Fiske

Investment Commentary

Q1
2024

Overview

Following the strong market rally at the end of last year, it was not surprising that 2024 got off to a slow start. Market indices continued to be driven by a small number of large technology stocks – considered the future winners from artificial intelligence (AI) – in America, and there was similar polarisation in other markets. March proved to be a better month, as the prospect of interest rate cuts returned to the fore.

Economic activity in the developed world has been driven by the US, where fourth-quarter GDP grew at an annual rate of 3.4% – helped to a degree by the substantial stimulus delivered by the Biden administration. Purchasing manager indices (PMIs) improved, with manufacturing (51.9 in March) returning to growth from contraction (48.2 in December) and services (51.7 in March) continuing to expand. Elsewhere – and without the stimulus – GDPs were flat, with the UK recording a technical recession of two consecutive quarters of negative returns. However, except for European manufacturing (46.1 in March), PMIs are now showing expansion and could lead to gentle recovery as the year progresses.

The big question is when interest rates will be cut and monetary policy will be loosened. Federal Reserve chairman Jay Powell leads the way in stating rates are likely to fall three times this year. With benign economic growth and falling inflation elsewhere, the Bank of England and the European Central Bank are expected to move in a similar direction. The Swiss National Bank jumped the gun with a 0.25% cut in March (inflation there is 1.0%), while the Bank of Japan has (finally) moved away from negative rates for the first time in eight years.

Inflation does remain above most central bank targets and could spike up again as the conflicts in Ukraine and the Middle East drive commodity prices higher. The oil price rallied 13% from last quarter's 17% fall, in part because of OPEC+ determination to control production. The gold price has continued to climb steadily, up 12% over the past 12 months. Another consideration for central banks is the continuing tightness in employment markets, with low unemployment contributing to robust wage growth.

The following table sets out the market movements for the past quarter.

Index	31/12/2023	31/03/2024	Change
CBOE UK 100	772	796	3.1%
CBOE UK All Companies	13,550	13,928	2.8%
CBOE UK 250	17,164	17,337	1.0%
MSCI Private Balanced	1,788	1,866	4.4%
MSCI Private Growth	1,995	2,112	5.9%

Macro-economic picture

Many global markets have reached record levels during the quarter. A main feature has been the continued polarisation of investment into the largest quoted companies. This is especially the case in the US, where the so-called “Magnificent Seven” have dominated the indices in recent times – although in the past quarter two of the seven, Apple (-11%) and Tesla (-29%), have suffered reversals. Microsoft (+12%), Amazon (+19%) and Meta (+37%) pushed things along, while Nvidia (+83%), a producer of microchips for the AI world, continued its astonishing run. This effect has also been felt in European markets, with Novo Nordisk (+26%), the Danish pharmaceutical company leading the way with obesity drugs, and LVMH (+14%), the leading global luxury brands group, the two largest quoted companies. These moves have a significant impact on the indices in which the companies are constituents.

The UK’s FTSE 100 has continued to fare better than the mid-cap and small-cap sections of the market, helped by decent moves in the oil (+3%), pharmaceutical (+5%) and bank (+3%) sectors. However, as we have mentioned before, others have noted the relative valuation attractions of the UK market. Takeover activity has picked up, with competing offers for DS Smith (paper manufacturing), Spirent (telecoms testing) and Wincanton (logistics), while there have also been offers for Direct Line (insurance), Virgin Money (banking) and Redrow (housebuilding). We feel that we could see more of this activity during the year.

Internationally, the Indian economy has continued to power ahead, with GDP growth of 8.4% in the fourth quarter. This was reflected in the stock market (+2%) consolidating a 19% rise last year. China is beginning to provide stimulus to help overcome the burden of the property debt in its economy. There have also been small steps taken to ease the tensions with the US. The Japanese market has continued to perform strongly and finally broke into new all-time-high ground after 30 years. The investment return to UK investors has been tempered by significant weakness in the yen, but attractive valuations and changes in corporate governance suggest the market should continue to perform well. Parts of the US market now look overheated. It will be interesting to look back and see if all the hype surrounding AI-related investments justifies current stock market valuations. The history of previous booms, such as the dot-com bubble in the 1990s, suggests not.

Outlook

Much has been written about the lacklustre performance of UK equity indices. There is no doubt that UK shares are generally undervalued compared to their overseas counterparts. This has not gone unnoticed, with a recent pick-up in takeover activity as opportunist corporations and private equity houses look to buy cheap UK assets. Meanwhile, geopolitical concerns may lead to an increase in investor interest in resource stocks and haven sectors, to which the UK market is more heavily weighted. At some stage, as asset allocation to the UK market increases from current low levels, a trickle-down effect should benefit unloved UK smaller companies, where valuations look compelling.

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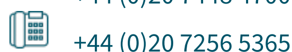
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