QUILTER CHEVIOT

Market commentary April 2024

Global stock markets have begun 2024 in much the same vein as they ended last year, with the first quarter seeing sizable gains in US and continental European equities. The MSCI AC World index returned 9.5% in the first quarter, in sterling terms. The persistence of the rally since October is all the more pleasing given that in recent months there has been a significant paring back of market expectations for interest rate cuts this year. This shift has capped the upside for fixed interest investments with gilt benchmarks returning -1.8% year-to-date.

US equities have been at the forefront of the advance over the last six months, powered by a robust labour market, strong economic growth and continued exuberance surrounding Artificial Intelligence (AI) stocks. Inflation has levelled off after falling substantially from its peak, with the US consumer price index (CPI) showing a 3%-4% range in annual terms for the last 10 months.

Compared to a peak of 9.1% in 2022 this is undoubtedly good news, although the stubbornness with which this measure has steadfastly remained above the Federal Reserve's 2% target explains why we are yet to see an interest rate reduction. This environment has helped Gold perform well of late, rising 8.1% on the quarter in sterling terms and hitting record highs in US dollar terms. The oil price is often also discussed when inflation talk arises and international benchmark Brent crude has jumped 21% year-to-date rising back near the US$90 a barrel mark.

That said, of late the market's driving force appears to be less of a laser-like focus on monetary policy, and more of a heightened sensitivity to gauges of economic activity supportive of a soft landing. There were widespread forecasts of the damage that such steep increases in central bank base rates would wreak upon economies, but it is now over two years since the Federal Reserve (Fed) and Bank of England (BoE) embarked on their aggressive tightening policies and economies have fared far better than feared. The US was the world's fastest growing advanced economy in 2023, delivering 2.5% GDP growth.

US stocks continued to outperform in the first three months of the year, with the MSCI North America index gaining 11.4%, in sterling terms. The volatility index has fallen in recent weeks to trade close to its lowest levels since the pandemic, pointing to sanguine market conditions despite the shift in interest rate cut expectations and sizable political risk on the horizon.

Past performance is no guarantee of future returns.

Approver: Quilter Cheviot Limited 8 April 2024

While the UK slid into a shallow technical recession in the second half of last year, the economy managed to eke out 0.1% GDP growth for 2023. The Eurozone similarly struggled to grow, registering 0.5% 2023 GDP growth, but given the bleak projections due to sharply higher interest rates the fact economies are not significantly contracting can be viewed as a positive development.

This has been a blessing for central bankers. Having found themselves stuck between a rock and a hard place a couple of years ago – with surging inflation and the spectre of deep recessions brought on by their sharply higher interest rates – rate setters are now in a much more comfortable position. Economies avoiding sharp contractions without the need for monetary support has allowed central bankers to bide their time, letting the current, restrictive interest rate levels continue to apply downward pressure on inflation. Should economic activity deteriorate substantially, central bankers are now poised in a position where they can act swiftly, having kept their powder dry thus far. The Fed has now been on hold with a funds rate of 5.25%-5.50% since June while the BoE has maintained its base rate of 5.25% since August, a 22-year high and a 16-year high respectively.

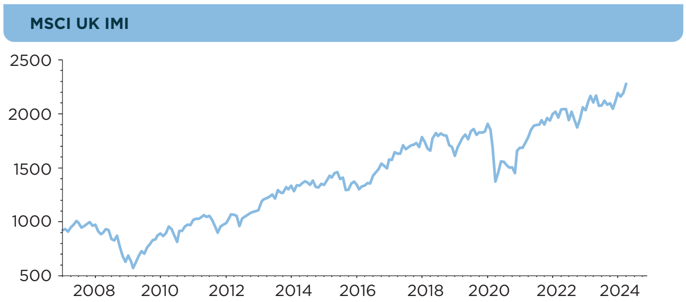
Are UK stocks cheap?

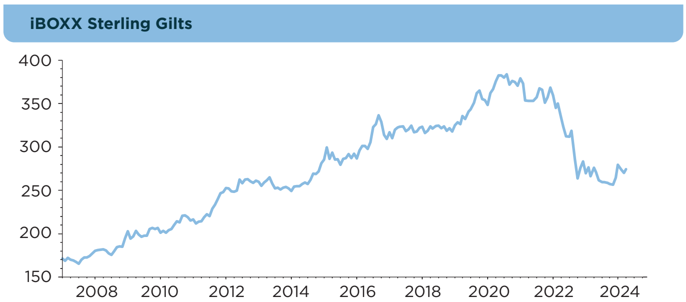
The underperformance of UK stocks has been a prevailing theme of the stock market rally since October. UK stocks lagged their peers during the quarter, delivering a 4.1% return while Europe ex UK delivered 7.0%.

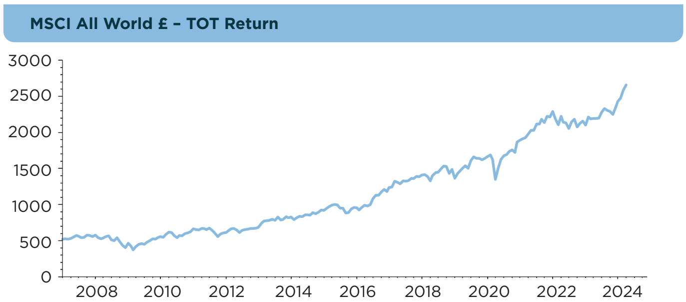
While US, continental European and Japanese equities have all enjoyed strong moves higher, the UK has struggled to keep pace. This has left London-listed companies trading at near record discount levels compared to Wall Street counterparts.

Several prominent trends in recent years go some way to explaining this gap; investors have become increasingly fond of growth stocks compared to value stocks. They have demonstrated a greater preference for US equities and they have also shown more desire to own larger companies at the expense of smaller ones — even if the ten largest US companies are removed, the average US large-cap stock is twice the size of UK equivalents.

We believe current relative valuations between the UK and US, while justified in part, are becoming stretched. We see plenty of opportunities in the UK market and consider several stocks cheap on a number of metrics.







Source: Refinitiv Datastream 04/04/2024

Fixed income outlook

Overall, we believe the backdrop for bonds is favourable with inflation falling and central banks likely to start cutting rates later this year. Resilient US growth and elevated levels of debt issuance are possible headwinds for the market, but for now we maintain our modest overweight duration view. We also believe that with credit spreads approaching post-Covid lows, there is not a sufficient pick-up over sovereign debt on offer to take on additional risk, and we maintain our underweight view.

Richard Carter
Head of Fixed Interest Research, Quilter Cheviot

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Quilter Cheviot
Senator House
85 Queen Victoria Street
London EC4V 4AB
+44 (0)20 7150 4000

To find out more please contact your investment manager or email: marketing@quiltercheviot.com

quiltercheviot.com