Markets Review - to end January 2025.

THORNTONS INVESTMENTS

Market Returns

(Returns in £)	1 month	3 months	6 months	1 year
UK Equities	5.4%	6.3%	2.7%	12.9%
Global Equities	4.3%	8.5%	10.7%	20.2%
UK Gilts	0.6%	-1.9%	-3.9%	-4.1%
UK Property	0.5%	1.6%	2.7%	4.4%
Gold	7.9%	6.1%	19.9%	40.6%
Commodities	4.0%	14.0%	16.0%	20.6%
Sterling	-1.1%	-0.6%	-0.7%	1.0%

Returns to 31st January 2025. Source: Refinitiv

Market Overview

2025 has seen a positive start in stock market terms, with most markets seeing healthy advances. The headlines and focus have been on the flurry of executive orders from President Trump, following his inauguration. Although this left most heads spinning it was generally accepted with optimism. February, however, brought a rude awakening with Trump utilising tariffs as a means to extract some policy changes overseas. This has all happened at speed and the early reaction is that tariffs are being used as a negotiating tool, not a long term policy, but it is still highly uncertain. Trump's tariffs were not the only rude awakening for markets, as one week earlier DeepSeek, a Chinese company, announced Artificial Intelligence as effective as developments in the West, but at a fraction of the cost. There is still much debate as to the veracity of the claim, but it challenges a lot of accepted wisdom built into market assumptions, particularly tech stocks.

The US dollar continued to appreciate and spiked higher on the tariff announcements, and gold, despite dollar strength, rallied to new highs. Gold normally struggles with a stronger dollar, but is also a haven in riskier times, so markets obviously feel risks are elevated. Commodity prices, particularly food, have also continued to rise and although metals and oil prices have been relatively calm, gas prices in Europe are now double the level of a year ago, keeping inflation bubbling away.

Apart from the US, economic growth in most major economies feels as though it is a bit bogged down. The urgency to revive it has, unfortunately, yet to be met by policy responses that give investors real confidence of escaping a Groundhog Day feeling (incidentally Groundhog Day was officially on 2nd February). Without stronger growth government deficits will remain elevated, leaving bond markets adrift. Europe has been steadily cutting interest rates to help revive activity and the Bank of England is now almost certain to follow suit this week.

Despite the uncertain economic outlook, much of this is already priced into stock markets, particularly the UK, and along with decent yields on bonds and physical assets, investors can still look forward to positive returns.

Gas prices in Europe are now double last year on a combination of restrictions on Russian supply and low levels of renewable energy production; unhelpful for either growth or inflation. Oil, meanwhile, remains in the $70s per barrel on weak economic growth outlooks whilst industrial metal prices remain depressed for similar reasons. New mine projects in general are few and far between, so any pickup in demand could easily see prices recover. Gold has seen strong demand from central banks, particularly in Asia, offsetting the recent headwinds of a strong dollar and higher bond yields.

The extended shipping times caused by attacks in the Red Sea notwithstanding, transport availability, as well as material and component supply are mostly back to normal. One notable exception is in aerospace, where multiple supply constraints are holding up delivery schedules. For European car manufacturers the issue is demand, where government policy is grating against lack of infrastructure and tariffs threaten a highly integrated supply chain.

A global interest rate cutting cycle (bar Japan) is now under way. Although there are different views on the pace and extent of cuts, they will help small companies and households with mortgages, albeit with delays reflecting the large use of fixed rate mortgages. The yields on long bonds, however, remain elevated, reflecting the growing levels of government debt across the western world, with little sign of seriously tackling budget deficits. This continues to act as a headwind against long term investment financing.

A number of property funds merged or were wound up in 2024 due to difficulties in offering sufficient liquidity. However, 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 quoted value, that are attracting interest. Listed infrastructure trusts also trade on wide discounts, renewable energy focused ones still face uncertainty on energy prices, but new regulations should provide more certainty on long term pricing. Despite windfall taxes and higher debt costs there is still plenty of room to grow.

The election indigestion that beset 2024, did little to settle political turmoil, despite clear outcomes in the UK and US. The one clear shift was a continued swing towards nationalist politics. The uncertainty in Europe, however, remains, as Germany faces an uncertain federal election later this month. In the US the Trump administration has unleashed a raft of executive orders, but almost all of these have to go through the process of implementation, although tariffs are now the primary concern of markets.

Despite flirting with technical recessions (two successive quarters of economic contraction) in Europe a full-on recession has so far been avoided; the fabled 'soft-landing'. However, 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 have still to work their way through finances, especially mortgages. Softness is now beginning to emerge in the employment market, although real wages are growing after a long period of erosion and there is a significant cohort of savers who actually benefit from higher interest rates.

The early company results from the last quarter of 2024 have in general held up reasonably well, with aggregate reported profits moving ahead, however, individually there has been a wide dispersion, with companies that disappoint often seeing a sharp drop in their share price. Consumers have been showing greater price sensitivity and some industrial companies have reported demand weakness, this is particularly true of car companies, who have been slashing their forecasts.

The recent ceasefire agreement in Gaza has come as a welcome relief and hopefully it will become embedded and continue to work through the various agreed stages. The situation in Ukraine remains unresolved and Trump's tariffs may further inflame East vs West tensions. This background necessitates well-diversified portfolios and a positive change in sentiment can result in some sharp market rallies. It is important to remain calm and keep the focus on long-term winners and survivors.

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Market Outlook

Equities	A strong start to 2025 has had two sticks thrown into the spokes of expectations. Trump has quickly opened his toolbox and pulled out tariffs at the first opportunity. This situation is very fluid as deferrals/withdrawals have swiftly followed after engagement with the country he was due to impose them on. Additionally China, through DeepSeek, have claimed AI equivalence to the best of the West, but with dramatically less resource. Both undermine assumptions of growth and profitability, but not ruin them; expect more volatility.
Fixed Interest	Enthusiasm for interest rate cuts has cooled in the US with the election of President Trump and a Republican Congress, whilst the economic funk in Europe is pressuring the ECB to cut rates faster. The Bank of England is still likely to cut this year, with the first cut likely by the time this goes out. With government debt levels high and in some cases rising, yield curves could well steepen (short term interest rates lower and long term bond yields remaining high).
Commercial Property	In contrast to housing, commercial property values have come down significantly, particularly office and retail values. With working and shopping patterns still settling into a new equilibrium, there is still some 'price discovery' ongoing and discounts on property trusts reflect the uncertainty. However, there has been little new build in recent years and demand is continuing to hold up. Debt costs are still a headwind but, selectively, there are some attractions.
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 risen. High debt costs, that weighed on the valuations of private equity and infrastructure trusts, remain an issue but de-gearing is taking place. 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 peaked and, whilst still attractive, should continue to decline this year.

Thorntons Investments **4th February 2025**