Fiske

Investment Commentary

Q4
2023

Overview

The fourth quarter of 2023 began with Hamas' surprise attack on Israel and the latter's retaliation, which has led to an ongoing tragic loss of life and destruction of property. In Ukraine, the war with Russia drags on as we enter the more difficult winter months. Geopolitical events will continue to have a destabilising effect, although this time the market reaction has been relatively benign. Even the oil price fell 17% over the quarter, despite OPEC+'s best efforts to control production. However, the muted reaction to date is unlikely to continue if events in the Middle East drag on and other participants from the region engage in the conflict.

Markets fell in October, although by the end of the month thoughts had turned decisively towards the interest rate environment. While proving far from transitory, inflation has continued to fall – to 3.1% in the US, 3.9% in the UK and 2.4% in the Eurozone. Combined with comments from Federal Reserve Bank chairman Jay Powell at the US rate-setting meeting in December, this more or less confirmed that interest rate increases have finished and cuts could be coming as soon as the first half of 2024. Markets reacted with delight and rallied strongly over the last two months of the year.

We have previously cautioned that the rapid rate of interest rate increases would take time to impact economies. The jury remains out – not so much in the US, which saw surprisingly strong third-quarter GDP growth of 4.9%, but rather in other developed regions. These include the Eurozone and the UK, which both saw contractions of 0.1%, and Japan, where the contraction was 0.7%. Purchasing manager indices, which measure economic activity, have shown manufacturing contracting in all regions, with readings below 50. For the services sector, the larger segment, they have remained above 50 – except in the Eurozone. Recession remains possible, but expectations are that it would be mild at worst.

The following table sets out the market movements for the past quarter and for the 12 months to 31st December 2023.

Index	30/09/2023	31/12/2023	Q4 Change	2023 Change
CBOE UK 100	761	772	1.5%	3.3%
CBOE UK All Companies	13,266	13,550	2.1%	3.6%
CBOE UK 250	16,026	17,164	7.1%	4.9%
MSCI Private Balanced	1,703	1,788	5.0%	7.4%
MSCI Private Growth	1,903	1,995	4.8%	8.7%

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Market picture

The change in interest rate expectations benefitted both equities and bonds over the quarter. 10-year Treasury bond yields fell to 3.9% in the US, from a high of more than 5% in October, and to 3.7% in the UK, from 4.6% at the end of September. The prospect of "cheaper" money helped "growth" stocks generally and the largest US technology companies in particular. The latter now represent more than a quarter of the US market by value and drove the main indices higher. The theme for the year revolved around AI (artificial intelligence) and its main beneficiaries. The so called "Magnificent Seven" – Apple, Microsoft, Amazon, Alphabet, Meta, Nvidia and Tesla – have largely accounted for all the performance of the leading US indices, with the performance of the remaining companies far more pedestrian.

It is worth saying that it has become very popular to rubbish the UK market, with its constituents being regarded as old-fashioned and the general "de-equitisation" of the market being blamed on UK institutional investors. For the record, following an appalling year for growth stocks in 2022 and clearly a much better one this year, the NASDAQ index is down 4.1% over the past two years. The FTSE 100 is up 4.7% over the same period.

Despite this much better longer-term performance, in the fourth quarter the UK market was again a laggard. The composition of the market has not helped, with the largest six stocks acting as a drag. Of these, only Rio Tinto (+13%) was up over the quarter, while BP (-12%) fared the worst. Of the other constituents in the FTSE 100 index, 64 stocks rose by more than 5% and 22 were over 15% higher. The interest-rate-sensitive housebuilders (+19%) and property sector (+20%) did especially well. The more economically sensitive – and perhaps more oversold – areas of the market performed well, with mid-caps up 8% and small-caps up 5%. The AIM also gained 5%. It should be noted that the equal-weighted 100 share index was up 10.8% for the year.

In other international markets, Japan had a good year – although nearly half the return was eroded for UK investors by the strength of sterling against the yen. The rise of Danish company Novo Nordisk on the success of its obesity drugs drove it to become the largest quoted business on the continent, helping lift European markets.

Outlook

As we enter the New Year and following a good rally in December, markets are looking overbought. However, notwithstanding the ongoing geopolitical risks, the forthcoming elections in the US, the UK and elsewhere and sluggish economic growth generally, the outlook for financial markets is not that bad. Both interest rates and inflation look as though they have peaked, bond yields are steady, and equity valuations are reasonable and could enjoy modest upward re-ratings as interest rates start to fall later in the year. With top-line growth harder to come by, we expect to see more merger-and-acquisition activity, particularly in the small/mid-cap space. The UK market continues to look relatively inexpensive.

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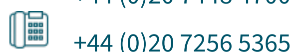
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