Investment Outlook

A monthly round-up of global markets and trends

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Balancing growth and inflation

Global economic growth continues to be resilient, providing a backbone of support for companies to deliver on analysts' earnings expectations. The J.P. Morgan Global Composite Purchasing Managers' Index, a lead indicator for Gross Domestic Product (GDP), covering both manufacturing and services, shows evidence of gathering steam in January. It reached a level that is consistent with global real GDP growth of 2.8% and has steadily improved over the last few months.[1]

In short, economies have been able to defy the pessimistic expectations from a year ago due largely to healthy job creation as firms continue to replace workers that left the workforce during the Covid pandemic. US demand for available workers (employed plus job openings) is running around 2 million higher than the supply of workers (employed plus unemployed).[1] This points to a healthy jobs market and increases the likelihood that the US can avoid a recession.

A key risk for financial markets is that rapid growth rekindles inflationary pressure and central bankers reconsider their intentions to cut interest rates. Although in the Monetary Policy Committee's (MPC) last interest rate setting meeting, some Bank of England (BoE) observers noted that inflation could drop below 2% in spring, enough to warrant an interest rate cut.[2] Indeed, the BoE removed its tightening bias and shifted to a more neutral setting by arguing that risks were "more evenly balanced".

However, elevated wage growth is still a concern for the hawks on the MPC. The Bank's annual Agents Survey expects wages to expand by 5.4% in 2024, which is above the latest 4% rate of consumer price inflation in January.[2] Should wage data come in stronger than expected it could lead to upward, cost-push pressure on prices. Under that scenario investors could have to wait until later in the year for interest rate cuts.

Wage inflation is less of a problem for the US central bank. The comprehensive Employment Cost Index (ECI), which includes wages, bonuses, and benefits for US civilian workers, grew 4.2% in the fourth quarter of 2023 from a year ago. This is down from a peak of 5.1% in the second quarter of 2022. Importantly, the number of workers quitting their jobs to look for better paid opportunities has steadily fallen over the past year. As a lead indicator for the ECI, the quit rate suggests that the risk of an upward spiral in overall compensation rates has likely eased. Given that consumer inflation is getting close to its 2% target rate, the Federal Reserve will probably feel confident to begin an interest rate cutting cycle in the coming months.

Overall, investors are becoming a little more comfortable that central banks can balance growth and inflation. Given the economic backdrop is relatively benign, the pressure could be on firms to exceed, or at least meet, market expectations for company earnings, and particularly for large-cap stocks.

Size matters for earnings delivery

The Magnificent Seven companies (i.e. Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) have become a dominant proportion of equity benchmarks. This group currently accounts for 29% of the S&P 500 by market capitalisation and were responsible for around 60% of the returns achieved by the index in 2023.[3]

These Magnificent Seven stocks generated significant net income to enable them to outperform the equity benchmark last year. However, this year has been a different story, as only four of the seven names are currently outperforming the S&P 500. This recent earnings season could hold some clues as to why. Nvidia and Meta have been the biggest drivers of returns so far in 2024, as both companies beat analysts' estimates and posted strong earnings figures for the fourth quarter of 2023. Take Nvidia, a company that is best known for designing some of the world's most advanced computing chips. It has seen its earnings for the most recent quarter increase by over 450% compared to 12 months prior.[3]

This rapidly increasing demand for chips is due to firms implementing Artificial Intelligence (AI) into their businesses, as advanced chips are essential to accelerating AI-led processes. This bumper earnings report saw Nvidia's market capitalisation increase by over $275 billion on the day following its latest earnings announcement, the largest daily increase in market value for any listed company ever.[3]

In contrast, Tesla has been the worst performer of the group this year. It was the only member of the Magnificent Seven to miss on analyst earnings expectations in the fourth quarter and has since seen large downward revisions to its earnings growth outlook. Falling profit margins have hindered the electric vehicle maker's profitability. This could be in part due to recent price cuts implemented to stay competitive against rival Chinese electric vehicle manufacturers. With this constrained earnings outlook and considering that they're the only member with a market value below $1 trillion, it might be time to reassess their membership of this exclusive club.

To summarise, the macro environment remains supportive for company earnings, and particularly for large cap stocks to drive the overall market. However, there are still risks. Analysts have already forecast strong earnings outlooks for most of these Magnificent Seven companies over the next five years and valuations have been bid up. The risk is this group of stocks fail to achieve these elevated expectations. Given the Magnificent Seven make up a decent chunk of the US (and global) stock markets, should they miss their earnings forecasts it would likely prove a headwind for stocks overall. Nevertheless, on balance, solid economic growth and lower inflation means this risk is probably manageable.

Sources:

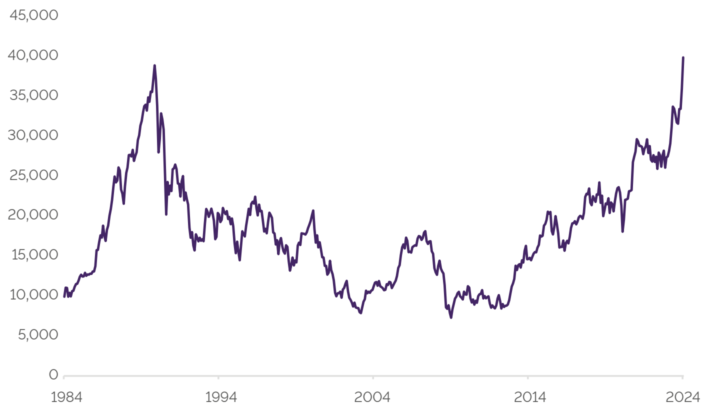
1. Starting the year with solid momentum, J.P. Morgan, 5 February 2024
2. BoE, Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 31 January 2024
3. LSEG Datastream/Evelyn Partners

Market highlights

Equities

A weak Yen, alongside recent corporate governance reforms, boosted Japanese equities, which performed strongly over the last three months. The Nikkei 225 benchmark index set a new all-time high - the first since 1989. When the Yen weakens, Japanese exports become cheaper, and this helped Japanese companies achieve the strongest upward earnings revisions of any of the major regions during this reporting period, with these earnings surprises helping drive share prices higher. Additionally, a weaker currency can also increase the relative attractiveness of Yen denominated assets, which become relatively less expensive compared to assets priced in other currencies, prompting further investment flows to the region.

Japanese Equity Performance, Nikkei 225 (Yen)



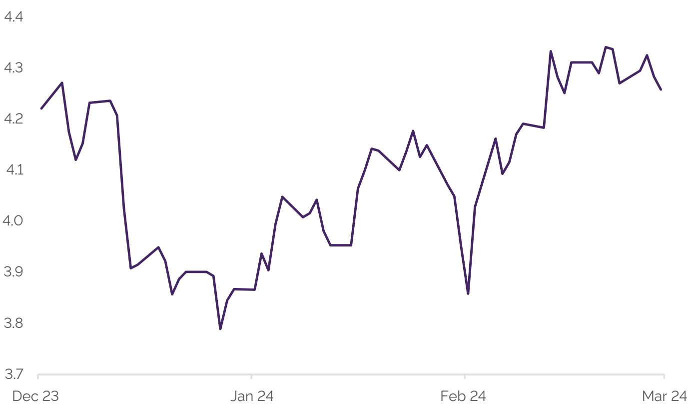
Source: LSEG Datastream/Evelyn Partners, data as at 29 February 2024

Past performance is not a guide to future performance

Fixed income

Market interest rate expectations for the US have moved substantially over the last three months. At the start of 2024, futures markets anticipated the Fed would start cutting rates in March and make at least six 25 basis point rate cuts this year. Since then, optimism has been reined in with markets now expecting the base rate to end 2024 at around 4.5%, with the first of these cuts now expected to materialise in June. This change in interest rate expectations meant a volatile period for fixed income so far this year. Yields, which had moved lower in December, increased as rate cut expectations were pushed back. The 10-year treasury bond yield had fallen to 3.8% at the end of December but it ended the three-month period just above where it started (yields move inversely to prices).

US 10-year treasury yield (%)



Source: LSEG Datastream/Evelyn Partners, data as at 29 February 2024

Current or past yield figures provided should not be considered a reliable indicator of future performance

Currencies and commodities

Higher US treasury yields over the last two months proved to be a headwind for the Japanese yen - it depreciated to 150 Yen per US dollar for the third time in two years. Prior to this, the Yen had not breached 150 in over three decades. The key driver is that Japanese government bond yields are significantly lower than other developed markets. This is due to the Bank of Japan's yield curve control policy, which involves buying government bonds to keep yields artificially low, in a bid to stimulate the economy. With treasury yields moving higher, the rate differential between US and Japanese government bonds widened. This led investors to sell the Yen in favour of other currencies, such as the US dollar, where they can take advantage of higher interest rates.

Japanese Yen to US Dollar exchange rate

Source: LSEG Datastream/Evelyn Partners, data as at 29 February 2024

Past performance is not a guide to future performance

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	5.0	10.1	18.4	77.6
MSCI UK	0.7	3.2	0.9	30.9
MSCI UK Broad	0.4	3.5	0.7	26.5
MSCI USA	6.1	12.1	25.1	108.9
MSCI Europe ex UK	2.7	7.6	10.8	62.5
MSCI Japan	3.7	12.6	21.9	52.0
MSCI Asia Pacific ex Japan	1.2	5.9	-2.6	21.8
MSCI Emerging Markets	5.5	3.9	4.5	17.7
Bonds				
iBoxx GBP Gilts	-1.3	2.0	0.6	-17.3
iBoxx USD Treasuries	-0.7	1.9	-2.2	5.8
iBoxx GBP Corporate	-0.6	3.1	6.4	0.7
Commodities and trade-weighted currencies				
Oil Brent Crude ($/barrel)	2.3	3.8	-0.3	26.9
Gold ($/ounce)	-0.1	0.4	12.0	55.5
GBP/USD	-0.7	-0.1	4.5	-4.9
GBP/EUR	-0.3	0.7	2.4	0.1
EUR/USD	-0.4	-0.8	2.0	-5.0
USD/JPY	2.4	1.2	9.9	34.5

Past performance is not a guide to future performance.

Market commentary

February was a strong month for equities with the MSCI All-Country World index gaining 5%, driven largely by the US, which gained 6.1%. Robust company earnings, particularly from AI related companies, helped drive the region higher. It was also a good month for Emerging Market equities thanks to a rebound in the Chinese stock market, which has struggled in recent years. The UK was the laggard for the month as weak domestic growth and a lack of exposure to the rallying tech sector led to underperformance. Fixed income markets struggled as investors continued to push their expectations for interest rate cuts further out into 2024. Crude oil gained 2.3% on the month with concerns growing about tensions in the Middle East. Gold ended the month almost flat, remaining close to all-time highs.

Key macro data	Latest	2024 Consensus forecast	Spot rates	29-Feb	Yields (%)	29-Feb
UK GDP (YoY%)	-0.24	0.40	GBP/USD	1.27	MSCI UK	4.03
UK CPI Inflation (YoY%)	4.00	2.50	GBP/Euro	1.17	MSCI UK broad	3.95
Bank of England Base	5.25	4.30	Euro/USD	1.08	10 Year Gilt	4.12

The market commentary, values and charts as at 29 February 2024. Total returns in sterling. Returns are shown on a total return (TR) basis ie including dividends reinvested (unless otherwise stated). Net return (NR) is total return including dividends reinvested after the deduction of withholding tax. Source: LSEG Datastream/Bloomberg

Sources

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