



Markets Review - to end February 2024.

Market Returns

(Returns in £)	1 month	3 months	6 months	1 year
UK Equities	-0.2%	2.7%	2.6%	-3.3%
Global Equities	3.3%	10.3%	12.0%	17.8%
UK Gilts	-1.3%	1.9%	2.0%	-1.5%
UK Property	-0.3%	-1.2%	-1.0%	0.0%
Gold	0.5%	0.5%	5.5%	7.2%
Commodities	2.1%	2.0%	0.4%	2.9%
Sterling	-0.1%	0.7%	0.1%	5.0%

Returns to 29th February 2024. Source: Refinitiv

Market Overview

The start of 2024 has had a familiar feel about it, with enthusiasm for a handful of Artificial Intelligence (AI) and weight-loss related stocks driving a number of stock markets to record highs. Economic data has also been relatively benign, with slowing inflation and still robust employment feeding hopes of a 'goldilocks' economy (not too hot, not too cold), particularly in the US. Although the UK has recorded a technical recession, it was only just two negative quarters of growth and the outlook for the current quarter is brighter. Even the Japanese stock market has raced to a new high, after a little over 34 years, and Chinese stocks have come out of the Chinese New Year holidays with a little spring in their step.

The brighter outlook has caused bonds to pull back as market expectations of interest rates cuts by central banks have been reined in. If economies do show some recovery (and falling energy costs should help here) cuts in interest rates may not happen till later in the year, keeping pressure on anyone carrying high levels of debt. In a year with roughly half the world's population facing scheduled elections, political machinations (remember the Truss mini-budget) could have an influence on how bond yields move.

Company results for 2023 have been mixed, with the clear winners being tech and AI related stocks. This has led to further concentration in the number of stocks driving equity markets higher, to a degree that causes some concern and requires continued growth momentum to justify valuations. The arms race being engaged in by big tech companies to stay at the forefront of AI, should keep the momentum going for a bit, but also carries the risk of capital misallocation; as witnessed by some recent eyebrow raising AI output from recent releases.

Back in the real world, growth looks set to sputter along without any great conviction in the developed world. Without any great engagement by China, the reality of a higher cost of debt and constant knocks to confidence from geopolitical crises will curb any great recovery. This, however, may be sufficient for reasonable returns, especially where valuations have been left low and the UK stock market has some catching up to do compared to other markets.



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Market energy costs have at last come back down to levels we were used to in Europe, before Russia invaded Ukraine. The mild winter has left gas reserves at unusually high levels and in the US natural gas prices have fallen to the lowest levels in decades. Although Western Europe still has to secure additional supplies on an ongoing basis and OPEC+ is extending supply restrictions, global supply and demand look quite well balanced. Expected economic activity in China remains the biggest swing factor in day-to-day commodity prices, particularly metals, and the government is still struggling to engineer a recovery from the property slump. Gold, meanwhile, as a non-yielding asset, has benefitted from the expected cut in interest rates. Central banks have also been significant gold buyers in a move to reduce foreign currency exposures in their reserves.

The never ending list of supply chain problems having eased significantly, with availability and container haulage costs back to pre-pandemic levels, is experiencing more problems with the recent attacks in the Red Sea. A reworking of global supply chains, with technology transfer restrictions and international subsidy fights breaking out, is still very much work in progress.

Even though central banks have paused interest rate increases, in the West, yield curves remain inverted (short term bond yields higher than long-term bond yields). This has historically been a harbinger of recession, but a higher proportion of fixed mortgages may be causing an extension of the transmission mechanism of monetary policy, delaying the economic impact. Government bond issuance continues to be very high, whilst central banks continue to sell down their bond holdings from QE.

Although more property funds are winding up, or merging, due to difficulties in offering sufficient liquidity, rental payments remain largely up-to-date, whilst repricing of properties settles down. The bond market turmoil has reduced valuations but many REITs still trade at discounts to restated property values. Listed infrastructure premiums have been replaced with discounts. Renewable energy focused ones no longer benefit from the rising energy prices and face windfall taxes and higher debt costs, but still have plenty of room to grow.

Geopolitics, already drawing up new divisions, is facing a very significant year, with 2024 seeing US elections, European elections, almost certainly a UK election, as well as India, the world's largest democracy. Whilst we can probably guess the outcome of Russian elections this month, there could well be surprises in the others. The fragile East-vs-West relationships could be further disturbed and continue to undermine the economic and cost benefits of globalisation, as national security concerns take precedence and new supply chains and relationships are established. Russia/Ukraine, Israel/Iran and US/China sabre rattling, look set to hang over markets for the foreseeable future.

The heavily predicted recession, last year, failed to arrive in the US, although a small technical one has been recorded here in the UK. Hopes of a 'soft landing' disguise the likelihood that growth will simply be disappointing. Supporting economies through Covid and the energy price spike, have a real cost and take away from other economic activity; the sharp rise in interest rate costs are still working their way through finances. However, the employment market remains firm, real wages are growing again after a long period of erosion and there is a significant cohort who actually benefit from higher interest rates.

Companies have reported mixed results through 2023, with the benefits of reopening weighed against supply and cost problems, but generally managing to maintain profitability and sales. However, there are some clear differences between the pullback in demand for companies that were 'Covid winners' and those with healthy demand following supply restrictions. Companies are reporting a mix of improving supply and cost inputs, but with some demand deterioration, especially where sensitive to higher costs of borrowing.

We are all worried about the conflicts we see daily and the numerous problems we and our investments face. Market volatility has been high and is likely to remain so, but markets are adept at climbing a wall of worry. A well-diversified portfolio should be able to carry you through this turbulence and making knee-jerk decisions on capricious data rarely works well. Keeping calm and trying to pick out the winners and survivors is still the order of the day.

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Market Outlook

Equities	2024 has started off in similar fashion to the way it finished 2023. US and European stocks making some new highs, and Japan joining in by surpassing its previous high way back in 1989! Much of the gains have been driven by a handful of technology stocks, leaving UK stocks lagging behind. Despite some small technical recessions, economies are showing some resilience and there is a sense of some growth this year. With some much anticipated interest rate cuts this year, value (UK) stocks should also join the party.
Fixed Interest	Easing inflation and central bank acknowledgement that interest rate cuts are likely this year, caused bond markets to surge into the year end. Market enthusiasm, though, ran ahead of central bank guidance and some of those gains have been given back. The higher levels of yields on bonds reestablishes their secure investment return credentials, particularly if economies hit trouble. However, with most governments continuing to run large deficits demand will have to be substantial to offset liberal supply.
Commercial Property	The spike in the cost of debt caused a recalibration, downward, of property values, with higher borrowing costs affecting returns and higher yields required to compensate for the more reliable returns offered by bonds. Even after reducing valuations, discounts to assessed value for many REITs still remain, reflecting worries about recession, although demand and rental payments still appear healthy, particularly on industrial property. We have limited exposure, looking for inflation protection and risk diversification benefits.
Alternative Assets	Infrastructure investment funds offer benefits for exposure to physical assets, often with attractive inflation linked contracts, and growth tied to improved connectivity and de-carbonising economies, although build costs are up. Higher debt costs have weighed on the valuations of private equity and infrastructure trusts, with energy related trusts also being hurt by lower market pricing. Absolute Return strategies have shown some defensiveness but generally offer low returns and we continue to choose sparingly.
Cash	The investment return on cash and cash like instruments has likely peaked and should begin to decline as the year progresses.

Thorntons Investments

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