Atkins Bland

Economic & Market Commentary

Q3 2024

Quarter to 30 September 2024

Markets bide their time

Not much has happened in terms of either economic outlook or the geopolitical background since our last commentary, as at 30th June.

Back then we looked at the potential impact of a Labour government, the looming US election and the ongoing hostilities in Ukraine and Gaza, all of which created uncertainty for investment markets to contend with.

Three months later we have the same uncertainties:

- The impact of a Labour government may become clearer after the 30th of October budget but, so far, what it will reveal is all just speculation, although there is a general consensus that it will be bad news for anyone who has accumulated capital or earns a high income.
- The potential outcome from the US election has shifted a bit, as Harris seems to have a better chance of beating Trump than Biden did, but it remains a very close call.
- The conflicts in Ukraine and the Middle East are showing no signs of ending. If anything, there seem to be increased risks of escalation.

Against this background, it is hardly surprising that most investment markets have seen only modest movement, but it is very encouraging that what movement we have seen has generally been in the right direction.

As has been the case for ages now, it is central government interest rate policy, particularly in the USA, rather than the political turmoil and deteriorating international relationships which has driven market sentiment.

While patience has been stretched as we await meaningful rate cuts, the direction of travel is positive, and this is demonstrated by the fact that bond markets have enjoyed a quarter where they have generally kept up with equities, or even beaten them.

Looking ahead to the final quarter of the year, the political and economic uncertainty created by the recent change in government in the UK and the upcoming US election should reduce. Over the next few weeks, we should have a better idea of what's in store, although plenty of questions will no doubt remain over exactly what the consequences of Labour economic policy and a new US president will be.

With the uncertainty expected to dissipate, we could see some more significant movement from investment markets over the next quarter, but we could also see a continuation of what we have seen in the last quarter, with markets reluctant to forge ahead without more clarity on what the future holds but shielded from any significant falls by a background of falling interest rates.

As always, time will tell.

Meantime, our advice is to treat speculation over the shorter term as interesting to ponder rather than a motivation to change investment strategy, as that should reflect longer term issues and not short-term fluctuations.

Market performance

How each of the major indices have performed to the end of the current quarter

Investment Association Sectors and Other Indices – Total Return to 30 September 2024 (in GBP)

	3m	1yr	3yr	5yr	10yr
Equities					
IA UK All Companies	2.3	14.2	9.0	25.9	72.0
IA UK Smaller Companies	-0.2	16.1	-19.2	21.6	88.4
IA Europe Excluding UK	0.3	14.6	14.1	43.9	123.9
IA North America	-0.1	20.5	27.8	74.9	243.5
IA Latin America	-1.4	-6.7	13.2	-5.5	18.0
IA Japan	1.4	11.1	4.5	28.7	124.1
IA Asia Pacific Excluding Japan	2.9	13.9	2.1	27.6	103.9
IA China/Greater China	12.2	5.2	-25.2	-3.6	70.4
IA Global Emerging Markets	1.4	13.0	-1.9	17.0	68.4
MSCI Frontier Markets	-1.5	4.7	-7.9	8.3	33.6
Equity specialist					
IA Healthcare	-1.1	9.4	2.4	39.2	145.5
IA Technology and Technology Innovations	-4.7	24.8	17.1	99.6	358.2
IA Commodity/Natural Resources	-1.6	0.4	24.1	51.3	91.6
MSCI ACWI/Energy	-7.8	-6.2	53.4	40.1	52.8
Bonds					
IA Standard Money Market	1.3	5.4	10.3	10.9	12.5
IA Sterling Corporate Bond	2.5	10.9	-5.5	-0.2	26.4
IA Sterling High Yield	3.5	13.0	6.7	17.6	43.0
IA UK Gilts	1.8	7.4	-19.7	-22.5	4.6
IA UK Index Linked Gilts	1.5	6.3	-33.8	-33.3	6.1
IA Global EM Bonds Blended	1.8	8.1	2.2	2.0	36.2
IA Global Mixed Bond	2.2	7.3	-2.6	-0.6	26.1
IA Global High Yield Bond	0.7	7.6	5.9	13.3	61.9
Alternatives/Specialist					
IA Infrastructure	6.9	13.5	10.7	15.2	89.0
IA UK Direct Property	1.8	1.9	0.7	0.9	27.2
IA Property Other	8.8	17.4	-3.1	1.7	54.0
IT Private Equity	-1.8	4.2	13.9	49.6	133.1
IA Targeted Absolute Return	1.6	8.3	10.1	17.3	27.2
Gold Bullion Sterling/Troy Ounce in GBP	7.3	29.3	53.6	63.5	164.7

Source: FE Analytics – Total Return; bid to bid

Equity markets overview

Equity market returns were mixed in the quarter, driven more by domestic policy rather than global issues.

There has been quite a spectacular recovery in the Chinese equity market following the most aggressive package of stimulus measures since Covid to reignite the country's economy and property market. The broad package of fiscal and monetary policy measures, alongside indications that further such measures will follow if required, shows that policymakers in China are ready to support the economy, following an extended period when they seemed to being doing the opposite.

We still feel that the geopolitical risks are high when it comes to investing in China, but many emerging markets and Asia funds have exposure here so will have seen some boost to returns over the quarter.

The notable detractors were energy and technology shares. The latter seemed destined to see a setback at some stage given the huge surge in share prices in recent times, which we have flagged several times in these commentaries.

However, it is interesting to see energy share prices fall. This is largely down to lower demand and a drop in oil prices over the quarter, but we feel this may well reverse, given the increased escalation of hostilities in the Middle East and the impact that has had on the oil price in recent weeks.

Bond and property markets overview

Bonds have had a good quarter, with all main fixed income markets enjoying positive momentum off the back of the first interest rate cut by the US Federal Reserve in September, signalling that the interest rate cycle in the US is reversing at last.

The outperformance from Sterling bonds relative to their global equivalent is due to a weaker Dollar/stronger Pound following the Fed rate cut and the expectation that rates will fall faster in the US than elsewhere, particularly in the UK.

We feel it is likely that bonds will continue to perform well against a background of falling interest rates across developed markets, although during an easing cycle we would generally prefer to own the shares in a company rather than lend money to it.

Infrastructure and property investments have had an excellent quarter, and at long last rewarded investors after a rather testing period of depressed valuations. As we have discussed several times in this section of our market commentaries, share prices in these sectors had fallen to values that seemed unrealistically low, so a recovery did seem very probable, although patience has been needed.

Whether this marks a reversal to positive sentiment of just an end to the negativity is hard to assess but falling interest rates should create a very helpful tailwind to push values back upwards again.

Our views on sectors and regions

What we think about investment opportunities in each sector or region, be it negative (✗), neutral (▬) positive (✓), or very positive (✓✓) over 12 months and 5 years.

Region or sector	12-month view	5-year view	Notes
Buy to let residential property	✗	▬	The new UK government wants to build 1.5 million homes over the next 5 years, with the hope of helping more people buy their own homes. This is likely to be a headwind for the buy to let market as renters look to become buyers, thus reducing demand. Another headwind for the sector is interest rates. Despite the first rate cut of this cycle bringing the Bank of England base rate to 5%, it seems unlikely rates will return to the ultra-low-level of the last decade, so higher borrowing costs will remain a drag on profits.
UK and Global Real Estate Investment Trusts (REITs)	✓✓	✓✓	Higher borrowing costs and reduced demand in a dull economy continue to depress sentiment. However, both these factors look set for improvement while weak values and consequently high-income yields are starting to attract investors back, so the outlook seems bright.
UK Gilts (Government bonds)	▬	✗	Higher interest rates brought Gilts values down to far more attractive levels than we'd seen for a long time, but a potential reversal in government policy, from requiring pension funds to hold Gilts to cover liabilities, to forcing them to sell a proportion of these to buy UK equities in support of the economy, might impact the supply/demand dynamics and keep prices weak.
UK Index Linked Gilts	✓	✓	Similar factors apply here as with traditional Gilt markets. However, after a savage fall, UK "linkers" do offer attractive prospects for some capital gains if sentiment improves.
UK Investment Grade Corporate Bonds	✓	✓	Unlike Government Bonds, these are priced to reflect the risk of default as well as the prospect for changing interest rates. An improving economic environment should be positive for these types of bonds. Although risk of default is higher than with Gilts, investment grade bonds are issued by the highest rated companies.
Global Bonds	✓	✓	This sector includes both government and corporate bonds issued almost anywhere in the world, so an enormous pond for a fund manager to fish in. While interest rate policy and economic prospects tend to travel in the same direction across the globe, there are large local differences in the pace and extent of changing fortunes, allowing plenty of opportunity for investors to benefit from the research and analysis capabilities of specialist fund managers.
UK High Yield Bonds	✓	✓	Very high income and an improving economic background supported by falling interest rates should drive valuations higher. UK interest rate cuts have commenced and providing a recession is avoided, this sector looks well placed to benefit from current themes.
Global High Yield Bonds	✓	✓	These are exposed to much of the same factors as their UK equivalents, looked at above. However, the much bigger marketplace creates more opportunities and assists diversification, both of which are supportive.
UK Large Cap	✓	✓	Many UK quoted shares look undervalued against their overseas counterparts and are also in sectors that have suffered in the period of higher interest rates, so seem well placed to benefit as rates fall back. Sadly, the combination of weak valuations, high taxation and burdensome regulation is discouraging companies from listing in the UK and encouraging some that already are here to move elsewhere. This is a worrying theme and Government action taken to address it, would be very welcome. Meantime, the weak valuations translate to high dividend yields and generate excellent prospects for some revaluation.
UK Mid and Small Cap	✓✓	✓✓	UK mid and small caps have been overlooked for some time as investors sought the relative safety of the biggest companies as higher interest rates threatened a slowdown. We feel this has created a particularly compelling opportunity as we expect the trend to reverse as confidence returns.
Europe (excluding UK)	▬	▬	Soft eurozone growth and political uncertainty make other sectors appear more appealing at the moment. That said, there are some excellent companies in Europe and the region can be an attractive diversifier, typically on lower valuations than US counterparts.

Region or sector	12-month view	5-year view	Notes
North America	▬	▬	The Magnificent 7 “big tech” shares make up a significant portion of the S&P 500 and their share prices enjoyed a spectacular rise, driven by strong earnings and excitement over AI. In line with our expectations, these have recently since sold-off as investors worried that prices had risen too far so took profits. Elsewhere, the US offers a wealth of opportunity to invest in solid companies at reasonable valuations, but we suspect the obsession with the tech sector may continue to dominate and the recent sell off is unlikely to be an end to the trend. Against this background the smaller company sector looks attractive as share prices have lagged but there are plenty of companies for tech lovers to move into if they do lose enthusiasm for the big boys.
Japan	✓	✓	The Japanese market has been volatile since the interest rate shock in July, which impacted the Yen “carry trade”. A “carry trade” is a strategy based on borrowing in a currency with a low interest rate and placing the money in a currency where a higher yield is available. The risk is, of course, currency values moving in the wrong direction. As Japanese interest rates have been around zero, the Yen was the currency of choice for this, especially as interest rates stayed low while those elsewhere rose, reducing the value of the Yen and adding to the profit for the speculators. This started to unwind as the Bank of Japan unexpectedly raised rates while the US Fed started talking about rate cuts. The Yen rose, the tide turned, and the currency speculators started facing losses instead of gains. The Japanese economy is in better shape than it has been for some time, with real wages growing in June for the first time in 26 months, and Japanese shares are, at last, moving away from decades at the bottom of the league table in terms of valuation metrics. We see these themes continuing and the patience of investors being rewarded handsomely over the next few years.
China	▬	▬	The Chinese market has been more and more at the mercy of the whims of Xi Jinping and the ruling CCP. Until very recently this has been a bad thing, but a reversal in policy from undermining business to supporting it has seen a dramatic turnaround in sentiment. Prior to this, Chinese shares looked very cheap but with good reason. Following the rally, they look a lot less cheap, but have the reasons they were so cheap really gone, or will the whimsical CCP change tack again? On top of the domestic economic uncertainty there is the spectre of China’s role in deteriorating international relations and its dangerous ambitions towards Taiwan. All this makes the outlook very unpredictable, with potentially large gains if things go well but equally large losses if they don’t.
Asia and the Far East	✓	✓✓	There are excellent opportunities for economic growth in Asia. A large proportion of the world’s population lives in the region and the middle class is growing. Taiwan is home to some of the world’s leading global technology companies, whilst India, Indonesia, Korea and Vietnam are a few of the potential beneficiaries of Western companies moving manufacturing away from China. China used to dominate the asset allocation strategies of many Asia funds, but we have seen a significant shift away from that in recent times, due to the added risks referred to earlier.
Emerging Markets	✓	✓	The Emerging Markets sector is likely to benefit from rate cuts in the US and a weakening Dollar, reshoring brought about by geo-political tension between China and the West, and rising commodity prices. There are some attractive high yielding stocks in the region in part brought about by a change in approach to corporate governance. This is particularly true in South Korea, where companies are now more willing to pay out dividends. China makes up a large part of the emerging market index, but a skilled fund management team can take advantage of opportunities there, while being well placed to invest elsewhere when the risks seem too high.
Latin America	▬	✓✓	Energy transition demand for industrial metals has been positive for the resource heavy region. Also, many companies are looking to move supply chains away from China due to geopolitical concerns and Latin America can be one of the beneficiaries. Resource dependence has historically left the region highly exposed to boom and bust cycles and political and policy risk has historically caused volatility, but investors could be well rewarded over the longer term for tolerating that.

Region or sector	12-month view	5-year view	Notes
Africa	—	—	As previously commented, Africa may reward investors handsomely one day, but the risks are high, and seem to be rising, so we feel exposure via emerging markets funds, or simply through companies quoted in the developed markets but operating in Africa, is currently adequate.
Frontier Markets	✓	✓✓	These are the smaller emerging markets and offer investors access to unusually high growth prospects in exchange for inevitably increased risks, albeit with those mitigated by diversification. Frontier Markets have large, young populations and low labour costs, creating significant potential for rising productivity and output. The economic growth potential is often linked to domestic demand, helping countries in this category to thrive regardless of the wider global economy.
Commodities and Natural Resources	✓	✓✓	Miners should be beneficiaries of central banks cutting rates as, with the cost of capital falling, projects become more attractive, and profits improve. Precious metal prices have risen significantly this year, and this has not yet fully filtered through to share valuations. Prices of industrial metals remain a bit depressed, but this could change with renewed Chinese demand. A global recession would be particularly negative for miners, and fear of that has kept values depressed, but those fears are abating, so we expect values to move forward to reflect that.
Gold	—	—	Gold has performed well this year, reflecting its status as a 'safe haven' during troubled times. Although its direction of travel is difficult to predict, a weakening dollar is generally seen as positive for the price of gold. It's a speculative asset though, that pays no interest or dividend, so an investor only receives a potential return if they sell.
Healthcare and Biotechnology	—	✓	An aging global population should drive ever-increasing demand, while scientific breakthroughs can offer exceptional opportunities. With core healthcare well represented in mainstream regional funds, we prefer funds focussed on the more specialist and cutting-edge biotechnology sector, but the higher risks must be factored in when assessing allocation levels.
Technology	—	✓	Technology stocks have performed exceptionally well and have continually beaten market earnings estimates. AI developments and the prospects for Big Tech have dominated the sector recently but there is much more to technology stocks than that. The recent sell-off has brought valuations back to a more reasonable level but they are hardly bargain basement.
Infrastructure	✓	✓	This sector has experienced similar headwinds to commercial real estate, with high borrowing costs weighing down on valuations. As with Real Estate Investment Trusts, we see this as a very attractive buying opportunity. The relatively low correlation with other sectors can also be helpful in risk management, while the high dividends are particularly appealing for those investing for income.
Clean Energy	✓	✓✓	Falling interest rates and attractive valuations should improve sentiment and encourage investors back to the sector. Geo-political tensions, particularly in Europe, have highlighted the need for countries to be self-sufficient and long-term investments in energy storage, solar and hydroelectric projects remain the obvious way to achieve that.

Important notes

The importance of investment time horizon

There is a direct relationship between risk and potential reward, and between risk and time horizon. One of our core objectives is to help our clients find a sensible balance with their capital to reflect these relationships and, of course, their own objectives and preferences. In this document we tend to look at shorter term history and future expectations, since that is the purpose of a quarterly market review. However, while short term movements in asset values are often critical to speculators, they are not nearly so relevant to the sensible investor. They are, of course, interesting to follow but it is the medium to long term outlook which really matters, and that is where Atkins Bland retains its main focus when assessing suitable investment strategies for our clients. This is because sensible people investing in stock markets, bonds or property do so with capital available for the medium to long term and will have positioned themselves, so they have enough cash to meet shorter term spending needs. Sensible investors are, therefore, able to ride through the ups and downs of capital values. For those investing for capital growth, shifts in the medium-term outlook, economic cycle or relative valuations between different investment areas can provide good opportunities to enhance capital values and our advice seeks to take advantage of this. For those investing for income, changing valuations and conditions seldom have much impact on the income being generated from investments already held (other than from deposit accounts) but they can alter the percentage income yield available from new investments. This means that moving from one area to another can prove a worthwhile strategy as conditions shift. Again, our reviews and ongoing advice processes are designed to take advantage of opportunities created by these changes. Advice we give does, therefore, take into account current conditions and some shorter-term developments but is always overlaid with the prime objective of a focus on medium to long term outlook, since this is what actually drives medium to long term results. During any year there will be good and bad days for the stock markets, and often there will be bad and good weeks or even months. The fact that this will be the case is easy to predict, but the timing of short-term changes in share prices is notoriously almost impossible to predict, so attempting to do so is largely the domain of gamblers rather than investors. For anyone prepared and able to put up with the short-term volatility of capital values, we firmly believe that equities and other asset backed investments are an ideal home for longer term investors seeking income, growth or a mixture of both, and our recommended strategies will continue to reflect this belief.

Risk warning and disclaimers

Prepared by Atkins Bland – October 2024.