Investment Outlook

A monthly round-up of global markets and trends

February 2024

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Investment outlook

Election engines are revving-up globally

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In 2024, voters will go to the polls in a record 77 countries, accounting for around half the world's population.[1] Many of these elections will likely be inconsequential for global financial markets. However, sometimes elections can have a material long-term impact on economies and stock markets. For instance, supply-side driven policies from governments led by Margaret Thatcher and Ronald Reagan in the 1980s helped to bring the UK and US out of the economic slumber seen in the troubled 1970s. Several elections this year may be important to investors.

UK: Prime Minister Sunak recently hinted that the general election could be held in the second half of the year. Since the Conservatives are materially behind Labour in the opinion polls, they may cut taxes in the March budget to try and win back public support. This would come on top of the National Insurance reduction seen in last year's autumn statement. The government also wants to boost public sector pay and avert labour stoppages. Such a "go for growth" strategy could keep Bank of England interest rates higher for longer, especially relative to other major central banks, and provide some support for sterling. A Labour victory may lead to closer ties with the EU which could further help sterling.

Continental Europe: European Parliament elections take place from the 6-9 June. After the success of Green parties in the 2019 election, there are signs of a rightward shift on the political spectrum, as some voters may put their purse ahead of climate issues. Current polls show right-leaning parties, which are generally less focused on environmental policies, are set to win 25% of seats, up from 20% in 2019.[2] Should they win more than a third of seats as a unified block, with mainstream parties becoming divided, there is a risk for investors that they could influence new legislation. However, opinion polls show that the centrist grand coalition is expected to retain power when the electorate goes to the polls.

Nevertheless, centre-right parties are expected to make gains in domestic parliamentary elections in Portugal (March), Austria (in the third quarter) and in three German state elections (September). With right-wing parties already in power in Italy and Hungary, and possibly in the Netherlands if the anti-immigration People's Party for Freedom and Democracy (VVD) can form a coalition government following its win in last year's election, the coordination of EU policy is under threat. Some national governments could veto decisions made in the European Council. Such uncertainty is a risk to the euro against major currencies. Moreover, analysis of data going back to the 1970s by Citi, a bank, shows that EU equity performance tends to be more volatile than other major regions after national elections.[3]

US: Undoubtedly the most important election for investors in 2024 takes place in the US this November. Given that America is increasingly split along ideological lines this election is likely to be highly contentious. This opens the possibility of stock market uncertainty, both in the run-up to, and after, the election. Although he has not been convicted, Colorado has taken Donald Trump off the Republican primary ballot due to his alleged role in the Capitol riots on 6 January 2021. The Supreme Court has agreed to review a petition by the former president against Colorado. Should the Supreme Court reject Trump's petition, it could lead other states to do the same in a tit-for-tat response from Republican states to remove President Biden from ballots, disrupting campaigns ahead of the election. As such, the Supreme Court is not likely to uphold the Colorado ruling. Unless there is a landslide win for either party, a tight election could well be disputed, as seen in 2000, 2016 and 2020. It is worth noting that President Biden beat Trump in the Electoral College system by just 44,000 votes across three states in 2020.[4]

Asia: Last month William Lai of the pro-independence Democratic Progressive Party won the Taiwan presidency. Given his party's stance on independence from China, this will serve to maintain ongoing tensions between the US and China. Considering that around half the world's container fleet passes through the Taiwan Straits, any conflict or blockade of the island would disrupt global trade. We view this as a tail risk (a low probability, high impact event). Taiwan has an outsized influence on the global economy, being home to around 65% of the total semiconductor foundry market and producing 90% of the worlds most advanced chips.[5]

Aside from the political risk driven by elections, investors will also be wary about geopolitical events in the Middle East. In January, UK and US military forces bombed Iran-financed Houthi rebels in Yemen. This followed Houthi drone, boat, and missile attacks on shipping in the Red Sea in retaliation for Israel's invasion of Gaza and effectively opens a second front in the Israel-Hamas war. However, it is still too early to estimate the full impact on supply chains and inflation. Shipping costs have ticked up, but nothing like the price jump caused by the pandemic. So far, the Houthis have not targeted oil and gas tankers and energy prices have been contained.

The world faces plenty of political and geopolitical risks in 2024, which are likely to create moments of market volatility. However, if the world avoids a recession and inflation continues to come down, this will enable central banks to cut interest rates and for companies to meet analysts' earnings expectations. The backdrop remains positive for both stock and bond markets. Gold should prove a useful hedge in portfolios against tail risks.

Sources:

1 What to watch in the 2024 election Super Bowl, JPMorgan, 10 January 2024

2 EU Election Monitor #1 - why European Parliamentary elections matter for markets, Deutsche Bank, 9 January 2024

3 Super Election Year Playbook, Citi, 19 January 2024

4 Narrow Wins In These Key States Powered Biden To The Presidency, NPR, 2 Dec 2020

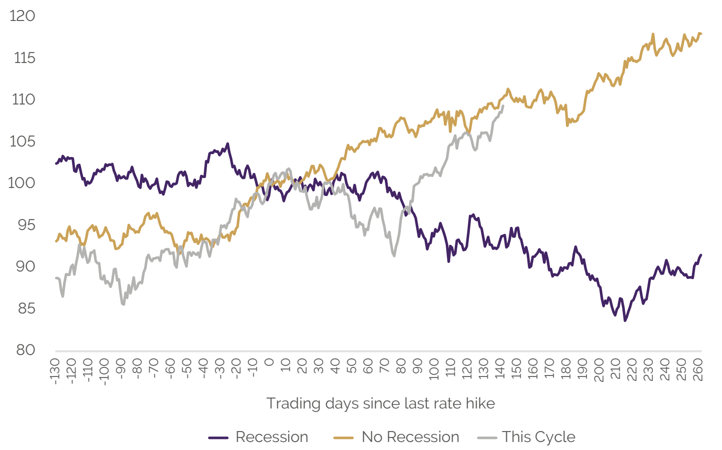
5 Taiwan : 7 slides on a key election, Deutsche Bank, January 2024

Market highlights

Equities

US equities rallied in January, and especially through the second half of the month, as US GDP growth proved stronger than expected for the fourth quarter of 2023. This strong growth came on the back of a resilient US consumer, with retail sales data accelerating over the holiday period. Consumer confidence has also rebounded to a two-year high in recent months, mitigating fears of a hard landing recession scenario for the US economy. When looking at the last eight rate hiking cycles, we observe four times when the US has entered recession and four times when it has avoided one. While equity performance this cycle had previously pointed toward a recessionary outcome, over recent months equity markets have recovered to a position which looks more consistent with no recession.

Median performance of the S&P500 around the last Fed rate hike (100 = date of last hike)

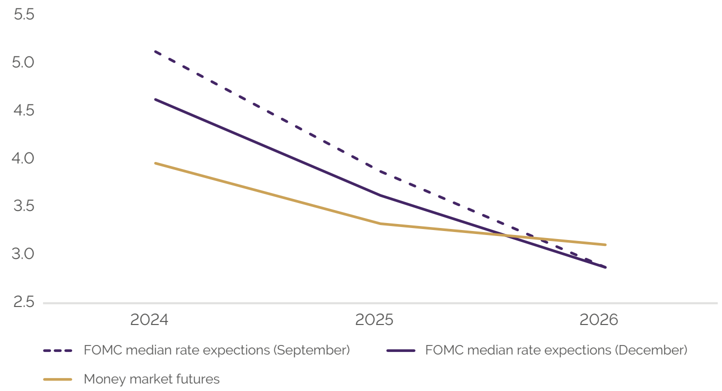


Source: LSEG/Evelyn Partners, data as at 31 January 2024
Performance calculated on a price return basis in US dollars
Past performance is not a guide to the future

Fixed income

Towards the end of 2023, investors began to believe that the Federal Reserve's (Fed) interest rate hiking cycle had reached its conclusion. This change in market sentiment was supported by dovish communication from the Federal Open Market Committee (FOMC), the group responsible for setting interest rates in the US. Despite holding the base interest rate unchanged at 5.25-5.5% during their December and January meetings, the committee changed its forward guidance in December to signal that it now expects to cut rates three times over 2024. This marked a considerable change in tone from their September meeting, when the committee did not expect to cut interest rates at all this year, but conflicts with market pricing, which implies roughly six cuts this year. In our view, markets are too ambitious with their expectations about the magnitude and timing of rate cuts.

FOMC median interest rate projections

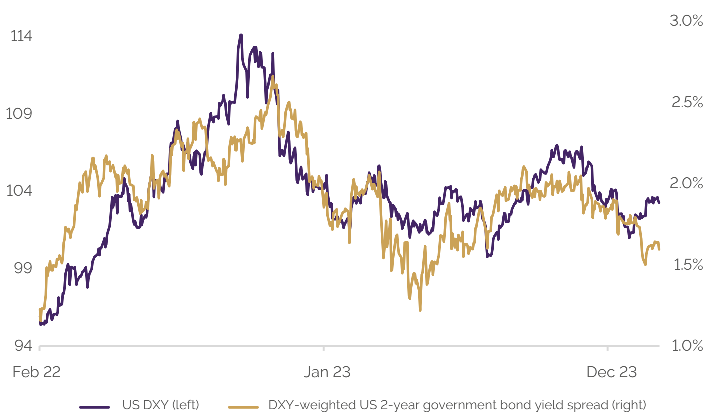


Source: LSEG/Evelyn Partners, data as at 31 January 2024
Past performance is not a guide to the future

Currencies and commodities

This movement in rate expectations has contributed to US dollar volatility. Typically, when interest rate expectations in one country move higher relative to another country, it causes their currencies to appreciate and depreciate, respectively. One way to measure this interest rate differential is in the difference between the yields available on government bonds. The 'spread' between the two-year government bonds from other developed economies (eurozone, UK, Japan, and Canada) and US government bonds narrowed over the last 3 months, until it started to widen again through the second half of January. This caused the US Dollar Index (DXY), which measures the value of the US dollar against a basket of global currencies, to weaken initially, before appreciating during the latter half of January.

US DXY and US DXY-weighted* 2-year government bond yield spread



Source: LSEG/Evelyn Partners, data as at 31 January 2024
**includes eurozone, UK, Japan and Canada*
Past performance is not a guide to the future

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	0.7	9.8	11.4	71.7
MSCI UK	-1.2	4.8	2.2	32.9
MSCI UK Broad	-1.3	6.1	2.1	28.9
MSCI USA	1.7	10.9	17.1	101.3
MSCI Europe ex UK	0.4	11.4	8.7	61.7
MSCI Japan	4.7	13.0	15.0	44.9
MSCI Asia Pacific ex Japan	-3.4	7.3	-8.5	23.5
MSCI Emerging Markets	-4.5	2.0	-5.8	10.6
Bonds				
iBoxx GBP Gilts	-2.3	6.6	-1.4	-17.0
iBoxx USD Treasuries	-0.1	1.9	-2.3	5.1
iBoxx GBP Corporate	-0.9	7.4	4.6	1.6
Commodities and trade-weighted currencies				
Oil Brent Crude ($/barrel)	5.5	-6.4	-3.7	31.6
Gold ($/ounce)	-0.8	2.6	6.2	54.9
GBP/USD	-0.1	4.9	3.4	-3.2
GBP/EUR	1.6	2.1	3.4	2.3
EUR/USD	-1.7	2.8	0.0	-5.3
USD/JPY	3.7	-3.5	12.4	34.3

Market commentary

January was a mixed month for equity performance with the MSCI All-Country World index delivering a 0.7% gain for the month in sterling terms, driven mainly by Japan and the US. The UK was the weakest of the developed markets, shedding 1.3% on the month, hindered in part by the country's underexposure to the rallying tech sector. Fixed income struggled as stronger economic data in the second half of January put pressure on money markets' interest rate expectations, pulling bond yields higher (yields move inversely to prices). Gold posted its first monthly loss since September 2023, falling 0.8% in US dollar terms, however, this occurred after making new all-time highs in December. Crude oil appreciated by 5.5% in January as tensions in the Middle East continue to escalate, yet the price remains lower than it was prior to the start of the Israel-Hamas conflict.

Key macro data	Latest	2024 Consensus forecast	Spot rates	31-Jan	Yields (%)	31-Jan
UK GDP (YoY%)	0.27	0.40	GBP/USD	1.27	MSCI UK	4.09
UK CPI Inflation (YoY%)	4.00	2.80	GBP/Euro	1.17	MSCI UK broad	3.99
Bank of England Base	5.25	4.30	Euro/USD	1.09	10 Year Gilt	4.00

The market commentary, values and charts as at 31 January 2024. Total returns in sterling. Returns are shown on a total return (TR) basis ie including dividends reinvested (unless otherwise stated). Net return (NR) is total return including dividends reinvested after the deduction of withholding tax. Source: LSEG Datastream/Bloomberg

Important information

Sources

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