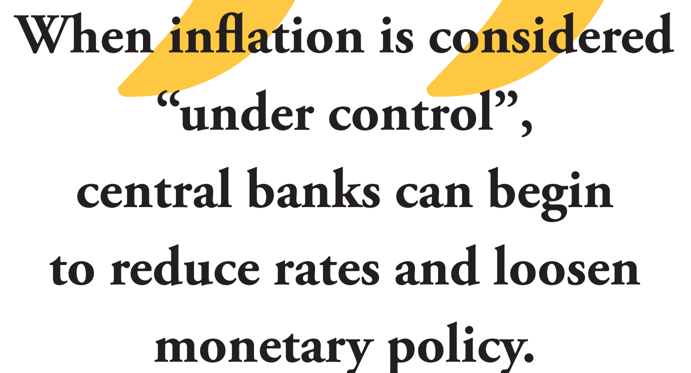
INVESTMENT UPDATE

DECEMBER 2023

FOR PROFESSIONAL INVESTORS ONLY

www.alphabetapartners.co.uk

Set against the backdrop of a cooling developed markets economy we were all encouraged to see risk assets performing strongly during November. What exactly were the drivers for the rally, and can it be sustained? We will seek to answer these important questions and provide key details in the investment update that follows.



When inflation is considered "under control", central banks can begin to reduce rates and loosen monetary policy.

Welcome to December, typically a decent month for risk assets courtesy of seasonal factors. The spectre of inflation and the forces of tighter monetary policy have stalked markets for some time, adding unwelcome volatility to all portfolio risk levels. A steep drop-off in inflation is being witnessed certainly in Europe and America. There are even some signs of deflation on the horizon, such is the steepness of the decline. When inflation is considered "under control", central banks can begin to reduce rates and loosen monetary policy.

All sounds simple in theory; however, the reality is central banks often remain too tight for too long, tipping economies into a hard landing recession then rush to cut rates fast in remedial fashion. There are occasions when central banks time policy to perfection and a soft landing is experienced with a recession avoided – often, the former rather than the latter being the outcome. We should guard against this risk, as prudent investors.

Key data released in US during early November pointed to a slowdown in economic activity and this coupled with soft inflation prints and more dovish tones from central bankers provoked a pleasing rally, which has broadened wider than the year-to-date narrow leadership of the 7 technology behemoth stocks. The rally included equities, bonds, commodities, and crypto.

The S&P 500 saw a notable increase of 9%, marking one of the most significant November rallies in a century. Financial conditions eased as bond yields fell, making the prospect of borrowing cheaper for many corporates. Market consensus is now firmly of the opinion that interest rates have peaked with only the question of when central banks will begin easing policy remaining unanswered. We know from history that rate cuts begin typically when core CPI inflation falls approximately 2.5% lower than the prevailing US interest rate. Quantitative tightening remains in force, reducing liquidity in markets.

The chart below courtesy of CME FedWatch shows market related probabilities for US interest rate policy.

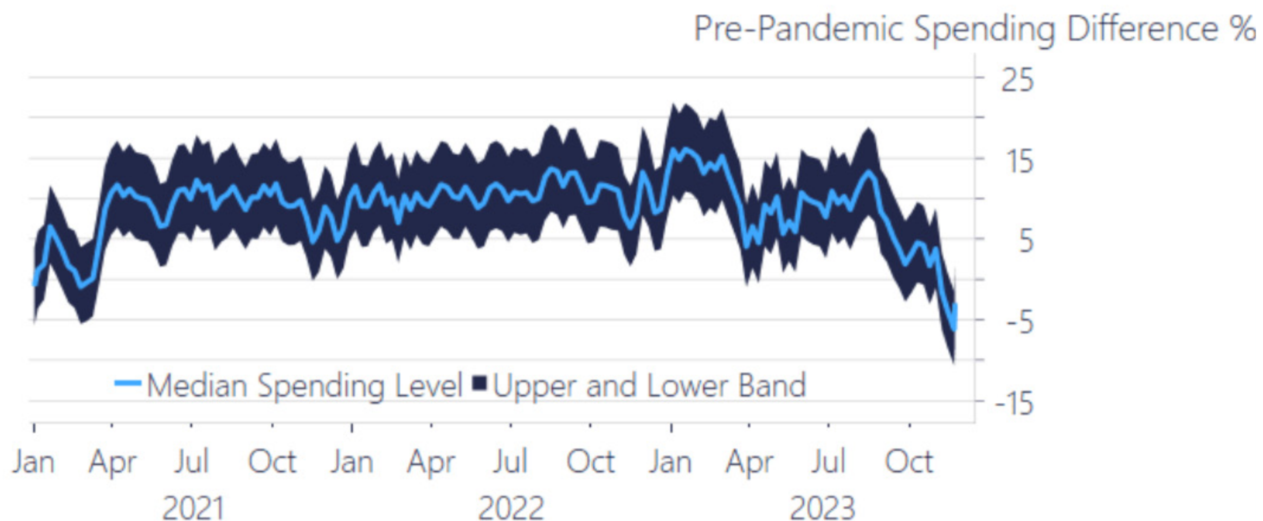
CME FEDWATCH TOOL - MEETING PROBABILITIES									
MEETING DATE	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550
12/13/2023				0.0%	0.0%	0.0%	0.0%	0.1%	99.9%
1/31/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	14.5%	85.5%
3/20/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	8.1%	54.2%	37.6%
5/1/2024	0.0%	0.0%	0.0%	0.0%	0.0%	5.5%	39.1%	43.1%	12.4%
6/12/2024	0.0%	0.0%	0.0%	0.0%	4.4%	32.5%	42.3%	18.4%	2.4%
7/31/2024	0.0%	0.0%	0.0%	3.5%	26.5%	40.2%	23.5%	5.9%	0.5%
9/18/2024	0.0%	0.0%	2.9%	22.8%	38.0%	26.2%	8.7%	1.4%	0.1%
11/7/2024	0.0%	1.8%	15.5%	32.4%	30.5%	15.1%	4.1%	0.6%	0.0%
12/18/2024	1.4%	12.0%	28.1%	31.0%	19.0%	6.9%	1.4%	0.2%	0.0%

Source: CME Fedwatch 05 December 2023

With positive economic news flow and the horrendous events in the Middle East not polluting market sentiment, the dollar has weakened nicely, offering a further tailwind to risk asset prices. Recession risks remain elevated with yield curves steeply inverted. Purchasing Managers Indices show a clear slowdown in orders and the labour market is beginning to weaken.

Whilst US GDP was revised higher to around 5% annualised, we note a sparkling GDP number is often the precursor to a slowdown. The ever-resilient consumer wallet remains open for business although first signs of a tail-off in spending are now being recorded. Stock valuations price-in

strong earnings growth during 2024 (around 12% annualised). Set against a slowing economy, we need to guard against earnings undershooting expectations. Once again, stocks are certainly not trading in cheap territory.



Source: Steno Research, Bloomberg and Macrobond, obtained via Twitter on 02 December 2023.

Meanwhile in Europe inflation has fallen precipitously with signs of deflation in producer prices, which will feed through to retail prices downstream. Germany is in recession and Sweden has joined the "recession club" too. France is teetering on the edge whilst Spain and Italy have undeniably slowed. Germany's manufacturing prowess, an unquestionable feature for so long, has been undermined by poor corporate and governmental strategy. Leadership today comes from consumer discretionary stocks and pharmaceutical ingenuity. Based upon pure economics, we see a case for the ECB cutting rates ahead of the Federal Reserve.

Domestically in the UK, a rally has been less obvious in stocks although we are encouraged to see gilt yields beginning now to respond to ebbing inflation. 10-year stock now yields 4.18% and yield compression having served-up pleasing capital upside for portfolios over the year. A wall of corporate and personal loan refinancing at higher rates could slow progress into 2024.

Japan, a favoured market, delivered strongly again with a continuum of economic growth, domestic expenditure and a weaker yen supporting exporters. At some point we do anticipate interest rates nudging higher to support a much weaker currency and to ease the decades-long policy of yield curve control. For now, we continue to enjoy market conditions.

China's recovery remains a little mooted. The drag of colossal debts and a bankrupt real estate sector weigh heavy. China's technology leadership is a bright spot, now being state funded in an ongoing tussle with the might of US tech hegemony. More broadly across the emerging world, a weaker US dollar is favourable indeed. Of course, geopolitical markets cannot be modelled accurately. However, we note 2024 is an election year in US and this phenomenon, rightly or wrongly, tends to hold risk assets higher. We are always mindful of human suffering in war zones and abhor the horrors. Taking a dispassionate stance, our research points to a stalemate situation in Ukraine awaiting a negotiated settlement with a new East/West border being drawn and defended. China will never accede to Taiwan being a separate nation, but for now we expect China to remain focussed on Eurasia and her own internal economic and demographic strategies. China's technology advances should not be ignored. The Middle East, forever the global tinder box, brings heightened risk with US force perhaps policing an uneasy relative calm outside of Gaza. We note gold, an insurance type asset, has surpassed the $2,000 per ounce mark. Prospects for lower rates and a weaker dollar no doubt have played a role too.

Portfolios have performed well against peers during 2023. We have deployed something of a barbell approach which offers downside protection against potential negative outcomes economically and geopolitically and aligns with our responsible investor approach. The same approach allows for market participation on the upside – a cake and eat it strategy, if you will. We have been pleased with returns from our overweight position in Japan. We have participated in the recent US equity market rally and the narrow leadership during the earlier part of the year. So many active managers shunned the "Magnificent Seven" stocks based purely on valuation – our passive approach did not.

At last, bond markets have begun to perform, and portfolios are enjoying upside here too. We have extended duration to benefit further and may well do more of the same as the trend builds. Above all, portfolios remain anchored comfortably within their stated risk corridors, exposing investors only to the risks they signed up for.

We sign-off 2023 in good shape and look forward to a positive and no doubt challenging New Year. We wish you all a very merry Christmas.

Written by the Alpha Beta Partners Investment Team.

All sources Bloomberg unless otherwise stated.

CONTACT

Andrew Thompson

Tel: 020 8152 5117

Email: at@alphabetapartners.co.uk

Address: Northgate House, Upper Borough Walls, Bath BA1 1RG.

Important Information
This is a marketing communication from Alpha Beta Partners a trading name of AB Investment Solutions Limited who are authorised and regulated by Financial Conduct Authority (FCA). Retail clients should not rely on any of the information provided in this document and should seek assistance from a Financial Adviser for all investment guidance and advice.

The information and opinions contained in this document are subject to updating and verification and may be subject to amendment. The information and opinions do not purport to be full or complete. No representation, warranty or undertaking, express or limited, is given as to the accuracy or completeness of the information or opinions contained in this document by Alpha Beta Partners and AB Investment Solutions Limited.

Please remember that you should not base decisions on past performance and that prices may fluctuate, and you may not get back your original investment. Past performance is not a reliable guide to future performance.

The Five Diamond rating awarded on Alpha Beta's Core portfolio range.