INVESTMENT UPDATE

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Index	Level 31 August	Level 30 September	Change*
S&P 500	5648	5762	+2.0%
FTSE 100	8376	8236	-1.67%
Euro Stoxx 600	525	522	-0.57%
Nikkei 225	38647	37919	-1.88%
Shanghai	2842	3336	+17.38%
US 10 Yr Treasury Yield	3.91%	3.80%	-0.19
UK 10 Yr Gilt Yield	4.02%	4.01%	-0.01
Bund 10 Yr	2.29%	2.13%	-0.16

*all returns in local currency terms

Overview

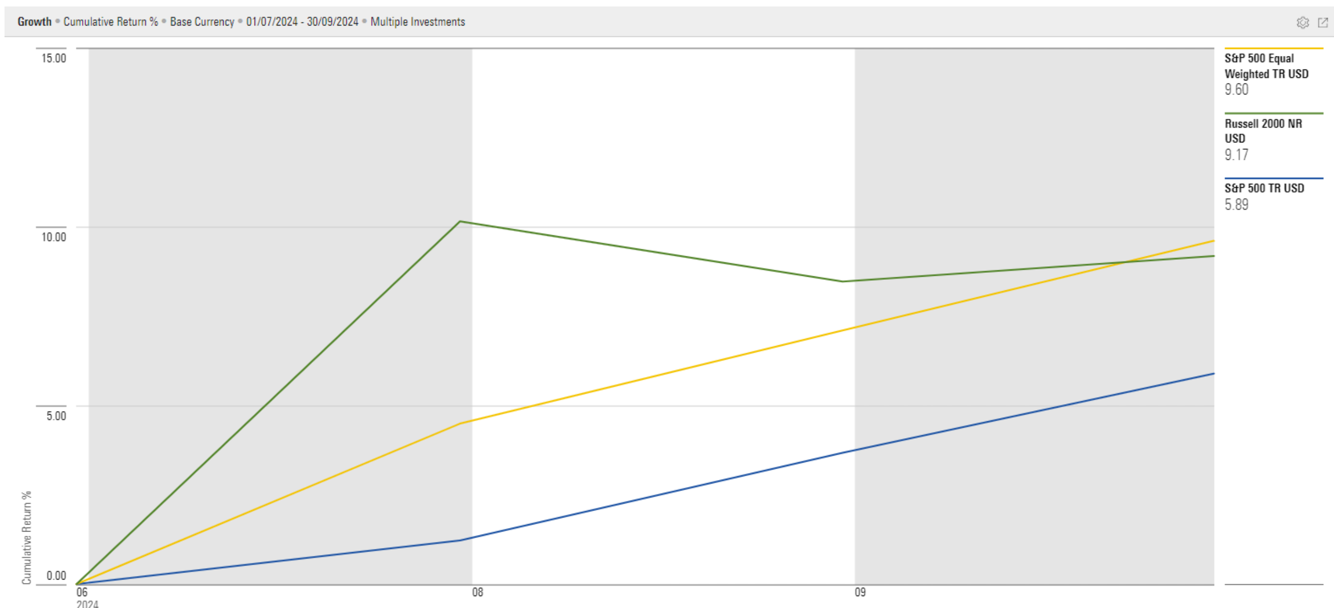
A larger than anticipated cut in US interest rates and a surprise fiscal stimulus package from the People's Bank of China (PBC) acting together with financial regulators, were the dominant themes during the month. September has a nasty habit of being difficult for equity markets and initially we saw them living up to that reputation, as they initially declined. However, the scale of the US rate reduction saw a complete reversal of fortunes there. One downside of this was the strength of the pound against both the dollar and euro, which dampens returns from assets priced in these currencies for sterling investors.

Fixed interest stocks continued to do well in portfolios, as the prospects for lower interest rates boosted their attractiveness, particularly in the US and Europe and currency risk in these markets is usually hedged out, so the full benefits were felt.

US

The US Federal Reserve ('Fed') finally cut interest rates and by a higher than expected 0.5%, as they attempted to navigate a 'soft landing' (i.e. avoid recession) for the US economy. Weaker jobs data of late probably helped to convince them to move a bit faster on interest rates, especially as the inflation rate continued to hover around their target rate of 2%, although subsequent comments from Fed officials seemed to indicate that the future pace of cuts would be slower. The Fed's own projections now seem to suggest that rates will be 2% lower than where they were before September's cut by the end of 2025.

At the stock market level, once again we saw the equally weighted S&P 500 outperform the market capitalisation weighted version (the former index is constructed so that each of the 500 stocks in the index contribute equally to returns, whereas the latter can be skewed by the impact of a few large companies). Indeed, both the equally weighted version and the Russell 2000 (small companies) index outperformed the S&P 500 over the quarter, which confirms that returns have widened out beyond the so-called 'Magnificent 7' stocks:



Source: Morningstar.

As previously mentioned, these returns were dampened by a stronger pound, although a partial hedge against this effect continues to justify its inclusion. We are now only a month or so away from the US Presidential Election and, as predicted, the result is likely to be determined by a small number of 'swing' states, so the result is difficult to call.

UK

The Bank of England's decision to keep interest rates on hold, coupled with uncertainty over the UK Government's future spending and taxation plans, served to keep both government bond yields higher and the pound stronger. The currency sensitive FTSE 100 struggled in comparison to the Mid-Cap weighted FTSE 250 index, which rose slightly over the month. The companies in the FTSE 100 index derive over 80 percent from their earning from overseas, so can suffer with a stronger pound, whereas mid and small-sized companies tend to benefit. With the budget on October 30th, it is widely expected to include significant changes to capital taxes and possibly fiscal accounting rules, so the bond markets are likely to be sensitive to any apparently unfunded policies.

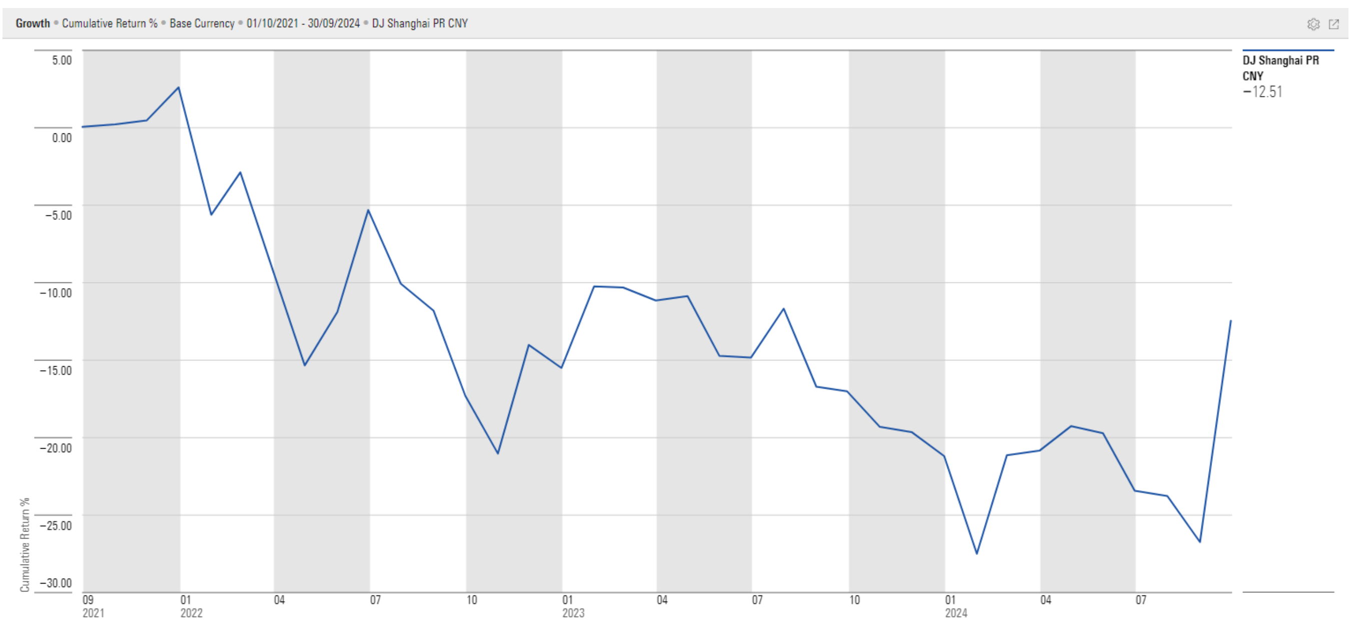
Japan

The appointment of an outsider as Prime Minister and his immediate announcement of a snap election, led to another bout of intra-month volatility. The new PM, Shigeru Ishiba, has been quite vocal in his demands for increases in corporation tax and has asked for a reset of defence relations with the US. Markets, therefore, worried about the impact on future corporate earnings. Meanwhile, inflation remains steady at 3% and although above the Bank of Japan's target, they seem to not be in a hurry to increase rates to counter this. This is perhaps understandable given the weakness of the domestic economy.

Asia and Emerging Markets

The PBC, together with regulators, surprised markets with a significant economic stimulus package designed to boost China's domestic demand, support the beleaguered property market and revive the stock market, which has been declining for three years now. The measures, which included lowering bank lending rates and setting up £53bn facility to support the equity market, certainly had the desired effect. Time will tell, but Chinese stocks rebounded meaningfully higher by the month's end and should have a positive knock-on impact in the pacific emerging markets region as a whole and several regional markets rallied over the month., although Korea and Taiwan were dragged lower by the waning AI trade globally. Growth in China fuelled by liquidity will naturally be good news for global growth and will be felt at portfolio level. A weaker dollar, if delivered, will also assist the emerging world. China's competitive edge remains lower prices which also helps suppress inflation in the west.

China's stock market gains from stimulus:



Source: Morningstar.

Outlook

Geopolitics is impossible to model within portfolios. Random events in the United States cannot be ruled out, particularly with 2 attempts to silence Mr Trump. Middle Eastern events are well publicised and need little further extrapolation, other than the potential impact on the oil price, which could negatively affect the global economy if the price continues to rise significantly. Likewise, the ongoing war in Ukraine. At portfolio level an important observation is linked with the fall in inflation and the impact that brings to the relationship between equities and fixed income. Fixed income typically acts as a stabiliser in portfolios, providing a cushion against equity price declines by reducing volatility. However, this relationship was disrupted in the past 2-3 years due to high inflation. Fortunately, the long-term stabilising role of fixed income is now returning to normal, which is a positive development. Portfolios have benefitted from the rise in valuations and the reduction in global interest rates. Returns are positive for the year, with the probability of further growth in sight, notwithstanding unforeseen events of a geopolitical nature. Prospects for a US recession is around 30% likely but globally the figure is higher, which does feel broadly accurate.

Rockhold Asset Management, with contribution from Alpha Beta Partners, Marlborough and LGT, October 2024

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