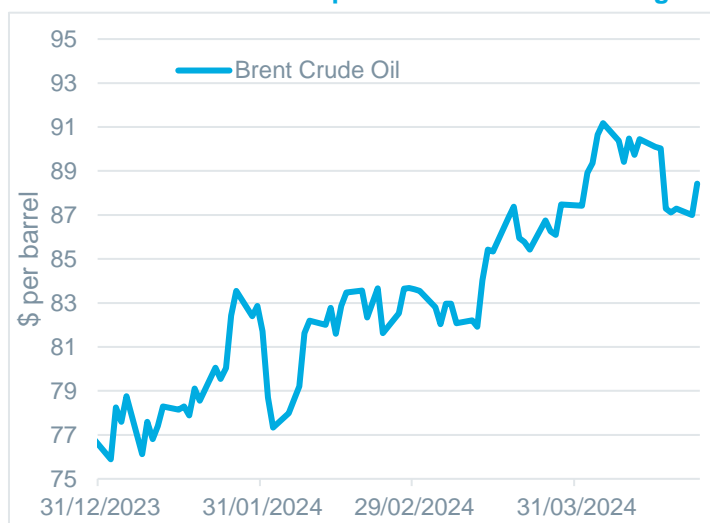
The Bank of England (BoE) looks set to cut interest rates in the summer, as minutes produced at the May meeting show optimism towards the progress with getting inflation back to target. Two out of nine of the Monetary Policy Committee (MPC) voted for an immediate cut in May. There is a good chance the first cut could come as soon as June, but this is conditional on positive inflation data between now and then – there are two more months of data between now and the next meeting. The BoE lowered their inflation forecast indicating that CPI would undershoot their target in two and three years' time. This indicates they expect to cut interest rates faster than markets are expecting. The BoE accepted that the strong labour market was still a risk and the MPC will be monitoring a range of wage data closely for signs of continued inflationary pressures. However, continued progress with this may be enough to line up a cut for June. With interest rate cuts around the corner, expected returns on cash are expected to fall over the medium-term, increasing the attractiveness of assets like government bonds, where high yields can be locked in for a longer period.

However, rising oil prices may mean inflation challenges remain

Since the start of the year, the price of oil has been on a steady march upwards from around \$75 per barrel at the turn of the year to over \$90. It may have fallen back slightly over the past few weeks but remains high. Several factors are driving this. The main driver that people will be aware of is the heightened tension and conflict in the Middle-East. As a key producer of fossil fuels, disruptions to the production or shipment of oil in the region can impact prices globally. There are also other supply/demand dynamics taking place though. Extended supply cuts from OPEC+, a cartel of oil producing nations, are starting to squeeze the market supply. On the demand side, the US economy has continued to go from strength to strength. Even China, which has been the disappointing growth story of the last year, is now producing higher than expected GDP figures meaning there may be greater demand from there too. There is a risk that a further escalation in the Middle-East could send the oil price far higher but, so far, full-blown conflict between Israel and Iran has been averted.

A higher oil price has consequences for central banks, as it feeds through to higher inflation. Oxford Economics predict a \$15 rise in oil prices would increase inflation in the US by around 0.6% within two quarters – a setback, but not disastrous. Some markets such as the FTSE have benefitted from the higher oil prices as a result of the high exposure to energy firms, which helps to explain the strong performance UK equities experienced in April.

Chart of the month – The price of oil has been rising so far this year



The chart shows price of Brent crude, a global oil benchmark, in \$ per barrel.

As described above, the price of oil has been driven higher by a number of factors this year including supply constraints, higher than expected demand and geopolitical tensions in the Middle-East.



Jack Richards
Investment Manager

Source: Morningstar

Annual market summary – covering the 12 months to 31 March 2024

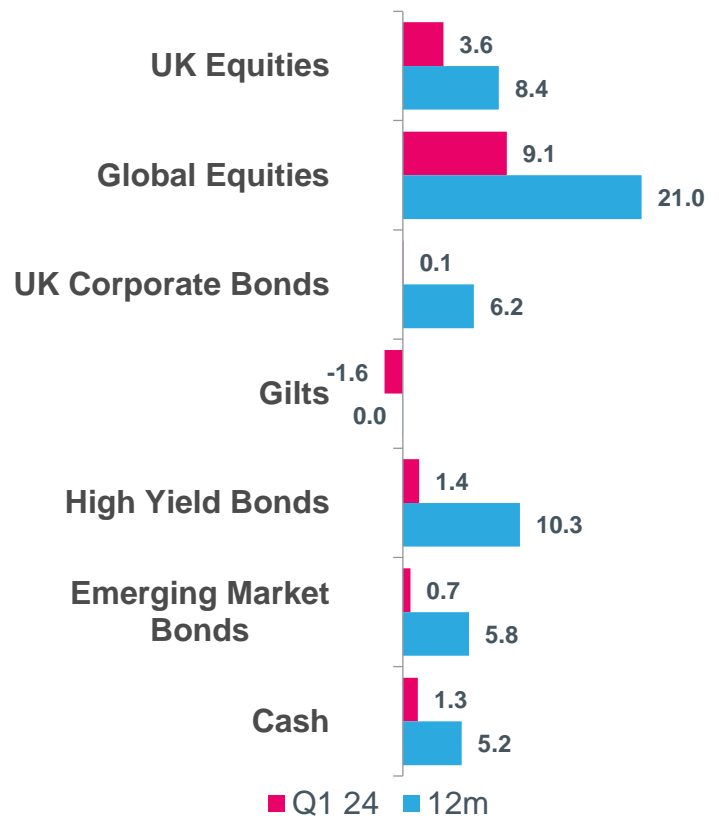
Throughout this 12-month period, the US economic story was one of consistently beating expectations. The consensus for a recession at the start of the period slowly but surely shifted towards a ‘soft landing’, where inflation falls back to target without the higher interest rates causing a significant economic slowdown. The story on this side of the pond was quite different. Economic stagnation finally led to recession, as the UK economy shrunk in Q3 and Q4 2023.

Investors were initially heavily focused on how high interest rates would need to get, to bring inflation sustainably back to target. The Bank of England eventually paused after raising rates to 5.25% in August 23. Pretty quickly, investors looked ahead to the prospect of rate cuts in 2024. During Q4 23, expectations were raised of several rate cuts over the next 12 months, boosting both equity and bond prices significantly. However, inflation stopped falling over Q1 24 in the US, quickly dampening hopes of imminent rate cuts. This reversal hurt bond prices, but equity markets continued to ride the waves of strong US economic growth. Over the period, UK inflation fell from 10.1% to 3.4%, while interest rates rose from 4.25% to 5.25%.

Geopolitical risk was once more highlighted in Q4 23, as conflict in Israel and Palestine threatened to escalate. The region’s importance to global trade and energy markets meant the price of oil increased towards the end of the period. This threatened to undo some of the disinflationary process experienced over the last 12 months and contributed to inflation flatlining in the US in Q1 24.

For most of the period, bonds continued to perform poorly, as uncertainty over inflation and interest rates kept bond yields high. Q4 23 was the exception to this, as the exuberance over potential rate cuts drove significant returns for bonds, offsetting losses from the past few quarters. Equity markets fared much better, as the US economic strength, the prospect of lower interest rates and excitement over Artificial Intelligence (“AI”) technologies boosted sentiment and corporate earnings. US and Japanese markets were the best performing regions, benefitting from a heavy tech exposure and corporate governance reforms respectively. Emerging Markets and the UK both lagged after weaker Chinese and UK growth prospects hurt both regions.

Asset class returns (%)



Source: Morningstar. Figures to 31 March 2024. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

Risk warning

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