INVESTMENT UPDATE

OCTOBER 2024

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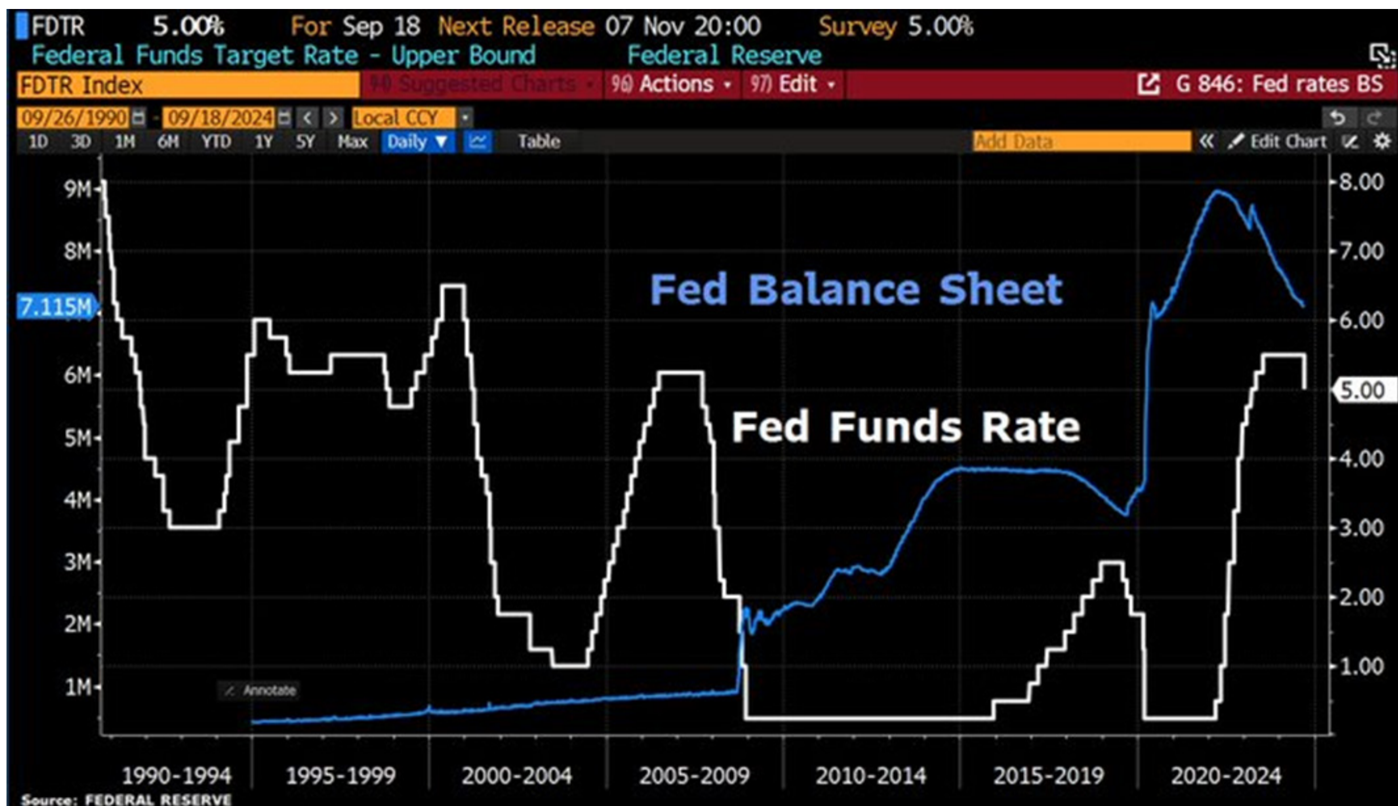
No matter how the results play out, September's 0.5% rate cut by the United States Federal Reserve will mark a turning point for markets. As ever, we seek to analyse the ripple effects and implications for portfolios in the update that follows.

The US economy is clearly strong and in better shape than all other G4 nations, suggesting fewer cuts are needed to drive growth higher.

A 0.5% rate cut in America was in discussion but appeared a lower probability than a more regular size 0.25% cut. So, the surprise of a larger than anticipated rate cut was celebrated with suspicion by markets, and perhaps with good reason. Quarter 2 GDP was revised upwards to 3% quarter-on-quarter. Looking at it one way, the US economy is clearly strong and in better shape than all other G4 nations, suggesting fewer cuts are needed to drive growth higher.

Inflation sits above the Federal Reserve target of 2% and a rate cut risks some resumption of unpalatable price hikes in the domestic economy. On the other hand, unemployment has certainly ticked notably higher sitting above the 4% mark, whilst a closer look at inflation reveals Owners' Equivalent Rent as a contributor to the overall CPI headline is high. This element of the CPI basked is entirely theoretical and not paid by consumers, and removing its notional impact reveals CPI comfortably lower than 2%. As such, real interest rates are high with scope for further cuts during the year ahead.

Of course, the saving in debt interest payments on the $35 trillion owed will have been a point of consideration too. US Treasury 10-year yields have been biased downwards by over 1% by subtle but deliberate policy, notably over the past 6-months. The key PCE inflation figure ended the month at an annualised 2.2%, as close to target as makes little difference.



Source: Federal Reserve

As discussed here multiple times before, liquidity is one key driver to asset class nominal returns. The trend in liquidity remains positive for the balance of 2024 and into 2025 with changes to bank solvency regulations likely to push liquidity higher again. The US dollar has weakened modestly as one might expect post interest rate cut, but with a strong economy and on a relative basis the scope for a deep retracement seems unlikely. Goldman Sachs sees the potential for a stronger British pound versus the US dollar; meaning our 50/50 hedged approach to the dollar is playing out nicely.

The other key news during September came from the world's second largest economy, China. We have noted deep underlying weakness caused by a dominant real estate sector here before and the drag of this, coupled with a stalling green energy export drive has pushed China towards recession. Longer term demographic imbalances have created a troubled economic view towards the horizon. The People's Bank of China have attempted to modestly stimulate growth previously but has failed, being accused by investors for "bringing chop sticks to a gun fight". However, the latest stimulus package (liquidity) is somewhat of a bazooka with a range of measures to create economic activity and growth.

China's "new monetary policy for the equity market" is specifically designed to support share prices. Is it too late? Time will tell, but Chinese stocks rebounded meaningfully higher at the months' end and will have a positive halo impact in the pacific emerging markets region. Growth in China fuelled by liquidity will naturally be good news for global growth and will be felt at portfolio level. A weaker dollar, if delivered, will also assist the emerging world. China's competitive edge remains lower prices which helps suppress inflation in the west.

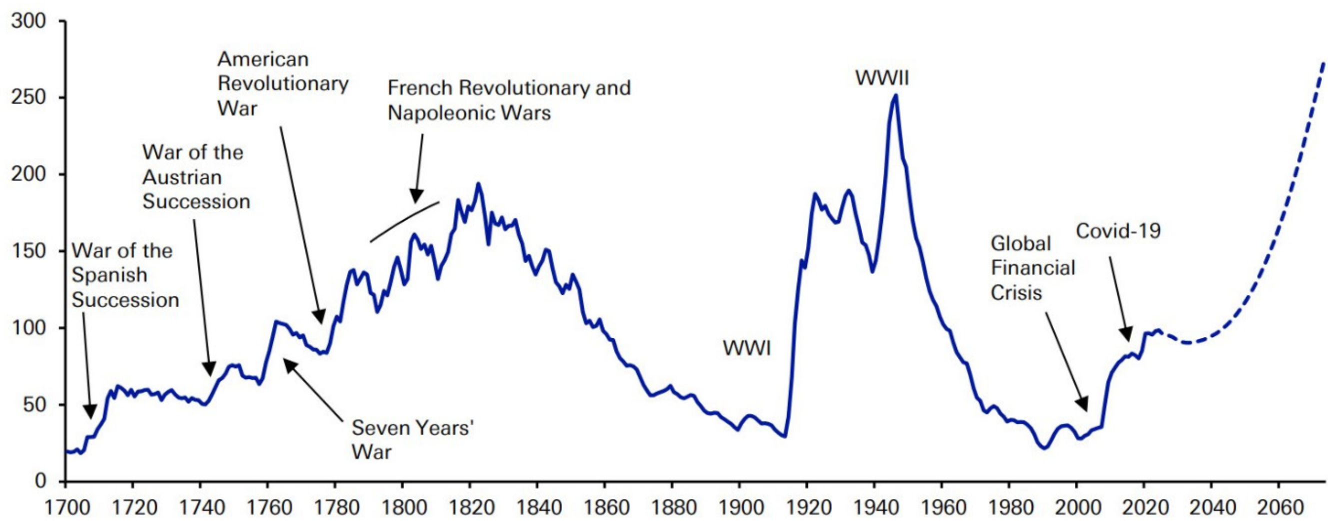
Key commodities, excluding oil but including copper and silver tracked higher during the month seemingly correlated with China's stimulus package and renewed prospects for growth. Gold has been on a strong growth path for a while, fuelled by geopolitics, but notably the trend in currency debasement by global central banks to control real debt levels.

Economic growth in Japan continues in good shape with output rising as well as wages. Inflation is not yet a problem but is certainly higher than for decades. The Bank of Japan raised rates modestly to arrest price rises and the precipitous fall in Yen value against other currencies. The resulting fallout in the global carry trade we discussed here last month, but we should not rule out further tightening in interest rate policy from the land of the rising sun. If and when this occurs, it may well signify a slowdown in equity prices and stimulate further thoughts for profit taking in portfolios.

At its 12 September 2024 meeting the European Central Bank cut its main interest rate by 0.25%, with the deposit rate lowered from 3.75% to 3.5%. This was the second time the ECB has cut rates since its cycle of rate rises ended in September 2023 (the first cut was in June 2024). The Swedish Riksbank cut rates in September signalling 2 more cuts to follow this year. As stated here before, the Eurozone is witnessing close to recessionary growth with Germany, once the strong man of Europe now seeing notable weakness in her manufacturing base.

Expectations for growth in the Eurozone remain subdued looking out from here, yet stocks have continued to do well driven by diversified global sources of corporate earnings.

Figure 1: UK National Debt (% of GDP) with OBR forecasts - this is the third leveraging supercycle in the last 300 years



Source: Bank of England

At home in the UK, we are not wholly impressed so far by the new Government policy. Settling wage demands in double quick time is commendable but caving in to settlements multiples higher than targeted inflation will not serve the country well. The Bank of England kept interest rates on hold whilst the Office for Budget Responsibility warned of rising borrowing strains as UK debt reached the highest levels since 1961 at 100% of GDP. Unsurprisingly, sterling and Gilt yields have remained firm for now. We await the Budget statement on 30th October with some hope that the much-flagged economic growth can indeed be triggered. The next interest rate decision by the Bank of England is scheduled for Thursday, November 7, 2024.

Geopolitics is impossible to model within portfolios. Random events in the United States cannot be ruled out, particularly with 2 attempts to silence Mr Trump. Middle Eastern events are well publicised and need little further extrapolation. Likewise, the ongoing war in Ukraine. We remain vigilant and have defensive plans ready should unforeseen happenings unfold.

At portfolio level, the important news of the month is linked with the fall in inflation and the impact that brings to the relationship between equities and fixed income. Fixed income typically acts as a stabiliser in portfolios, providing a cushion against equity price declines by reducing volatility. However, this relationship was disrupted in the past 2-3 years due to high inflation. Fortunately, the long-term stabilising role of fixed income is now returning to normal, which is a positive development. Portfolios have benefitted from the melt-up in valuations and the reduction in global interest rates.

We are content with the composition for now and see little point moving deck chairs for small impact and adding costs to client accounts. Performance is importantly ahead of the Investment Association comparators for the year, with the probability of further growth in sight notwithstanding unforeseen events of a geopolitical nature. Prospects for a US recession is around 30% likely but globally the figure is higher, which does feel broadly accurate to us. We look forward to updating you on progress next month.

Written by the Alpha Beta Partners Investment Team.

All sources Bloomberg unless otherwise stated.

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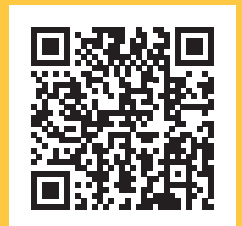

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