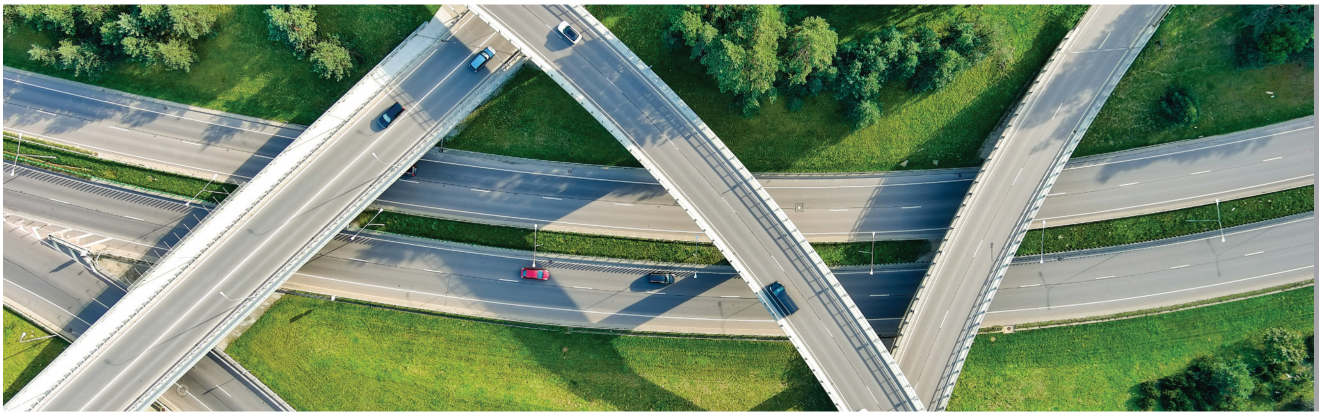
Investment Update - January 2024



Dear Investors,

May I take this opportunity to wish you all a healthy and prosperous New Year. In the Insights published in July we wrote about the emotions of an investor and how being patient can often bring rewards. This played out in the latter part of 2023 and as expected – albeit a little later than we hoped – inflation started to fall. Central banks were now able to relax and take stock of the changing economic landscape. This enabled them to freeze further rate rises as well as give an indication that rates would fall in 2024.

This was especially the case in the US, however the UK inflation outlook followed the same narrative. We are seeing significant rate reductions in mortgage rates, which is a sign that future rate cuts are likely.

Toward the end of 2023 – especially in November and December – equity and fixed income markets were buoyed by the news flows on inflation, and the expectation that the US economy would have a soft landing rather than a recession. As such our portfolios had a good end to the year; both in terms of absolute performance and performance relative to our peers. The patience of our investors was rewarded.

So, what about 2024? What is in store for investors this coming year? It is becoming more and more difficult to predict what the investment landscape will look like in 3 months – never mind 12 months – in this ever-changing geopolitical landscape. Add to this the speed in which information flows and the advancement of technology, it makes forecasting more challenging.

What we can be certain of is that the focus for 2024 is very much centred on both economics and politics and the potential impact on investing.

Economics

The likely positive news comes in the form of a continual fall in inflation and the widespread expectation that the Fed – as well as other central banks, including the Bank of England – will start to cut interest rates during the year. As we have already stated, the anticipation of this policy shift sparked a strong rally in equities and fixed income in the latter part of 2023. The question that is being asked by a number of economists is whether the monetary tightening in 2022 and 2023 will have a lagging economic effect in 2024?

The fundamental question is whether central banks have got rate setting right; Have they done enough to slow inflation without sending economies into recession? The current thinking is that UK and US policy makers are looking positive, whereas in Europe recession is looking more likely.

Inflationary impulses that are ingrained in society and business can lead to central banks having to raise rates. Further to this are situations outside the control of central banks, such as the Houthi attacks in the Red Sea. Situations like this can have an impact on supply chains which can be inflationary and cause a change in tack of central bank decision making. Both equities and fixed income would not welcome a return of rising inflation, albeit this is looking less likely as we start the year.

Falling interest rates are generally good for equities and certain types of fixed income investments, providing the rate reductions are not followed by a deep recession. The oil price is well down on its levels in 2022 when investors were spooked by the Russian invasion of Ukraine. Lower prices should bring some relief to both consumers and businesses and if, as many suspect, China's growth rate slows, commodity prices in general will come under pressure and that should help bring inflation down even further.

Falling commodity prices and a sluggish Chinese economy are not a great combination for emerging markets. However, a lower US interest rate cycle should allow central banks in developing economies to cut rates as well. It will be interesting to see whether the cross currents of falling commodity prices and China's slowdown are stronger than the tailwinds of falling rates.

On the surface, the prospects of fixed income markets in the UK and US are becoming clearer following the once-in-a-lifetime period where gilts became more risky than emerging market equities. If inflation has peaked and interest rates cut, then government and corporate bonds could do reasonably well, even when taking into account the recent upturn in valuations.

Politics

What we do know is that sometimes markets can be derailed by events that do not have their underlying drivers in economics. The pandemic and the invasion of Ukraine are two recent examples. In 2024 the primary concern is elections, in particular in the US and the UK.

Election Season

Here in the UK, it seems likely that Labour will win a majority in the next election, which is predicted to occur in October. As Sir Keir Starmer has moved the Labour party to centre left, and away from the more left-wing Jeremy Corbyn, a change of government is unlikely to startle investors. But if a hung Parliament were to seem likely, in which Labour was dependent on support from, say, the Scottish National Party, uncertainty would increase. This in turn could rattle the markets.

Further to this is the current government's March Budget where it is expected that the Conservatives will look to use tax cuts to persuade voters . We know what happened to the gilt markets in the autumn of 2022 when tax cuts were not cross examined by the OBR. One would hope that history doesn't repeat itself and any tax cutting measures are for the benefit of the country in the medium to long term, rather than endeavouring to persuade voters.

In the US, the November election seems likely to be a repeat of the 2020 contest between Biden and Trump – candidates with a combined age of 159. The markets did pretty well under the first administration. This was not unexpected as Trump is first-and-foremost a businessman, and he gravitated towards achieving US growth via tax incentives and deregulation. It might seem then that investors have not much to worry about. If Biden wins then it's status quo, and if Trump wins it's growth, growth, growth for the US. However, what happened in the 2020 election cannot be forgotten and should be a concern to all those that worry about the long-term stability of the US and its democratic norms.

Should Trump lose, it is not inconceivable that he will, once again, refuse to accept the result. This could lead to unrest by his supporters, and at state government level if they look to alter the recorded vote. This could lead to widespread protest by his opponents, and a protracted legal action could keep the outcome in doubt. This possible political turmoil could unnerve the markets as they like stability, not just economically but politically too.

The ongoing geopolitical risks centre on Russia, and its continual invasion of Ukraine as well as Israel's conflict with Hamas, and the possibility of further escalation in the Middle East. In the Ukraine the aggression may intensify as the level of support declines from the US, especially as the US are supporting Israel in the Middle East whilst trying to prevent a wider conflict. We are also monitoring the Chinese actions following elections in Taiwan.

Outlook summary

The world has perpetual political and economic worries, and, in most years, the world manages to find a path through. If, as expected, the Federal Reserve Board (Fed) cuts interest rates several times in 2024, then consumers and businesses will feel more confident to spend and deploy capital. This could support equity markets, whilst the fixed income markets would continue to benefit from falling rates even with the recent upturn in performance.

Recent history does remind us that it is unwise to be overconfident, the past few years have shown that negative surprises can come in many forms, and as such patience may well be needed at times in 2024.

Whilst the general outlook is cautiously optimistic rather than the more bearish outlook back in July 2023, the headwinds investors have faced certainly look to have been replaced by cross currents and hopefully tailwinds become prominent as we move through 2024.

Other matters

Happy 40th Birthday FTSE100

I read this interesting article by the Financial Times on the 40th anniversary of the UK's top 100 companies.

"This year marks the 40th anniversary of the FTSE 100 index, which was created in 1984 to replace the rather old-fashioned FT-30 as the main benchmark of the UK stock market. The index's history can be divided into halves. In the first, between the start of 1984 and the end of 1999, the benchmark had lots of momentum, advancing from its original level of 1,000 to almost 7,000 at the end of the last millennium. Since then, it has been very slow progress. The 7,000 mark was not properly breached until 2015 and while the 8,000 mark was passed early in 2023, the index is still stuck in the 7,000-8,000 range.

To put that performance in perspective, the Dow Jones Industrial Average was only just above 1,000 at the start of 1984 but trades in the mid-30,000s today. The broader S&P 500 was 164 at the start of 1984 and is in the mid-4,000s now. Instead of mimicking the entrepreneurial US, the UK market has behaved rather more like corporatist France; Paris's CAC 40 index started in 1987 with a level of 1,000 and is in the mid-7000s today.

Part of the reason for Footsie's sluggish performance relative to the Dow or the S&P 500 is the lack of a thriving technology sector. In 1984, when the internet was a twinkle in the eye of Tim Berners-Lee, the UK's leading index had two technology stocks. Forty years later, it still does. It was a sign of the times when Arm, the chip designer, decided to list in the US rather than the UK when it returned to the market in September. In some ways, the UK market is frozen in aspic; almost a quarter of the index in 1984 was composed of financials and real estate; they make up the same proportion of the index today.

However, at the individual stock level, there has been plenty of change. Just 26 of the original 100 constituents have survived, although not all in the same form. The best performer over the 40 years is RELX, an analytics and information company. Back in 1984, when it was Reed International, a book and magazine publisher, it would probably not have been many people's pick as the stock that would rise more than sixtyfold over the next 40 years. But a merger with Elsevier, a Dutch scientific publisher, in 1993 transformed the group's prospects.

The other four of the top five performers over the past 40 years are all in the consumer staples sector, which is not often tipped by pundits selecting the next hot stock. But Unilever, Associated British Foods and Reckitt Benckiser all sell goods that consumers demand, year after year, while British American Tobacco produces goods that some people simply cannot do without.

That said, selling to consumers has not been a sure-fire route to success; two of the five worst-performing stocks have been J Sainsbury and Marks and Spencer, which have each seen their positions eroded by competition. But the two worst performers of all are Lloyds Bank and NatWest. The latter has a complicated history. The original NatWest was taken over in 2000 by the Royal Bank of Scotland, as part of an acquisition spree that turned RBS into the world's biggest bank. After RBS collapsed in the 2008 financial crisis, it reverted to the NatWest name.

If the FTSE 100 index is to do better in the next 40 years than the past four decades, it is going to need to depend less on financials and more on some dynamic sectors."

The country needs to retain its entrepreneurial talent, which we have in abundance. It is up to policy makers and government to find the balance of making UK PLC attractive with incentives and taxation for business. We must ensure we maintain a stable UK PLC balance sheet, and rebuild our global reputation as a nation of entrepreneurs.

Investment services update

There are a number of exciting developments as we widen the range of investment services that we offer our clients. We will be communicating to those that may benefit in the coming weeks.

Many Thanks,

RStott

Richard Stott, CEO

Source: Financial Times Jan 2024.