Autumn 2024

market outlook.

Brought to you by the Investment Management Team

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contents.

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The UK Economy

The UK economy demonstrated notable resilience and growth over the quarter, with inflation not only cooling to the Bank of England's 2% target in August, but even dipping slightly below it to 1.7% in September. Wage growth has also remained strong, which has supported consumer purchasing power and contributed positively to consumer health.

Due to the lengthy wait between the appointment of the Labour government and the Autumn Budget 2024, both business and consumer sentiment in the UK took a downturn. Uncertainty and speculation surrounding the potential fiscal adjustments to come – and concerns about the subsequent economic challenges they could bring - frustrated businesses and consumers who cancelled and deferred investment decisions. We expect this hesitancy to be reflected in economic data in the short-term.

The long-awaited Autumn Budget has now been delivered, and the Office for Budget Responsibility's recent outlook offers a promising forecast for the UK economy. It projects GDP growth reaching 2% in 2025, alongside increased public spending in critical areas like infrastructure and health and social care. Coupled with this, the increased hope for greater economic stability under the new government is expected to create a more fruitful environment for businesses and consumers, improving conditions for investment planning and long-term growth.

The European Economy

European monetary policy continues to be data-dependent with policymakers not committing to a predetermined rate path. Economic data remains mixed, with some regions showing signs of growth while others struggle, it is likely that this cautious policy approach will persist in the near term as policymakers await incoming data currently being impacted by external factors such as trade relations and elections around the world.

Germany's economy, particularly its automotive sector, is a drag on the broader European economy, as German automakers face increased competition from Chinese manufacturers producing more affordable electric vehicles. Manufacturers like Volkswagen have responded by closing plants in both Germany and China due to high production costs. Given Germany's reliance on manufacturing and its substantial role in the Eurozone's capital structure, this uncertainty is likely to increase investor caution, potentially leading to short-term volatility in the market.

Trade relations between Europe and China remain a focal point, with recent developments impacting various industries. In response to the European Union's decision to increase tariffs on Chinese-made electric vehicles to as much as 45%, China has targeted EU industries, including brandy, pork, and dairy products. Negotiations between the EU and China are ongoing. If an agreement is reached, the EU may lift these duties, potentially creating a more balanced trade framework. This could pave the way for stronger economic ties between Europe and China, with the potential to stabilise and enhance cross-border trade dynamics.

The return of a Trump presidency in the US could introduce uncertainty in European markets. His unconventional approach to trade, regulation, and foreign policy might lead to shifts in US-European relations. Changes in tariffs, international agreements, climate accords, or multilateral trade deals could pose challenges for European exports and businesses. Although President Trump is known for his pro-business stance, he may adopt a different, more strategic approach to trade but given these uncertainties, a cautious outlook is prudent.

The US Economy

Markets perceived the Federal Reserve as falling "behind the curve" when it chose to maintain interest rates in July, viewing this decision as a potential policy misstep. However, the Fed adhered to its data-dependent approach, opting to ease policy only after observing consistent cooling in the labour market and signs of stabilising inflation amongst other data sets. This underscores the tendency of markets to misinterpret the Fed's policy intentions, shown also by the subsequent rate cut in September which was widely mis-forecast by investors. This disjoint has presented buying opportunities and is set to continue into 2025.

During his campaign, President-Elect Trump pledged to reduce regulation and lower corporate taxes, increase oil production, and enforce stricter immigration policies. These measures could benefit domestic markets and net importers by fostering stronger growth, which may positively impact equities. Sectors such as banking, technology, defence, and fossil fuels may also be likely to see gains. However, Trump's proposed spending initiatives could additionally lead to some upward pressure on inflation. Nevertheless, the scope of the Fed's monetary policy could curtail this, depending on how Trump's relationship with the central bank unfolds moving forward.

Despite the market actively teetering in and out of anticipation of a recession, U.S. economic data has remained robust and has done little to suggest a recession is immanent. As such, and in line with their data-dependent stance, Fed policy has had no need to loosen at pace. It is this inconsistency of market sentiment and its detachment from a data-dependent Fed that creates opportunities for investors. In addition, market worries over rising debt levels have proven unfounded, as to date the strong data (GDP, labour market, treasury purchase levels) has made it more than serviceable.

The uncertainty and media speculation surrounding the election led to some short-term market volatility, a pattern we may also observe around upcoming interest rate decisions. However, we anticipate the market will demonstrate resilience amid such fluctuations, and we continue to see the potential for the US dollar to remain strong and serve as a safe haven for investors during periods of uncertainty. We may see robust market performance to close out the year, with investors likely to look past short-term volatility. Optimism and market performance will in part be driven by domestic policy initiatives ahead of Trump's inauguration in January 2025.

The Japanese Economy

Japan recently experienced political instability after New Prime Minister Ishiba called a snap election where the new leader failed to secure support, following Prime Minister Kishida's previous challenges. This lack of a stable leadership could hinder effective policy implementation and create uncertainty in the markets.

Over the quarter, the Bank of Japan has opted to maintain its current stance on major policy moves, following its historic decision to raise interest rates earlier this year. While there has been speculation about the possibility of further rate increases, the prevailing signs of fragility in the economic environment suggest that the BoJ may prioritise stability over more aggressive monetary policy shifts.

Japanese markets experienced significant volatility early in the quarter due to the unwinding of the carry trade, a strategy where investors borrow in a low-interest-rate currency like the yen to invest in higher-yielding assets. The Bank of Japan raised interest rates, while the U.S. Federal Reserve held rates steady, creating a divergence in monetary policy. This prompted many investors to exit their carry trades, leading to substantial capital outflows from Japan. Given the current climate there is potential for this to volatility reoccur, in the near term.

The yen remains weak but relatively stable, with potential for strengthening largely tied to global central bank policies. However, domestic economic data is disappointing, with weak industrial production and despite record levels of stimulus inflation came in at 2.4% in September (excluding food and energy). Wages and cash earnings are also not rising as expected, reflecting underlying economic challenges. These factors indicate that any strengthening of the yen will depend significantly on external developments and the overall health of Japan's economy, introducing excess short-term volatility.

Emerging Markets & Asia Economy

Over the past quarter, Chinese markets have shown notable improvement, fuelled by record policy stimulus announced by the government. To address a slowing economy and support its approximately 5% growth target for the year, authorities introduced fiscal stimulus, ramped up infrastructure investments, and provided targeted support for key sectors such as technology and renewable energy. The recent reduction in rates on buyback loans has restored market confidence, leading to substantial inflows. Additional signals suggest that further stimulus measures may be on the horizon, offering potential for continued support and growth in the market.

China's valuations are appealing by historical standards, offering a compelling investment opportunity. However, the potential return of a Trump presidency introduces an element of uncertainty. As the United States' largest trading partner, China may face renewed trade tensions if Trump pursues his campaign proposal to impose tariffs as high as 60% on Chinese goods. While such high tariffs are unlikely to apply across the board, the potential for selective tariffs could disrupt trade flows. The possibility of tariffs may open the door for negotiations, allowing for strengthened trade relations given the deep economic interdependence between the two countries. China may respond to potential disruptions with targeted stimulus measures aimed at stabilising its economy and supporting markets. Notably, China performed relatively well during the last Trump administration compared to the Biden administration, with successful trade agreements reached under Trump.

Indian equities have performed well year-to-date, though growth has recently moderated as investors took profits amid high valuations, especially compared to more attractive Chinese markets. India may benefit from a Trump presidency due to the trade policies and tariffs implemented during his previous administration, which favoured India. With his proposal to impose high tariffs on Chinese imports, India could emerge as an alternative manufacturing hub for U.S. companies seeking to reduce dependence on China.

LATAM markets currently present interesting valuation opportunities, particularly in light of potential shifts in U.S. policy. Mexico, in particular, could benefit from stronger ties to the U.S., under the Trump administration, which has historically emphasised border security and immigration control. As Mexico seeks to tighten its borders to manage immigration flows, it may also strengthen its economic ties with the U.S., leading to increased investment and trade. However, these potential policy shifts may take time to materialise. In the short-term, we may see some volatility and ongoing discussions around the automobile industry and immigration.

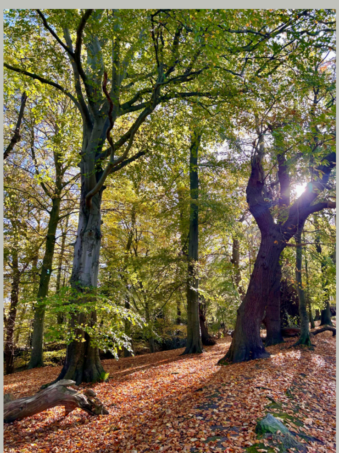
Fixed Interest

Government bond yields have increased over the quarter due to both global and UK specific factors. Notably, the recent UK budget announcement, which includes plans for higher debt issuance, has contributed to this rise in yields and may also influence the future trajectory of interest rate cuts.

Despite the rise in yields, spreads remain tight, indicating a stable risk premium for corporate bonds relative to government bonds and reflecting ongoing investor confidence in credit quality.

Company balance sheets, especially in the investment-grade segment, remain strong. Current economic data suggests stability, particularly for corporate bonds, which are well-positioned in the market.

Although rate cuts have started in developed markets, current economic data remains favourable, particularly for corporate bonds. Overall, all-in yields continue to be attractive to investors in the sector of the fixed income market.



If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on 01423 501 401, Monday to Friday 9am-5pm or you can email us at info@mzltd.co.uk

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