Alpha Beta
PARTNERS

INVESTMENT UPDATE

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FOR PROFESSIONAL INVESTORS ONLY

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The new year began as the old year ended – with positive momentum from equity markets fuelled by the allure of lower interest rates ahead and growing liquidity. A decent run was brought to a clattering halt by the sometimes-good guy and sometimes-villain, Mr Jerome Powell, Chairman of the Federal Reserve, on the final day of January. The question is, will this intervention spoil progress in more fulsome fashion? We will seek to offer an insight and unpack essential detail in the update that follows.

Adding fuel to the fire, the International Monetary Fund announced the imminent arrival of a soft economic landing during 2024.

Like a pendulum, market sentiments swing to extreme points before momentum switches. Markets priced-in up to 8 interest rate cuts this year based on inflation continuing to fall back without interruption. This was always optimistic. Whilst inflation certainly has fallen back steeply, the drive down to 2% target from the 3.4% CPI figure of December was always likely to be a grind. The fact that CPI rose slightly in December created the probability that rate cuts would be slower to appear than had been hitherto expected. Markets chose to ignore this, but realisation dawned during the press conference following the Federal Open Market Committee decision to keep rates on hold and to reduce the probability of an "automatic cut" in March.

Adding fuel to the fire, the International Monetary Fund announced the imminent arrival of a soft economic landing during 2024. Whilst an important voice, the IMF have not proven the best forecasters in the past. If this forecast were true, why would the Federal Reserve need to cut rates deeply, if at all?

Conversely, leading economic indicators from respected bodies such as the US Conference Board continue to point towards an economic slowdown, if not an outright recession. Bond markets and Purchasing Managers Indices support the case. The lagged impact of higher rates continues to play out despite ongoing spending by the consumer and a labour market which is perhaps only slightly less tight than late 2023. Eyes are focused on the fortunes of the latest regional bank, New York Community Bancorp, who are suffering from the impact of higher rates and are clearly in some difficulty. Longer term mortgage rates have moved decisively lower, with the 30-year mortgage rate falling from 8% to just sub-7%. This is all fine, but perhaps the biggest indicator is the sizeable debt refinancing cycle which plays out this year. Corporate debts are being refinanced along with those of the US Treasury. Further US Treasury debt issuance is also scheduled, as was announced at the important Quarterly Refunding Announcement during late January and we expect the theory of "ample liquidity" to support risk assets as the year plays out. Corporate America along with Uncle Sam in the guise of the US Treasury will absolutely demand lower ongoing debt servicing costs, and we believe this will serve to pull rates lower in 2024, with a beneficial knock-on to liquidity. The Federal Reserve will not aim to keep real interest rates at restrictive levels as inflation falls and debt servicing costs bite. Likewise, we would anticipate quantitative tightening being reduced during the year ahead.

The chart below dated 3rd February, courtesy of CME FedWatch shows the market related probabilities and timings for rate cuts in US during 2024.

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
3/20/2024				0.0%	0.0%	0.0%	0.0%	38.0%	62.0%
5/1/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	34.2%	59.6%	6.2%
6/12/2024	0.0%	0.0%	0.0%	0.0%	5.7%	38.5%	50.7%	5.1%	0.0%
7/31/2024	0.0%	0.0%	0.0%	5.7%	38.2%	50.6%	5.5%	0.0%	0.0%
9/18/2024	0.0%	0.1%	6.3%	38.5%	49.7%	5.4%	0.0%	0.0%	0.0%
11/7/2024	0.1%	3.9%	25.8%	45.2%	22.9%	2.2%	0.0%	0.0%	0.0%
12/18/2024	3.4%	23.0%	42.8%	25.7%	4.7%	0.3%	0.0%	0.0%	0.0%

Source: CME FedWatch February 2024

In Europe and Germany in particular, weakness and recession are the order, with the UK doing a little better but still struggling to post any meaningful growth. The European Central Bank kept rates on hold despite very weak data and at home, the Bank of England chose the same path; leaving rates at a challenging 5.25%, although UK inflation did nudge slightly higher to 4% at the last print.

China continues to struggle, and January marked the imminent demise of Evergrande; the colossal property developer with out sized debts totalling over $300 billion, the biggest debt burden of any company in the world today. Evergrande will slide into insolvency with knock-on impacts to the Chinese economy. We would expect to see stimulus provided by the People's Bank of China to reflate economic activity during the months ahead. Elsewhere, in the so-called emerging world, progress is undaunted by recession and prospects for a weaker dollar will add to forward momentum.

Japanese stocks wrapped up 2023 with historic gains thanks in large part to key drivers: the Bank of Japan's push for reform, and a rise in acquisitions and inbound domestic investment. The Nikkei Stock Average ended the final trading day of the year at 33,464 up 28% on the year for the biggest rise since the record-setting year of 1989. Our proprietary momentum indicator is now signalling much of the growth is done, without further stimuli. We will keep you updated as we consider current valuations.

In a multi polar world, geopolitical risk is more relevant in 2024 than for many years. The ongoing war in Ukraine, the Israel / Palestine disaster and the China / Taiwan dispute need no further introduction. Of course, we travel hopefully with an expectation for resolution over time. More than 70 countries will hold nationwide elections in 2024. Most ballots will be cast in Asia and many elections will likely result in the entrenchment of populist leaders. For investors, the most impactful will be the 2024 presidential election in the US, where a second Trump presidency is now a real possibility. Effectively an unpopularity contest between ageing candidates with fallout that could reshape America as we know it. We pay close attention to the twists and turns that lie ahead. For markets, in over 80% of all previous election years the US stock market ended the year higher than it began.

Presently, we pay particular attention to the Red Sea / Suez Canal debacle as the interruption to commercial shipping and safe passage away from attack has seen freight insurance costs spike more than 400%. Delays and bottlenecks provoke higher prices with knock-on impacts to economic policy at a broader level.

Container shipping has decisively shifted away from the trouble spot – bringing delivery delays as ships take a further 2-3 weeks to unload at their destination ports. The map below, courtesy of Steno Research in January 2024, shows very few container ships en route towards the Suez Canal / Red Sea.

Source: Steno Research January 2024

At portfolio level, we employ a steady position with no changes made during January and have enjoyed a decent beginning to the new year. We maintain a positive forward view for 2024, expecting equity markets to outperform bonds. That said, we are optimistic for further yield compression and for the Dollar Index to weaken as the year plays out, supporting the move up in the broader base of more attractively valued stock. Our hedge on the dollar, now at around the 50% mark, will likely continue to support progress. Geopolitical risk is ever-present and can of course upset progress.

We close this month by drawing your attention to further external endorsement for what we do at Alpha Beta Partners. We continue to enjoy the highest available Defaqto ratings for both investment process and overall proposition.

Written by the Alpha Beta Partners Investment Team.

All sources Bloomberg unless otherwise stated.

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