Markets Review - to end June 2024.

THORNTONS INVESTMENTS

Market Returns

(Returns in £)	1 month	3 months	6 months	1 year
UK Equities	-1.4%	2.6%	5.2%	8.7%
Global Equities	2.9%	2.0%	11.5%	19.0%
UK Gilts	1.3%	-2.4%	-4.1%	1.6%
UK Property	0.5%	1.2%	0.5%	0.5%
Gold	0.5%	5.0%	13.6%	22.1%
Commodities	1.2%	1.4%	14.0%	17.6%
Sterling	0.2%	0.8%	2.1%	1.3%

Returns to 30th June 2024. Source: Refinitiv

Market Overview

At the half-way mark, 2024 has delivered strong returns from most financial assets, with a number of markets achieving new highs. The strength of global equities is almost solely down to the strength of the US stock market and in particular the 'Magnificent Seven' group of tech stocks, that have captured most of the excitement around Artificial Intelligence (AI). The level of performance concentration is exceptional and without these stocks the US market would have made limited headway. Slowly improving economic sentiment and lower inflation reports provided the positive background that has buoyed most other stock markets. The lowly valuations in the UK market have tempted a string of takeover offers and more are likely.

Gold was another financial asset that rose to new highs along with strength in some industrial metals such as copper. Gold defied conventional wisdom, as high interest rates and a strong dollar normally spell trouble for gold. Record buying by central banks, most particularly the Peoples Bank of China, provided the demand. Oil prices remained sensitive to developments in Gaza and the Red Sea, although supply and demand are in rough balance. Despite the improving inflation picture debt costs have risen back to levels that could impinge on investment decisions, mortgage costs being an obvious example, and they have been the notable weak asset this year. All this aside, employment remains firm in most western markets, reducing pressure for any radical policy shifts.

In a year with a record number of elections, the IMF recently issued a warning that budget deficits are too high and national debts rising to dangerous levels, with the US notably having a finger pointed at it. The nature of politics is that politicians are disinclined to campaign on austerity. Currencies could be vulnerable to significant shifts, with Japanese yen weakness and the recent dip in the euro cases in point. This environment is one to keep markets twitchy, although stable as long as there is no radical surprise.

With the UK election almost upon us (at writing), it is likely to be one of the least surprising in outcome and UK stocks still look cheap to elsewhere.

The mild winter has left gas reserves at unusually high levels and gas prices have come back to levels before Russia invaded Ukraine. Oil, meanwhile, has been creeping higher, sensitive to the Middle East, even though global supply and demand look quite well balanced. Better economic activity in China and a number of mine outages have pushed metal prices higher, particularly copper where long term demand is expected to exceed planned supply – the shift to renewable energy will require substantial investment in grid capacity. Gold has been the standout beneficiary of heightened uncertainty, even whilst interest rates and the dollar remain high. Central banks have also been significant gold buyers in a move to reduce foreign currency exposures in their reserves.

The extended shipping times caused by attacks in the Red Sea notwithstanding, transport availability and cost as well as material and component supply are mostly back to normal. A reworking of global supply chains, with technology transfer restrictions and international subsidy fights ongoing, is still very much work in progress.

Even though central banks have paused interest rate increases, in the West, and the ECB cutting, 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. Supply/demand dynamics, with high government bond issuance and central banks continue to sell down their bond holdings from QE, could yet push debt costs higher, with signs that they are already fraying some investment decisions.

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 that are attracting interest. 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, having already draw up new divisions, is in the midst of a very significant year, with our own General Election, US elections, European elections (some planned, some not!), as well as the largest democracy, India. Whilst the outcome of Russian elections were no surprise, nationalist politicians are on the rise elsewhere. 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's 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 of savers who actually benefit from higher interest rates.

Companies have reported mixed results, with the benefits of reopening weighed against supply and cost problems and some commercial demand disappointment, but generally managing to maintain profitability and sales. There are still pockets of supply shortages, but by and large most companies now report that supply and demand have normalised. Companies sensitive to higher costs of debt are finding life more difficult, whilst those exposed to the burgeoning interest in AI or weight loss drugs are seeing very strong demand.

We are all worried about the conflicts we see daily and the numerous problems we and our investments face. Stock 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	June rounded out a strong first half for most stock markets, with the US continuing to power ahead with the continued strength of the 'Magnificent Seven' and AI theme in general. The UK and European markets drifted through June, with elections taking centre stage and creating a few upsets. Last year's fears of recession have dispersed and inflation diminished to levels where interest rate cuts can be enacted, with the ECB making the first move in June. Politics aside this should underpin markets through the summer.
Fixed Interest	The expectations of rapid cuts to interest rates, as inflation fell, that boosted bond markets at the start of the year, have been pushed out. With employment remaining firm, service inflation has remained high and sticky, nixing central banks' ability to cut significantly this year. Government bond yields spiked on the back of the snap French elections and likelihood of another Trump Presidency, both potentially bad for budget deficits. This ties with the IMF warning about further supply from budget deficits being troublesome.
Commercial Property	The spike in the cost of debt has 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 still remain, that are beginning to attract attention. 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, some with attractive inflation linked contracts, and growth tied to improved connectivity and de-carbonising economies, although build costs have inflated. 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 decline later this year.

Thorntons Investments **2nd July 2024**