CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

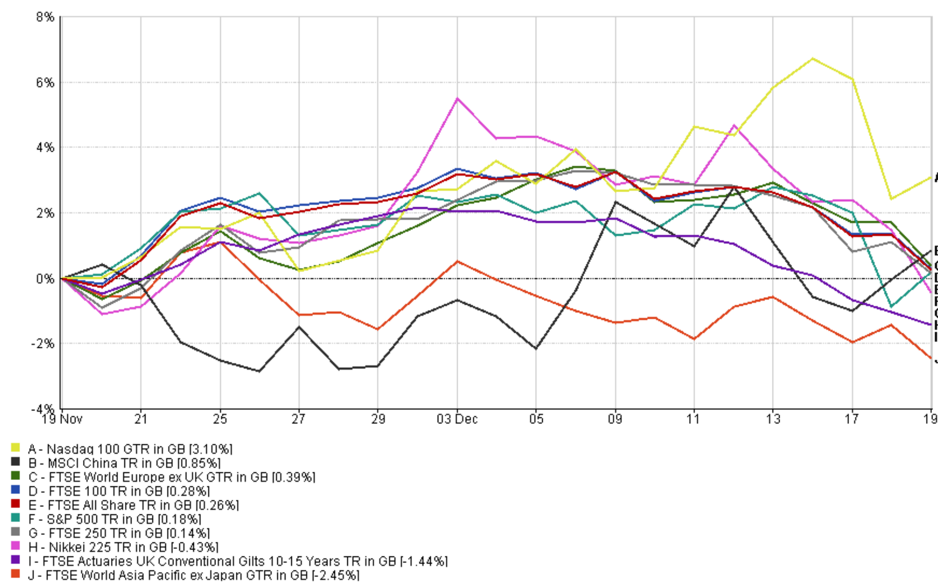
INVESTMENT COMMENTARY

19 DECEMBER 2024

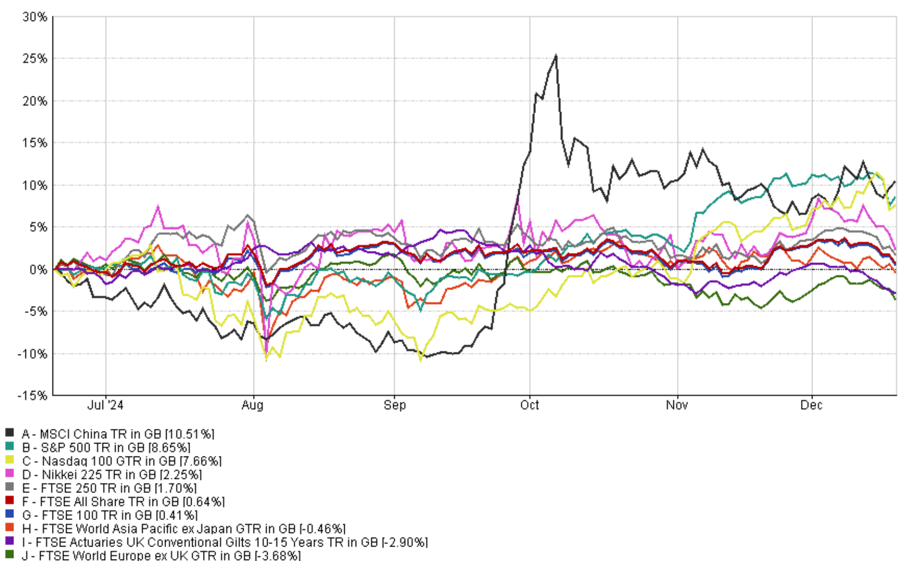
OVERVIEW

Since the result of the US Presidential Election in early November, the US stock market had been performing well. The prospect of President-Elect Trump's pro-growth stance had been highly supportive, as it was following his election in 2016. Again the Magnificent 7 led the market, reflected in the sharp rise in the NASDAQ 100, as investors renewed their enthusiasm for the benefits of artificial intelligence (AI). The share prices of Amazon, Alphabet, Meta and Tesla reached record highs. Other equity markets made positive returns against this backdrop although the lack of detail surrounding China's stimulatory fiscal and monetary policies dampened sentiment in the Asia Pacific region. However, as we have seen many times before, the interest rate decision and supporting comments following the latest meeting of the US Federal Reserve (17/18 December) had a significant impact on markets - the result has been falls in global equity markets in recent days.

ONE MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



SIX MONTHS INVESTMENT MARKETS STERLING TOTAL RETURNS



The US Federal Reserve (Fed) cut the Fed Rate by 0.25% to a range of 4.25-4.50% - the third reduction this year. Normally a cut would be well received by markets but not this time; markets were surprised by the accompanying hawkish message from the Fed. Three or four further interest rate cuts were expected in 2025 but the Fed's forecast is now for two cuts of 0.25% each. Jay Powell, the Chair of the Fed, commented that policy makers would be more cautious when considering further monetary easing. The core personal consumption expenditure price index (PCE), the Fed's preferred inflation measure, rose by 2.8% pa in October which is above the Fed's 2.0% target. There has been some weakness in the jobs market with initial unemployment claims jumping to a two month high whilst continuing claims rose indicating that it was taking longer for workers to find jobs. The unemployment rate increased to 4.2%. The Fed is now taking into account President-Elect Trump's policies including tax cuts, lighter regulation, increased tariffs and immigration controls in its forecasts. These polices are likely to drive prices higher whilst inflation still remains above target.

The European Central Bank (ECB) also cut interest rates by 0.25% with its key deposit rate lowered to 3.0%. The eurozone inflation rate increased to 2.2% in November from 2.0% in October – so remaining around target. Eurozone economic growth is weak so lower interest rates should be supportive. The ECB looks likely to cut rates further into 2025, stating that rates will be kept "sufficiently restrictive for as long as necessary". The ECB lowered its outlook for growth and inflation.

The Bank of England (BoE) maintained Bank Rate at 4.75% at its December meeting as inflation increased for the second month running to reach 2.6% in November, from 2.3% in October. Worryingly UK wage growth, a key driver of inflation, increased to 5.2% pa in November having been steadily falling in recent months. The BoE is likely to proceed cautiously in 2025 with further interest rate cuts expected but perhaps fewer than anticipated whilst inflation remains above target – in particular services inflation which is currently 5.0% pa. The UK economy is weak with growth contracting by 0.1% in both September and October. The BoE is facing the dilemma of above target inflation coupled with anaemic growth – so possibly a period of 'stagflation'.

The Bank of Japan (BoJ) is likely to continue to normalise its monetary policy with further interest rate rises expected, after decades of historically low rates. However, it maintained short term interest rates at its December meeting at 0.25%. A rate rise was expected at its January 2025 meeting but the BoJ Governor commented that further details of Japanese wage growth and the impact of President-Elect Trump's policies, would be required ahead of future decisions. The Japanese economy grew 0.3% in the third quarter of 2024 with business confidence improving. The annual inflation rate fell to 2.3% in October. The BoJ expects economic growth of around 1.0% pa in each of the next two years.

The Chinese authorities changed their monetary guidance for the first time in 14 years, moving from "prudent" to "moderately loose" in 2025. They have also stated that they would be more pro-active on fiscal policy and would stabilise the property and stock markets. Such stimulatory measures would be welcomed and drive the Chinese and Asian Pacific regional equity markets higher as they would also provide support for the struggling Chinese consumer. Investors are now waiting to assess the details of these monetary and fiscal measures. However, the Chinese authorities may delay announcements until after Donald Trump becomes President, so that the impact of any changes in US trade tariffs and policy can be assessed.

The US equity market performed well in anticipation of President Elect Trump's growth policies. Prior to the latest Fed meeting, the NASDAQ had risen over 7% in a month in Sterling terms. The Fed has now dampened expectations of further rate cuts and it would appear that investors decided to take profits against this backdrop. Business confidence has increased dramatically as interest rates have fallen and inflation tamed. Economic growth continues as does government spending on infrastructure. Although impacted by the recent Fed hawkish stance on interest rates, smaller companies, in particular, should benefit from domestically focused government policies.

European equity markets have struggled over the last few months as European economic growth remained lacklustre. The luxury goods companies such as LMVH, have been hard hit by the weakness of the Chinese consumer. European car manufacturers have also lagged as developments in EV have been slower than their Chinese counterparts. ASML, which supplies the semi conductor industry and is one of Europe's largest companies, has fallen in value as there have been margin pressures on some of its systems, whilst US export restrictions on shipments to China are viewed negatively.

The UK equity market had seen improving performance largely driven by positive sentiment in the US. UK companies with exposure to the US such as financials and cyclicals had benefited. The October Budget has led to continuing weakness in the domestically oriented mid and small cap parts of the equity market which are more impacted by the increase in employer's National Insurance Contributions, as well as in the living wage level (hospitality and retailers in particular). The recent downgrading of UK growth prospects by the BoE and retail sales looking more fragile than expected have seen equity market sentiment deteriorate lately.

Sentiment towards the Japanese equity market has improved after the volatility during the Summer. The outlook for the domestic economy remains positive, whilst corporate governance improvements are ongoing. Companies are spending to improve their productivity, whilst individuals are encouraged to invest in the new NISA (Nippon Individual Savings Account).

Gilts (UK government bonds) have made experienced negative capital returns recently, with gilt yields moving higher in the aftermath of the October Budget. Increased government spending will lead to higher borrowing, potentially rising inflation and eventually lower economic growth over the medium term, although an exceptional boost to shorter term growth is likely.

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

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.

President-Elect Trump's pro-growth policies should provide support to the US economy and corporate America. We have increased our US equity exposure across our portfolios, risk permitting, given this background. UK and European equity positions have been trimmed to cater for this higher allocation, but these markets still appear considerably undervalued by both historic and current US standards. The UK equity market offers extremely sound value with its return potential supported by high dividend yields and share buy backs. Additional US equity exposure is also obtained from our technology fund/ETF positions. The yields from gilt funds look attractive at around 4.4%. If the UK economy does weaken, we may see more interest rate cuts than currently priced in, which should support further capital growth.

The fortunes of developed Western markets will be heavily influenced by policy decisions and outcomes in the US. Amidst a continuing political vacuum in France, Germany and (therefore) the EU, markets are likely to take their cue from US newsflows. Any recovery in Chinese consumer demand will provide an obvious boost to the European luxury goods and automotive sectors. European/UK pharma is also a strong sector globally, with the Chinese increasingly inclined to allow access to branded US/European pharmaceuticals in preference to domestically manufactured generic medicines which have often breached patent protection. The growing willingness of Western pharma to manufacture in China has encouraged greater compliance.

Tariffs are blunt instruments, with their imposition tending to also have detrimental consequences for the nation imposing them. President Trump believes global terms of trade to be weighted against US business and is demanding a level playing field. His argument is not without justification – the US is a huge net goods importer and the benefits its companies derive from a comparatively open US domestic goods market is questionable. It seems more likely that tariff barriers will be carefully considered prior to their being erected – rather than arbitrarily and rashly imposed, as the President-Elect's campaign rhetoric suggested. UK, European and Japanese goods exporters may have less to fear than has been suggested.

As we have alluded to previously, the US has acquired freshly increased hegemony in the global economic system and the rest of the world is yet to find a method of catching up. Economically, the US currently appears far less troubled than UK/Europe/Japan – but it will be wise to keep in mind the soaring US Federal deficit, which is likely to rise further – and upon which much of recent US economic success has depended. US consumers have spent their COVID savings and 'chickens may come home to roost' if President Trump's policies stoke inflation and interest rates have to rise. UK/European and Japanese consumers are cash rich and have vast potential to spend more – meaning there remains a source of stimulus beyond government borrowing. The 'tortoises trailing the hare' still have their fundamental underlying strengths and although we have responded to current conditions with increased US exposure, we are unwilling to take the risk of weightings to levels suggested by global investment indices. Opportunities and risks must remain properly diversified.

We take this opportunity to wish all our clients a very Merry Christmas and send our best wishes for 2025.

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