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Investment Commentary

Q4
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Overview

Donald Trump's re-election as President of the United States concluded a long year of elections around the world. The margin of victory confounded pollsters and gave the Republicans control of both houses of Congress, as well as the Presidency. Trump's unusual approach to politics, with statements of perceived policy made on the hoof and on social media, make it difficult to know exactly what to expect post inauguration on 20th January. What we can say is that tariffs are very likely to be imposed on most US trading partners, but the quantum is uncertain. Tax cuts will be introduced in the US, boosting the economy in the short term, while some of outgoing President Biden's big spending projects, particularly those targeted towards a greener economy, may be scrapped. Trump's influence on the geopolitical stage will be difficult to predict. Perhaps the biggest difference from his first term, when broad statements of intent were often scaled back, is that his 'cabinet' this time is full of Trump devotees with little political experience but plenty of business acumen.

The other main political event of the quarter was the long-awaited UK Budget from Labour's Chancellor, Rachel Reeves. After four months of talking down the economy, blaming the Conservatives for everything (including an unexpected £22bn black hole), warning those with "the broadest shoulders" to prepare for the worst and at the same time promising a Budget for growth, the outcome was very disappointing. In particular, the hike in both Employer's National Insurance and the minimum wage puts considerably more cost on all corporations – especially small and mid-sized companies, which have always been the backbone of growth in the domestic economy. Companies with higher numbers of relatively low-paid workers, such as those in retail and hospitality, look likely to be most impacted by this approach. Even the excitement surrounding the promise to ease the planning process and target building 1.5m homes during this parliament waned when it became clear that this target was no different to when targets were abandoned years ago as none had been met since the 1970s.

Further interest rate cuts were made in most regions over the quarter, although inflation has generally remained stickier than hoped. Rates in the US were cut from 5.0% to 4.5%, despite a robust economy. A more circumspect Bank of England cut rates from 5.0% to 4.75%, while European rates fell from 3.65% to 3.15%. Japan – now in a tightening frame of mind – held rates at 0.25%. Economic indicators such as Purchasing Manager Indices have been mixed. Services sectors, typically much larger parts of developed economies, have remained in expansion, with the US showing 58.5 in December and Japan, the UK and the Eurozone all reading 51.4. Conversely, manufacturing was in contraction, with the US reading 49.4, the UK 47.3 and the Eurozone 45.2 – the last of these reflecting a particularly weak German economy.

On the geopolitical front, the surprisingly rapid removal of the Russian-and-Iranian-backed Assad regime in Syria added an extra degree of uncertainty in the Middle East. Ukraine remains under extreme pressure from Russia, now supported by North Korean troops, and Trump's promise to end the war on day one adds further uncertainty. China's domestic economic woes are perhaps constraining military pressures in the region for now.

The following table sets out the market movements for the past quarter and for the 12 months to 31st December 2024.

Index	30/09/2024	31/12/2024	Q4 Change	2024 Change
CBOE UK 100	825	819	-0.7%	6.0%
CBOE UK All Companies	14,480	14,355	-0.9%	5.9%
CBOE UK 250	18,506	18,057	-2.4%	5.2%
MSCI Private Balanced	1,902	1,936	1.8%	8.3%
MSCI Private Growth	2,162	2,222	2.8%	11.4%

Macro-economic picture

Over the quarter there was increased volatility in markets but relatively little actual change in index levels. The pattern of earlier in the year continued, with the largest technology companies driving the US market to the top of the leaderboard. The “Magnificent Seven” now account for 35% of the S&P 500 by market capitalisation, and they were reponsible for 40% of the index return for the year. US households now hold 30% of their wealth in equities – the highest proportion since 1970. Japan was the next-best-performing market, but weakness in the yen (-9.5% for a sterling investor) took some of the shine off.

Large-cap stocks continued to outperform mid-sized and smaller companies in the UK, with the AIM market being especially weak as changes to the tax advantages of holding these stocks were made in the Budget. On an equal-weighted basis, the top 100 stocks rose by 2.5% over the year, compared to a 5.7% gain on a market-weighted basis. Along with the bank sector in general (+34%), HSBC (+24%) was a major driver, while Unilever (+20%) also contributed strongly. On the other hand, reflecting the fall in the industrial metals sector (-15%), weakening economic prospects saw BP (-16%) and Rio Tinto (-19%) drag the index back. Sectors sensitive to interest rates suffered as expectations for further cuts moderated. In particular, post-Budget blues and evidence of building cost pressures negatively impacted real estate (-17%) and housebuilders (-16%).

Despite interest rate cuts during the quarter, bond markets moved in the opposite direction. With inflation remaining above target and economic outlooks deteriorating, government bond yields have risen sharply. In the US, 10-year and 30-year yields have risen from 3.78% to 4.57% and 4.12% to 4.78% respectively. In the UK, 10-year yields moved from 4.08% to 4.67% and 30-year yields from 4.58% to 5.13%. These higher borrowing costs could conceivably have a negative knock-on effect on long-duration risk assets.

Outlook

The economic and political backdrop may lead to a period of uncertainty for financial markets over the short term, so we expect to see more volatility. The spectre of domestic stagflation is a distinct possibility. In the US, although the economy is strong, equity valuations are now quite full compared to those in other developed markets, and the dominance of a handful of mega-cap companies creates a risk for US-index-tracking funds. Internationally, trade friction resulting from higher US tariffs is likely to materialise. Meanwhile, further interest rate reductions might be tempered by the outlook for higher inflation. Our policy of sticking with quality equites on reasonable ratings still looks to be the right strategy. Short-dated bonds and index-linked gilts have defensive attractions.

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