CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

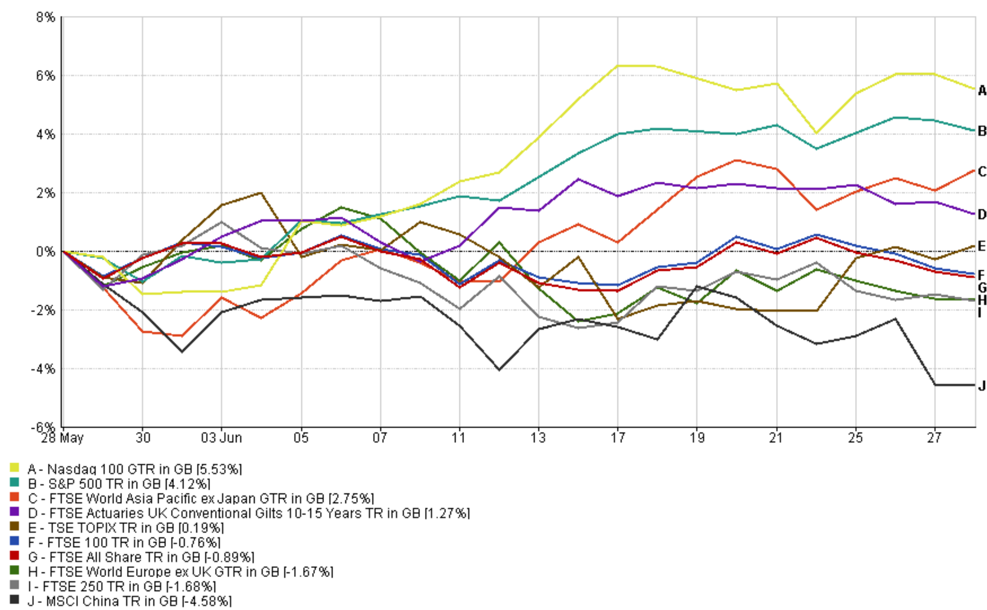
INVESTMENT COMMENTARY

28 JUNE 2024

OVERVIEW

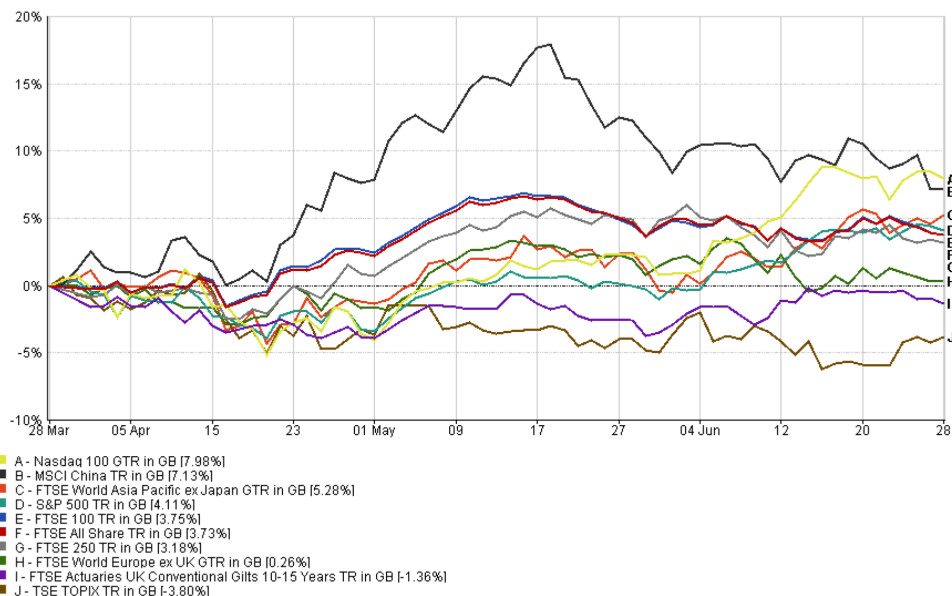
The last month has seen the NASDAQ 100 index, comprising mainly technology companies, and the broader S&P 500 index make exceptionally strong returns reaching new highs. Investors' appetite for shares in artificial intelligence (AI) related companies accelerated once again. Encouraging US inflation data was also supportive of sentiment as the market anticipated interest rate cuts later this year. Despite the European Central Bank (ECB) cutting interest rates, European markets were impacted by political uncertainty as a snap general election in France was called in the wake of EU elections showing a broad shift to right wing parties. The UK market also faced its own uncertainties ahead of the general election. After recovering to some extent over the earlier part of 2024 as economic data looked more positive, the Chinese equity market struggled as consumer confidence remained fragile and ongoing weakness in the property market weighed on market returns.

ONE MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



28/05/2024 - 28/06/2024 Data from FE fundinfo2024

THREE MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS

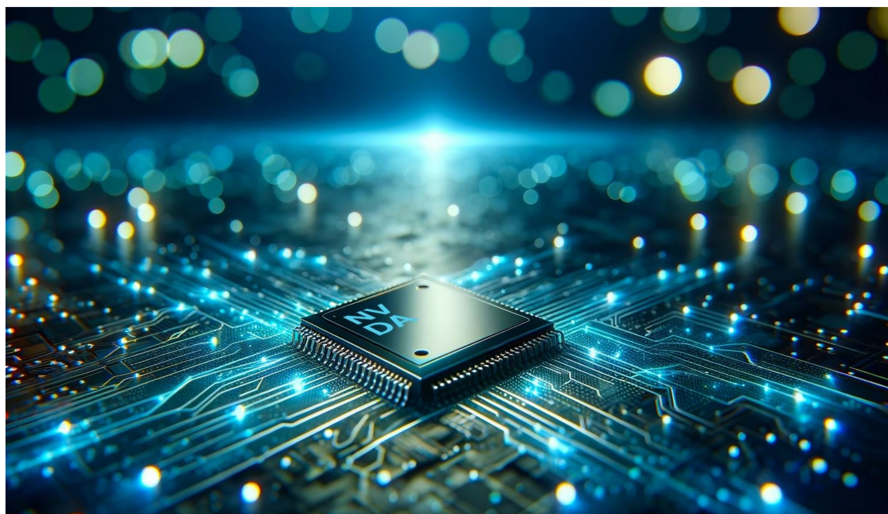


28/03/2024 - 28/06/2024 Data from FE fundinfo2024

US inflation has proved remarkably sticky and slow progress is being made towards the Fed's 2.0% target despite the sharp increase in interest rates over the last two years. In May, the annual inflation rate did unexpectedly slow to 3.3% pa from 3.4% pa in April 2024. Food, shelter and transport costs all fell whilst energy costs increased. Core inflation which does not include food and energy also fell. However, it is unlikely that the Fed will cut rates until such time that inflation falls to around 2.0% pa and looks set to stay at that level. The data relating to employment is mixed with the number of new jobs added to the economy remaining high but the unemployment rate has ticked up to 4.0%. Whilst, the services sector has been relatively strong, US economic growth has slowed to 1.4% pa in the first quarter. Against this backdrop, the US Federal Reserve (Fed) once again kept interest rates at a range of 5.25-5.5% for the seventh consecutive time. It is now expected that there may be just one interest rate cut this year – a far cry from the three or even four cuts expected at the start of 2024. Further cuts are predicted for 2025. The Fed believes that inflation will return to 2.0% in 2026 with the economy growing at 2.0% pa and unemployment peaking at 4.2% - currently the Fed sees a 'soft landing' for the economy.

This relatively benign outlook has been supportive of the US equity market. If interest rates are set to fall, the valuations of future earnings of growth companies should increase so underpinning their share prices. Lower interest rates will benefit corporates and consumers alike as borrowing costs decrease. We would expect to see equity market returns come from a broad range of companies which has not been the case recently.

We have discussed in previous investment commentaries, the impact of the performance of a small number of mega tech companies on the return of the S&P 500 index. Nvidia, for example, comprises around 7.3% of the index. Since the start of 2024, this one stock has increased by over 150% driven by the potential for growth in AI applications, in particular, for which Nvidia produces a key part of the underlying technology.



The European Central Bank (ECB) was the first of the major central banks to cut interest rates following its June monetary committee meeting. It cut its main deposit rate by 0.25% to 3.75% as expected. Inflation is still above target at 2.6% pa in May ticking up from 2.4% pa in April as energy prices picked up and services inflation increased. The ECB predicts that inflation will average out at 2.5% pa for 2024 and reach 1.9% pa in 2026. Christine Lagarde, President of the ECB, commented that the ECB is confident in the inflation forecasts which in part drove their decision to cut rates. However, economic growth remains fragile with the eurozone economy growing by 0.3% in the first quarter of 2024 after contracting over the second half of 2023.

The results of the European Parliamentary elections which saw right and far right parties perform well have led to uncertainty in the region and impacted on investor sentiment. In France, a general election was called with the policies of both the right and left wing parties possibly leading to weaker public finances and inflationary pressures.

UK GDP growth in the first quarter of 2024 has been revised up to 0.7% with the services sector relatively strong, whilst construction contracted over the period although by less than originally estimated. This was the strongest expansion in two years. Economic growth in April is expected to have flat lined. The Bank of England's Monetary Policy Committee (MPC) did not cut Bank Rate despite inflation, as measured by CPI, falling back to its 2.0% target in May 2024 from 3.2% in April. Falls in energy and food prices contributed significantly to the lower inflation level. Whilst stating that high interest rates had weighed on inflationary pressures and on economic activity and led to a looser labour market, the MPC pointed to other key indicators of inflation remaining elevated. Services inflation was 5.7% pa in May falling from 6.0% pa. A key driver of services inflation is wage growth which had eased to 5.8% pa in the three months to April 2024.

The Bank of Japan (BoJ) also kept its monetary policy unchanged with interest rates remaining at 0.1%. It is likely that the normalisation of monetary policy will be gradual with bond buying by the BoJ reducing over time and interest rates rising. The BoJ would have to be confident that its 2.0% pa inflation target would be sustained. Currently, core CPI is running at 2.5% pa which may prompt an interest rate rise. The Japanese economy contracted by 1.8% in the first quarter of 2024 due to the Noto earthquake and the suspension of some auto production. The yen continues to struggle against other currencies, particularly the US dollar, due to the vast differential in interest rates. The weak yen is supportive of Japan's exporting companies as their products and services are competitively priced. Japanese exports increased by 13.5% pa in May as a result. However, uncertainty about the future direction of monetary policy has weighed on investor sentiment of late.

Until the last few weeks, the Chinese equity market had shown signs of recovery as economic statistics pointed to stronger growth. However, recent data have shown weaker economic activity and continuing fragile domestic demand as growth in import levels fell. New home prices have continued to fall. The Chinese authorities had introduced initiatives to shore up the troubled property market but it appears that further measures may be required to restore confidence. Chinese inflation is muted with CPI increasing 0.3% pa in May 2024.

OUR VIEW

Compiled by Angela Cooper, MD - Investment Services.

Angela runs Cartlidge Morland's Investment Management team, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

Portfolio values have risen strongly over the past 12 months – but most of the return has been earned since October 2023, when as earlier predicted in our Investment Commentary, a turning point came in the outlook for inflation rates in the developed economies and scope for interest reductions during 2024 becoming apparent.

Getting inflation down to the central banks' consensus target of 2.0% pa has taken slightly longer than anticipated in UK/Europe and having progressed fastest in initially curbing inflation, the US is now the laggard. This said, the ECB has now cut interest rates and the Bank of England seems likely to follow in August. A September rate cut by the US Federal Reserve is now widely forecast too, following May's improved inflation figures.

No sane analyst is anticipating a return to rock bottom interest rates. The financial system is normalising and a graduated return to core rates in the order of 3.5% to 4.0% is widely predicted, with the UK at the top of that range. Although this is lower than businesses and householders are presently tolerating it is far higher than they had grown used to. The point is that with inflation under control, rates are in reverse rather than rising to unpredictable highs as was the case eighteen months ago.

Political leaders are now chorusing the need for stronger economic growth as only the taxes resulting from it can curb spiralling public sector deficits and national debt to GDP ratios. The temptation is the Keynsian remedy of public sector 'investment' to stimulate wider economic growth already being applied widely in the EU and the US. In the US, it has certainly worked by maintaining a conspicuously impressive rate of growth but there is no sign of improvement in the federal fiscal position, which continues to deteriorate. Europe and the UK cannot afford the same largesse, their public services/welfare/pension/healthcare systems consume ever greater proportions of GDP and have a propensity to consume most public sector 'investment' without adding to productivity. As demonstrated by France (public sector expenditure now amounts to 58% of GDP) where bond markets are becoming rattled, major European economies need to stimulate expansion, without incurring burgeoning public sector deficits.

This said, manufacturers and business services providers should prosper from higher public sector spending as we have witnessed in the US. They can certainly benefit from lucrative government contracts – as indeed shareholders can too*. What may be bad for the public finances – and ultimately those paying taxes – can be good for business and shareholders. It seems to us that a return to growth is likely to be driven by fiscal stimulus (higher taxes yes, but even higher public spending) and by monetary stimulus (lower interest rates). It will be good for businesses, many of which pay little tax in the countries from which they derive their profits, and inevitable of variable value to the taxpayer/public finances internationally.

**It is no coincidence that defence contractors such as Rolls Royce, Babcock and BAE Systems have seen transformational increases in their share prices, nor that some of the smaller contractors have been taken out at a premium.*

This investment commentary is written ahead of the UK General Election. The impact of the newly elected administration will take time to assess given the lack of detail in party manifestos. The election in France brings uncertainty with it as does the outcome of the US Presidential election in November.

We are long term investors seeking to invest in a combination of high quality active funds and some passive exposure. Asset allocation is reviewed regularly. Our portfolios are diversified by asset class and region although we have a heavier weighting in UK equities given the predominance of sterling based clients. We have increased US equity exposure over time and introduced specific technology exposure into portfolios, risk parameters permitting, more recently. With the normalisation of monetary policy, we have taken opportunities to rebuild lower risk asset allocations through fixed interest assets offering attractive yields. We believe that interest rate cuts will be forthcoming in developed economies, with the exception of Japan, which should support investor sentiment. We had expected cuts to be made earlier in the year, but above target levels of inflation around the world proved to be stickier than most investors expected which has seen positive sentiment dissipate to some extent in recent months.

If you have any queries please do not hesitate to contact your Cartlidge Morland consultant.

CARTLIDGE MORLAND

83-85 Mansell Street London E1 8AN **t:** +44 (0)20 7709 5560 **e:** enquiries@cartlidgemorland.com **www.cartlidgemorland.com**

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