HYMANS ROBERTSON
INVESTMENT SERVICES

Hymans Robertson Investment Services (HRIS)

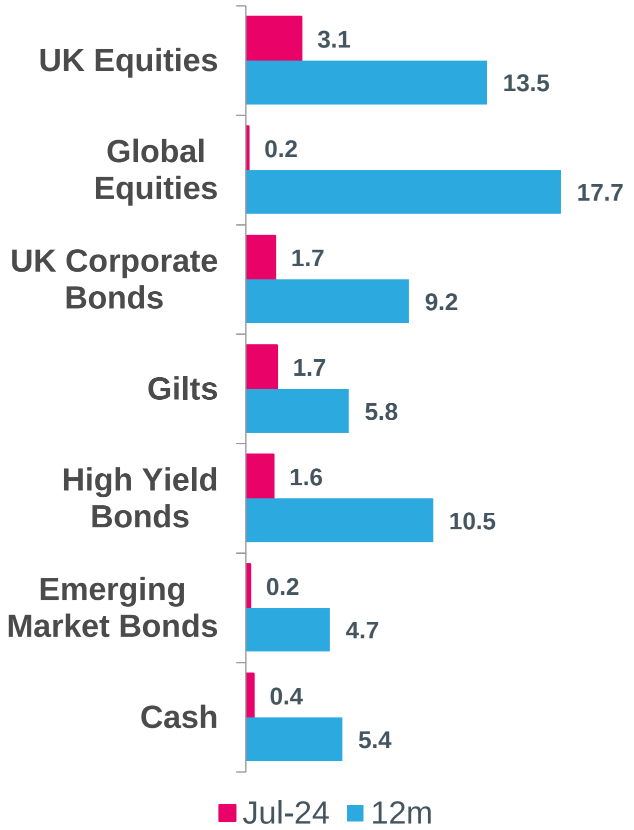
Market Digest

July 2024

Monthly highlights

- Equities and bond markets both generated positive returns to portfolio performance. Lower bond yields over the month were a key driver of performance, as were UK equities.
- The Federal Reserve signalled an interest rate cut for September while the Bank of England cut to 5.0% just after the end of the month.
- On page 3 of this document, we provide market commentary to cover the past year to 30 June 2024.
- High levels of market volatility have been experienced in early August.

Asset class returns (%)



Source: Morningstar. Figures to 31 July 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.

Market summary

- Our model portfolios typically invest in a combination of the asset classes shown in the left-hand chart.
- The Federal Reserve opened the door to interest rate cuts in September after inflation fell more than expected in June, although rates were held at their July meeting. The Bank of England, on the other hand, went ahead and cut interest rates from its 5.25% peak to 5% as inflation remained at the 2% target for the second month in a row.
- Election results in the UK led to little market reaction, while French elections led to a boost in French equities as the far-right National Rally did worse than expected.
- Global equity markets were mostly flat over the month, but volatility picked up towards the end of the period and accelerated as we entered August (more on this on the next page). Although US corporate earnings were largely in line with expectations, the tech sector underwhelmed sky-high expectations leading to a fall in share price for some of the mega-cap tech stocks.
- The UK market outperformed as strong economic data and the election result helped boost investor confidence. Volatility in the Japanese market picked up as the yen violently swung in value.
- Bonds performed well as expectations of interest rate cuts from the likes of the Bank of England and the Federal Reserve lowered bond yields (bond prices rise as yields fall).
- At a portfolio level, bonds outperformed equities, meaning lower risk portfolios outperformed higher risk portfolios over the month.

Outlook and topical market themes

- Equity markets suffered a bout of volatility as we moved into August, with the Japanese market, in particular, seeing large ups and downs.
- The Bank of England cut interest rates to 5.0%. More cuts should follow but it will probably be at a slow pace and are unlikely to be at every meeting.

Market volatility picks up on back of US data weakness and stronger yen

The last week or so has seen a pickup in volatility in markets with some assets prices falling as a result. As with most market selloffs, there is not one trigger, but a few interlinked dynamics and themes along with a shift in market sentiment. The main three contributing drivers include a reversal of fortunes for AI-sensitive stocks, a Bank of Japan interest rate hike and accompanying strengthening of the yen, and weak US economic data. We write more about the key drivers here.

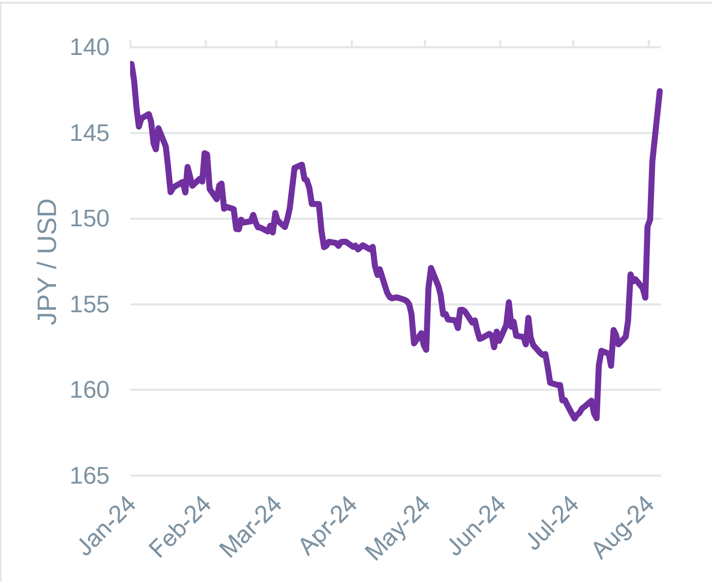
Volatility seemed to peak on the morning of Monday 5th August, as things calmed later that afternoon when a US services sector survey indicated strength in that part of the economy. On Tuesday morning we saw a strong recovery in the Japanese market as it rose by around 10%. This indicates that a lot of the selling over the previous few days may have been exacerbated by panic and forced selling of leveraged positions.

Bank of England cuts interest rates for first time since 2020

After holding interest rates at 5.25% for a year, the Bank of England (BoE) voted to cut interest rates to 5.0% on 1st August. The decision to cut was a close call with five of the nine members of the Monetary Policy Committee (MPC) voting to cut (the other four voted to hold rates at 5.25%). CPI inflation has reached the BoE's 2% target. However, there is still plenty of caution amongst the MPC. This is because, so far, the main reason inflation has fallen from the 11.1% peak has been lower food, energy, and goods prices. Now that energy and food inflation have little left to fall, (energy bills are expected to increase this autumn) the headline figure will likely start to rise over the next few months.

We expect the MPC to tread cautiously until there is greater certainty that inflation is sustainably around the 2% mark. Therefore, the BoE is likely to cut at a slower pace than they raised interest rates. There will probably be meetings where they keep rates on hold. The MPC meet three more times in 2024 so we can expect 1-2 more 0.25% rate cuts this year. However, if we see a meaningful slowdown in economic growth then the pace of cuts may increase. We explain more about what this means for investors here.

Chart of the month – The Japanese yen has appreciated sharply over the past few weeks



Source: Thomson Reuters

The chart shows the Japanese yen to US dollar exchange rate.

The Bank of Japan (BoJ) has been keeping interest rates low, even as other central banks hiked significantly. This has put severe pressure on the yen, especially against the US dollar.

Last week this flipped as the BoJ increased interest rates, just as the Federal Reserve signalled that they would soon be cutting, leading to a sharp increase in the value of the yen.

Jack Richards
Investment Manager

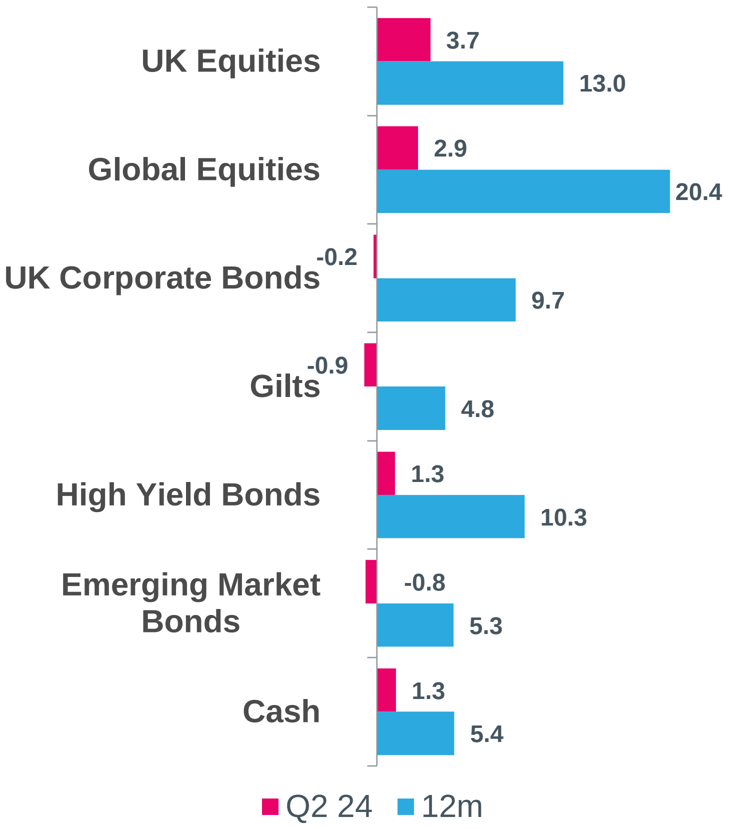
Annual market summary – covering the 12 months to 30 June 2024

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.

Central banks mostly kept interest rates level. The Bank of England made one final hike to 5.25% in August 2023, before holding for the remainder of the 12m period. Pretty quickly, investors looked ahead to the prospect of rate cuts in 2024. During Q4 23, expectations were raised for several rate cuts over the next 12 months, boosting both equity and bond prices significantly. However, the disinflation story stalled in the US. In the UK, despite headline CPI falling back to 2%, services inflation remained too high, 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 7.9% to 2.0%, 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.

Asset class returns (%)



Source: Morningstar. Figures to 30 June 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.

For most of the period, bonds performed 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. This was enough to offset small losses from the other quarters over the period. 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. The US market was the best performing region, benefitting from a heavy tech exposure and several companies that gained from the AI excitement, such as chipmaker Nvidia. Emerging Markets and the UK both lagged after weaker Chinese and UK growth prospects hurt both regions, although in the case of the UK the second half of the period provided a more positive economic picture.