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Investment Commentary

Overview

For financial markets the summer quarter can often be quiet – yet suddenly a few events can trigger great excitement. This year was no exception. After a calm start, worries that the US economy was heading into recession, essentially based on a weak employment number, saw US equity market indices fall by 6%-8% in the first week of August. Then the diverging direction of interest rates between the US and Japan threatened the so-called “carry trade”, where speculators borrow at very low rates in yen to invest for higher returns elsewhere. This resulted in the Japanese equity market falling 12% in a day and then recovering by 9% the day after. This hiatus was followed, just before the end of the quarter, by China announcing a huge stimulus package for its ailing economy. Its domestic stock market took off, rising by 20% in the last few days of September, while the Hong Kong market rallied by over 30%.

On the political front, the expected sweeping election victory for Sir Keir Starmer’s Labour party – admittedly with only a third of the vote – hardly raised an eyebrow on the London market. The more telling moment may well be the Budget due on 30th October. In America, following his disastrous showing in a television debate with Donald Trump, Joe Biden stood aside as the Democratic candidate, and his Vice-President, Kamala Harris, secured the nomination for the presidential election in November. Polls now show the contenders much more evenly matched than they had been before Biden’s decision. In France, despite a promising start, the far right failed to deliver in the snap presidential election. Emmanuel Macron was returned and duly appointed Michel Barnier – he of the “non” to everything discussed as the UK left the European Union – as his new prime minister, with proposals for painfully higher taxes and lower spending to try to reinvigorate the economy.

The direction of inflation and interest rates has continued to impact markets. As has been the case for most of the year, inflation has been subsiding towards – or reaching – central bank targets. In response, interest rates have been cut – most significantly by 0.5% in the US in mid-September. Elsewhere, over the quarter, reductions have been by the more conventional 0.25%. The aim is to try to engineer an economic soft landing. Only in Japan have interest rates increased, with the very long-run negative level rising to a positive 0.25%. Additionally, the level of stimulative bond purchases has been halved.

Other economic indicators have shown a mixed picture. Employment levels are easing. In four of the past five months non-farm payroll numbers in the US have fallen below the 200,000 level deemed to be expansionary, and this helps to moderate wage inflation. Purchasing Manager Indices (PMIs) are generally showing expansion (over 50) for the service sector but contraction (below 50) for manufacturing. Eurozone manufacturing stood at 45, with German industry in particular a drag. The UK saw its economy grow by 0.5% during the second quarter and has been one of the more resilient of the G7 nations, especially compared to our continental cousins.

Regrettably, geopolitical tensions remain high, with the conflicts in the Middle East and Ukraine continuing to add to the level of uncertainty in markets.

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

Index	30/06/2024	30/09/2024	Change
CBOE UK 100	814	825	1.3%
CBOE UK All Companies	14,234	14,480	1.7%
CBOE UK 250	17,625	18,506	5.0%
MSCI Private Balanced	1,888	1,902	0.7%
MSCI Private Growth	2,149	2,162	0.6%

Macro-economic picture

The table above shows that, despite the excitements mentioned earlier, equity markets have ultimately reacted quite calmly. The gold price has seen more significant moves, reaching record highs and up 15% over the quarter. Geopolitical and economic worries have helped stimulate demand. The oil price, despite the Middle Eastern crisis, fell 15% over the quarter. The yen recovered by 11% against the US dollar and 6% against sterling from the very depressed levels of earlier in the year.

The UK market index was again substantially influenced by some of its largest constituents. The falling oil price saw BP (-18%) and Shell (-14%) have the most significant impact, while AstraZeneca (-6%) was also a drag. Unilever (+11%) was the only leader to show good positive progress. The influence of these stocks is borne out by the fact that half of the FTSE 100 share index constituents rose by more than 5%, while only 18 were down by more than 5%. Housebuilders showed good gains as the new government reintroduces targets for new builds over its parliamentary term, and Persimmon and Vistry were elevated to the main index. Retailers performed strongly and utilities picked up as government bond yields fell.

We have mentioned on several occasions the relatively attractive valuation of the UK market and the possibility this may lead to takeover activity. Broker Peel Hunt recently produced a note showing that in the past quarter there were 11 meaningful bids among the top 350 quoted companies; there have been 40 over the year to date, with a value of £47bn. While not good for the de-equitisation of the UK market, this does support our valuation argument.

Elsewhere, the supersized technology companies in the US showed mixed performance, with the tech-focused NASDAQ index up a modest 2.6% and underperforming the Dow Jones (+8.2%) and S&P 500 (+5.5%). In Europe the largest stock, weight-loss drug company Novo Nordisk (-22%), succumbed to profit-taking and competition fears. Its main competitor, Eli Lilly, fell sharply in sympathy but has since recovered.

Outlook

In the UK we await, with some concern, the Budget due at the end of this month. With the government constrained by promises not to raise income tax, VAT, corporation tax or National Insurance, it seems likely we could see changes to capital gains tax rates. If you are likely to need funds from your taxable portfolio in the near future it would be sensible to discuss this with your Investment Manager while the current low rate of CGT pertains. There is also a possibility that the existing Business Property Relief allowed on holdings of some AIM stocks could be removed. The AIM index, down 3.3%, has already shown some reaction to this prospect.

In conclusion, with inflation rates falling back to central bank targets, there is scope for further cuts in interest rates, which should support both bond and equity market valuations. The UK market in particular continues to look relatively inexpensive – a feature that has not gone unnoticed, judging by the increase in mergers and acquisitions of UK companies at values well above prevailing share prices.

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