eden park INVESTMENT MANAGEMENT

POWERED BY HYMANS ROBERTSON INVESTMENT SERVICES

Eden Park | Hymans Robertson Investment Services (HRIS)

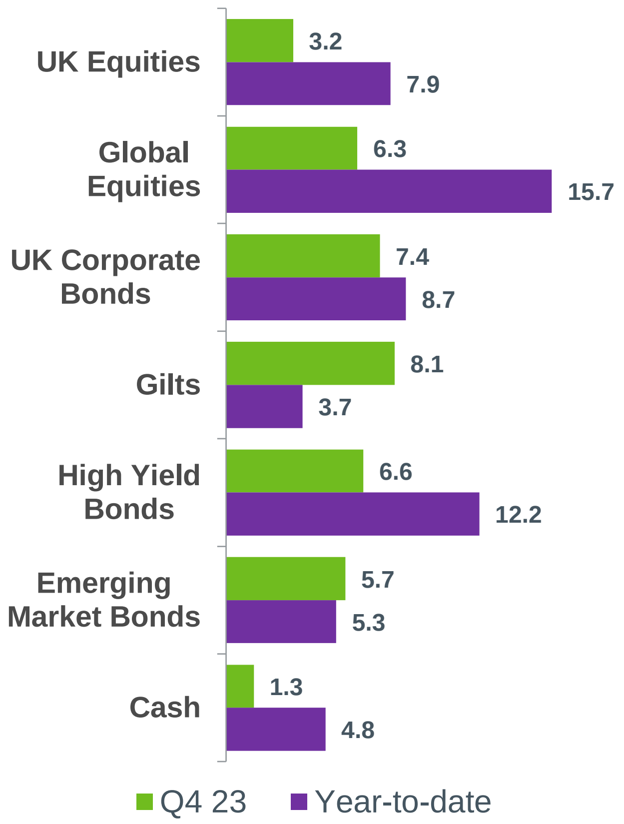
Market Digest

Q4 2023

Quarterly Highlights

- All asset classes performed strongly over Q4 2023 as positive sentiment drove equity and bond prices higher. Global equities generated 6.3% over the quarter and ended the year up over 15%.
- Better than expected inflation data from the US, UK, and euro-zone, as well as talk of rate cuts from the Federal Reserve (Fed), helped support the asset rally. UK inflation fell by 2.8% to 3.9% in the three months to November.
- The Bank of England held interest rates level at 5.25% throughout the quarter.
- Given these market conditions, portfolios generated a positive absolute return over the quarter.

Asset class returns (%)



Source: Morningstar. Figures to 31 December 2023. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds..

Market summary

- Our model portfolios are typically invested in a combination of the asset classes shown in the left-hand chart.
- Markets ended the year on a high, with strong performance for most asset classes, especially in the final few weeks of the quarter. A shift in rhetoric from the Fed, that raised hopes for interest rate cuts in 2024, accompanied positive data showing inflation falling faster than expected.
- Global equities were boosted by the strengthening of the 'soft landing' narrative - where inflation falls back to target without a significant slowing of the economy. US and European equities performed well but the UK lagged as weaker energy prices and a strong pound acted as headwinds for the FTSE.
- In the UK, inflation continued to fall, and faster than expected. Despite this, the Bank of England, unlike the Federal Reserve, opted against giving much of an indication as to when interest rates may start to fall.
- The expectation of lower interest rates in 2024 lowered bond yields which helped to generate a broad rally for bonds (bond prices increase as yields fall). Gilts, which had been performing poorly earlier in the year, were one of the strongest performing asset classes over the quarter.
- Cash returns on money-market funds remained stable at around 5.25% p.a. following the Bank of England's decision to hold rates, and therefore lagged behind other asset classes.
- At a portfolio level, equities and bonds both performed strongly meaning higher and lower-risk portfolios produced similar returns.

Outlook and topical market themes

- A new year brings new areas of focus for investors including growth prospects, cash rates, and elections.
- Markets are focusing heavily on the path of interest rate cuts. The Fed's latest interest rate projections showed they expect to make 0.75% of cuts in 2024.

What investors should expect in 2024

As we bring in a new year, investment matters that investors should pay attention to include:

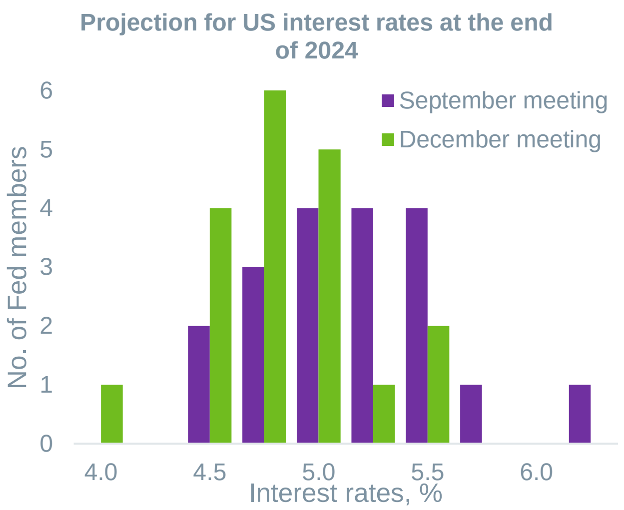
1. Inflation and interest rates remaining top of investors' agendas, but growth prospects will also come into focus.
2. The expected fall in cash rates will likely reduce the attractiveness of money-market funds.
3. Elections having the potential to increase short-term volatility.

For further information on these three topics plus more, please see our recent article on these.

Change in tone from Federal Reserve has boosted market optimism

The fourth quarter of 2023 was already looking healthy in terms of performance leading up to the Federal Reserve's ("the Fed") meeting on 13th December. Although there was no change in interest rates, the meeting showed the impact forward guidance from central banks can have. A change in tone from the Fed chairman, who no longer pushed against the market's assumption of several rate cuts in 2024, had just as much an impact as other meetings where changes to interest rates have actually taken place. Investors also took notice of the Fed's updated "dot plot". This illustrates each Fed official's projection for interest rates over various timeframes. The latest data showed the Fed expects to cut interest rates to 4.75% by the end of this year (see chart below). Investors jumped on this shift with exuberance and themselves priced in cuts all the way to 4.0%. Whether there will be as many cuts as the market expects is uncertain, but it looks increasingly likely that the next move from the Fed will be downwards and could be as early as Spring.

Chart of the month - Members of the Federal Reserve expect more cuts in 2024



Source: Federal Reserve

The Fed updated their projections for interest rates in December. The new projections showed a more pronounced consensus for three rate cuts over 2024 from the current 5.5% rate, (6 members believe rates will end the year at 4.75%) marking a significant shift compared to September.

It's important to note that even the Fed's projections normally don't come to fruition. What this does highlight though, is that the Fed is more open to cutting rates sooner rather than later.

Jack Richards
Investment Manager, HRIS