Economic Outlook and Portfolio Review
Second Quarter 2024

Q2

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WEALTH PLANNING

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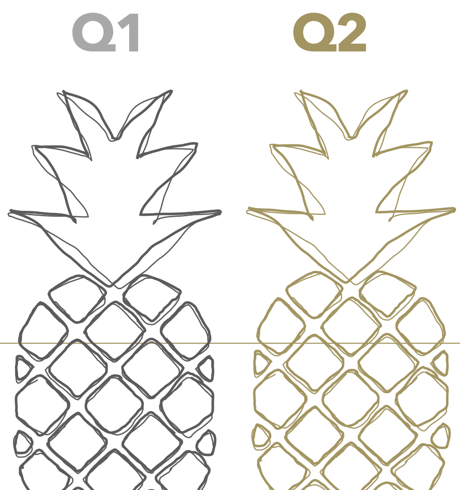
The Contents



Out with the Old, in with the New

At first glance, there seems to be lots to look forward to in the UK as we approach the second half of 2024. The longer days and reprieve from months of rain (despite a rather dreary June & still dreary July it seems!) bring winds of change. Amongst UK investors, the most welcome improvement is the record-breaking FTSE 100 currently sitting at roughly 8,100 at the time of writing. It is a sight for sore eyes after the prolonged relative underperformance of the UK markets on a global stage, and perhaps a sign of optimism for the year ahead.

Yet this record high isn't good news for everyone, as some of the underlying constituents have had upset in the recent reconstitution of the index. These 'reshuffles' occur after a quarterly review, in which the index assesses each underlying constituent's market capitalisation. Should any company's market capitalisation have slipped too far it faces demotion to the lower index. To enter the FTSE 100, as a FTSE 250 constituent, companies need to have a market cap in the top 90%, meaning a company falling must have a market cap below that of the 110th biggest company. These parameters mean that companies should be less likely to continuously dip in and out of indices. However, this is not always the case with Hiscox making its debut into the FTSE 100 in January 2023, only to be swiftly dropped in September of the same year.[1]

The most recent quarterly review has led to a couple of long-stay companies being relegated to the FTSE 250. The most anticipated is the relegation of the wealth management behemoth, St. James's Place. With recent regulatory changes from the FCA regarding consumer duty, SJP's inflows have suffered and as a result, the share price has been steadily affected over the past year totaling a loss of approximately 53%. It may signal a change of direction within the industry and a revolt by clients against its previous expensive and opaque fee structure.

Source: Google Finance (2024)

[1] LSEG (2024)

It may unsettle some investors to see household names falling out of the index, but it is a natural process of the investment cycle. Funds tracking the index are supported by the performance of the strongest constituents, by definition more than offsetting the negative impact of the index leavers. To target the upward or downward momentum of the reshuffle, as a potential arbitrage opportunity, is extremely difficult without facing any insider trading allegations. Tom Stevenson (The Telegraph) noted that the majority of price movement happens prior to any announcement [2], the quarterly reviews are very predictable by the time any results are announced - they have already been priced in by the market.

Elections here, there, and everywhere!

FTSE demotions are not the only potential upsets this year as we see the snap UK general election that took place on the 4th of July. Both Starmer and Sunak battled it out in the metaphorical campaign trenches, with policies and key points being keenly debated by both sides. This was a landmark election as it has seen the end of the 14-year Conservative run. Many are still speculating what this could mean for Britain and the economy, despite Starmer claiming personal tax increases are not in the firing line (other than another potential capital gains tax upset). But the same question seems to be at the forefront of conversations, 'how will this affect my finances and the economy?'.

Labour wishes to be seen as the party of 'wealth creation' for the working people; helping improve the living standards that have been battered in recent years by the cost-of-living crisis. The BBC found that the typical working person is only 5% better off now than at the end of the 2008 financial crisis when removing inflation from the picture.[3] Rather than raising income tax and corporation tax, Labour intends to raise funds via VAT on private school fees and squeezing non-domiciled taxpayers further. Labour claims, alongside its other policies, it should raise £8bn to invest in areas such as the NHS and green initiatives.

The reality is that Labour has inherited a stagnating UK economy and a volatile electorate, which is a challenge, to say the least. Most analysts agree that the overall economy will most likely be unaffected. Inflation is predicted to fall regardless[4] and this will likely lead the Bank of England to lower interest rates soon, an immediate reprieve from the recent expensive public debt repayments. Realistically, this would be expected regardless of political powers, so even with a Labour victory it is probably business as usual for the economy in the near term. It is always handy to remember that the market often knows best and will have already priced in Starmer's stint at 10 Downing Street.

Source: The Guardian (2024)

[2] The Telegraph (2018)
[3] BBC (2024)
[4] Capital Economics (2024)

Economic Outlook & Market Commentary July 2024

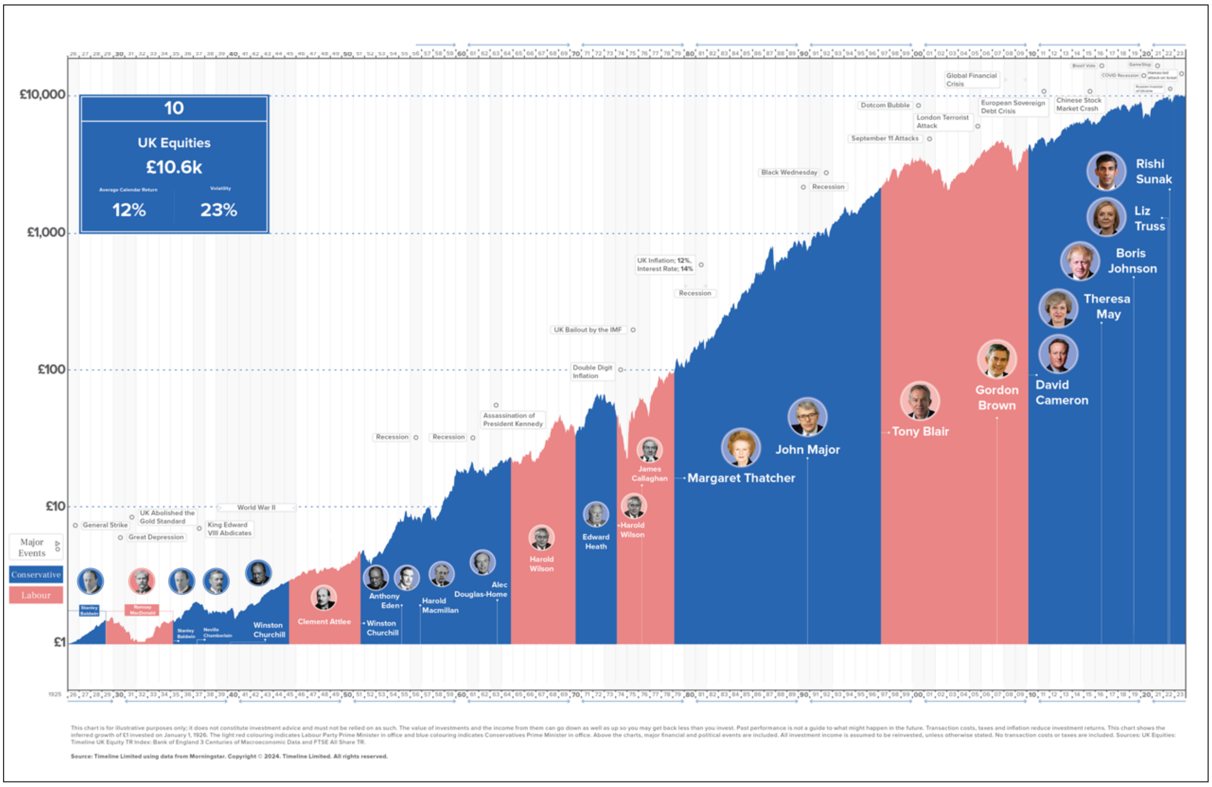
The UK is not the only country that headed to the polls this year, approximately 60% of the global GDP and roughly 54% of the global population will be joining the Brits in this election 'supercycle'[5], shown by the countries in red in the previous image.

Our close neighbours in France recently followed the UK's suit in calling a snap election after the far right gained a surge of seats in the recent EU elections. Whilst Macron's presidency is safe a hung parliament was the outcome which leads to more uncertainty.

The chants of 'crooked Hillary' have not aged as well as some would have hoped, as 'crooked Trump' might well be leading the US in 2025 despite supply chains and inflation normalising, boosting the incumbent president's campaign. Goldman Sachs predicts that this election will be particularly 'market-relevant' as an event, due to future policy issues having a knock-on effect on rates and currency markets once the dust has settled.[6]

In truth, politics and markets whilst correlated, are not causational. Regardless of outcomes and policies, both in the UK and abroad, the markets power forwards. The lesson to glean from this information is to keep politics out of your portfolio; stay the course and let the markets do what they do best.

Investing & Politics

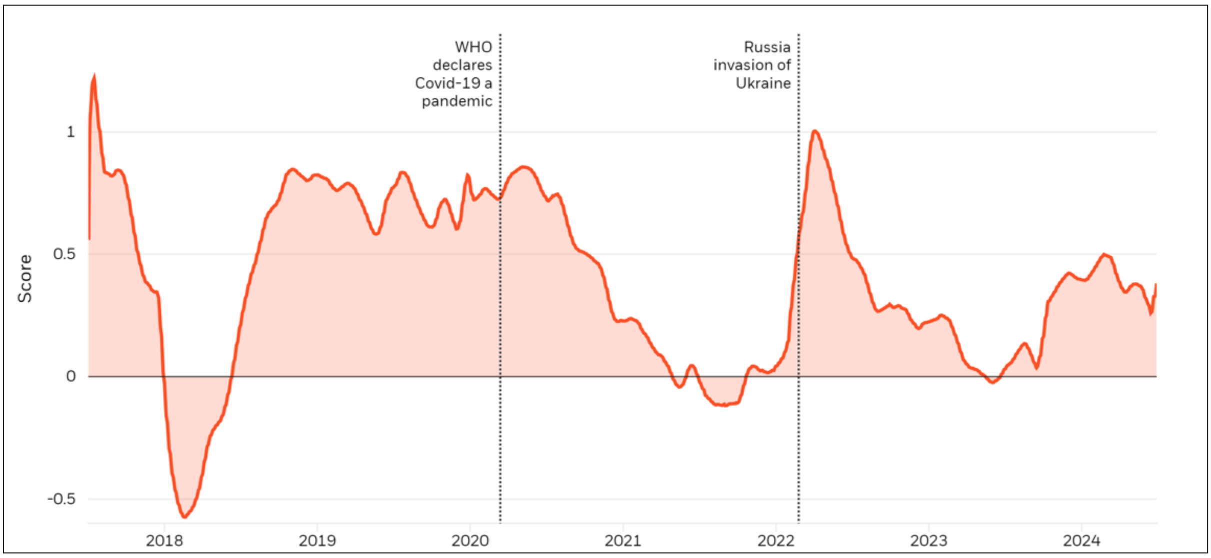


Source: Timeline (2024)

5 EY (2023)
6 Goldman Sachs (2024)

The Changing Tides of Geopolitics - Investing through the Unknown

Analysts from various financial institutions rarely agree on forecasts, however, at present there is one risk factor that they are all cautious of - geopolitical tensions. Often in tandem with elections, there is a level of geopolitical unrest, and this supercycle is demonstrating just that. Recent years have been tempestuous across the geopolitical landscape with several wars and many close calls between global superpowers. The graph below shows some of the major spikes in geopolitical risk since 2018. Goldman Sachs's research has suggested that the average risk has increased since 2020 by 21%[7] , highlighting the scale of potential impact these tensions pose. The main contributors to this increase have been the recent Middle Eastern tensions, the ongoing Ukraine/Russian war and US/China relations; all of which seem to be a long-standing issue.



Source: Bloomberg (2024)

Currently, China represents roughly 30% of the (FTSE) emerging markets investable universe, and several countries rely on Chinese goods and manufacturing: no more apparent than in the world's reliance on Taiwan for over 93% of its semiconductors.[8]
In the recent Tawain election, the Democratic Progressive Party (DPP) won and retained the hard fast independence of Taiwan, but the continued threat of China taking the democratic island by force looms over its almost 24 million residents.

This reliance on Chinese goods and the ongoing tensions between the East and West, which some have dubbed the 'New Cold War', has caused uncertainty across global stock markets. An important catalyst for how the future will look between the two superpowers will be revealed after the US election. Whilst there might seem to be nothing that garners cross party support, one thing both Republicans and Democrats can agree on is the need to control the US's relationship with China. With both parties looking to reshore some key supply chains, including semiconductor production, it may cause the rift to continue to grow.

[7] Goldman Sachs (2024)
[8] Bank of America Global Research, 2020, as reported by Goldman Sachs, 2024

The pattern of ‘deglobalisation’ has also reared its head across Europe because of the Russia/Ukraine war. This varies between countries, but for us in the UK the shocks have been felt in several discrete and obvious ways. Many readers will remember the sudden jump in energy costs and weekly shops when Ukraine was invaded by Russia in 2022 due to disrupted supply chains. In 2021 the EU imported more than 40% of its gas and 27% of its oil from Russia.[9] The European Commission has taken drastic action to reshore its energy production aiming to reduce its reliance on Russian gas by two-thirds in the near future and have complete independence from its energy by the end of the decade. The hope is to prevent any sudden price spikes in the future, which in turn may lead to less market volatility as the political powers disentangle their interdependence.

Middle Eastern tensions are certainly not new, but with both sides garnering support from global superpowers, the stakes are incredibly high. The potential effects may not be as immediate as those felt with the Russian/Ukraine conflict (due to the different proximities), but there could be a spike in market volatility in the near term. Analysts seem to agree that the likely effect will be felt in the higher price of both oil and gold as supply chains are disrupted and investors flock to ‘safe haven’ assets.
This is a troubling time for investors. As advisers, you are at the forefront of client questions, and when faced with uncertainty the answers may not be apparent. Whilst no one can predict what will happen, we look to historical data to provide some guidance. The below graph from Schroders[10] shows that after periods of heightened geopolitical risk, stock markets fall in the near term whilst that risk is reassessed. In the long term, markets tend to show resilience with strong recoveries within months of the initial risk spike. Investors spooked by volatility need to focus on the longer term, remain invested and stay the course. Advisers that help clients pause and remember their investment goals are worth their weight in gold in times of uncertainty.

Source: Refinitiv, Schroders, (2024)

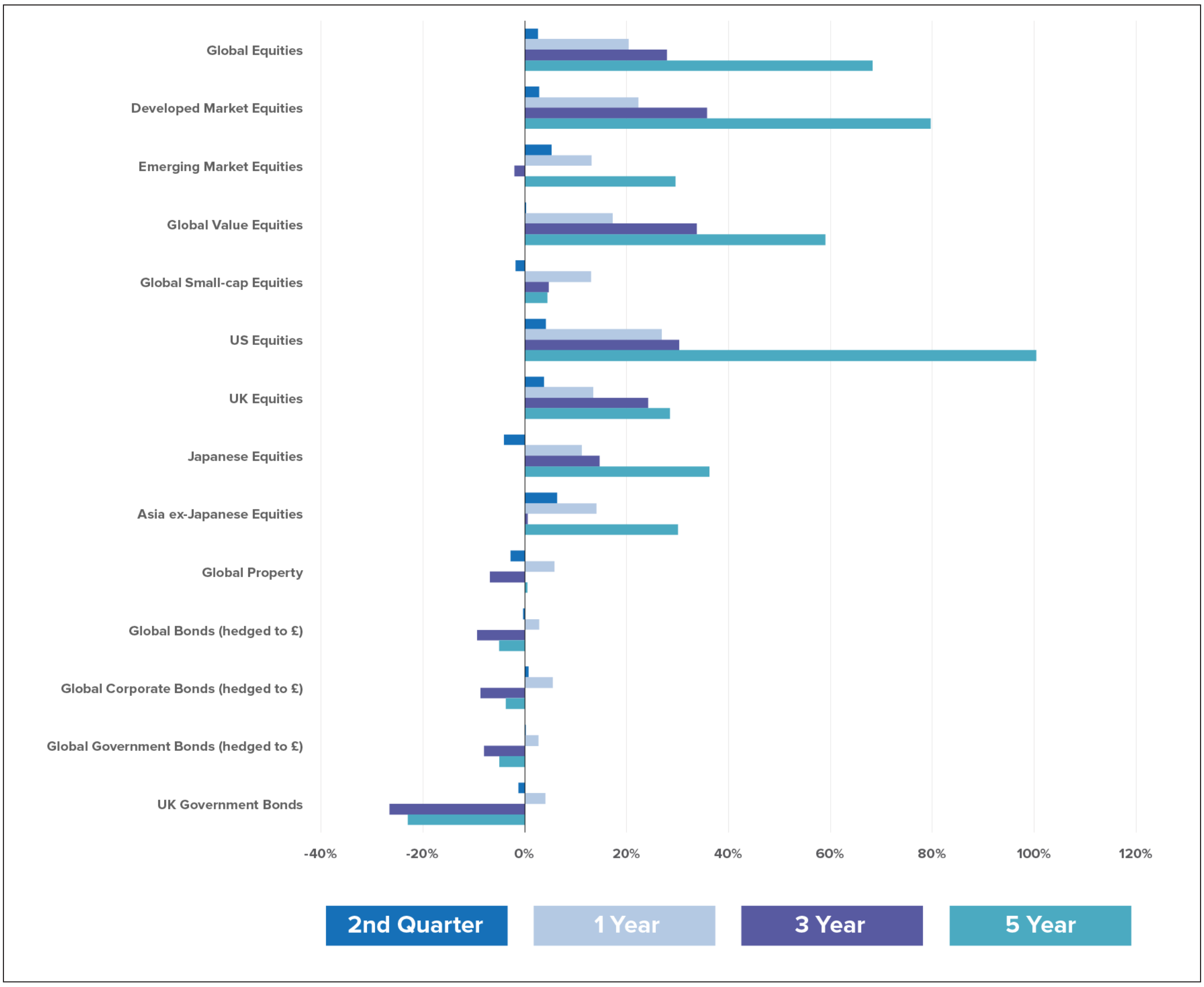
It is also interesting to note that in the face of adversity, there are those that thrive, and small companies nimble enough to adjust may benefit from this political shift in tides. Northern Trust’s analysts[11] have coined the phrase ‘slowbalisation’ in reference to the deglobalisation trend facing countries at present. As global trade continues to plateau large corporations are looking to restructure their supply chains to domestic firms. Small caps generally generate most of their revenues from domestic markets making this trend extremely beneficial to small-cap companies in the future. This is welcome news for evidence-based investors, and perhaps a silver lining to a relatively threatening market storm cloud.

[9] European Commission, 2022.
[10] Schroders 2024
[11] Northern Trust (2024)

Asset Class Returns

This quarter, global markets experienced increased volatility as investors faced mixed economic signals and uncertainties around central bank policies. Despite these challenges, growth persisted, reflecting the adaptability of market participants in the evolving economic landscape.

Asset Class Returns



Source: Timeline (2024)

Global Equity

This quarter, the global equity market exhibited increased volatility and signs of slowdowns, marking a departure from the buoyant conditions of the previous two quarters. In April, the S&P 500 dipped by 4%, experiencing its first monthly decline since last October. Although the index quickly rebounded in May and June, the volatility raised concerns in some quarters about the potential for a more significant market correction.[12]

[12] Bloomberg, 2024

A similar pattern emerged in Europe, where major indices dropped in April but swiftly recovered in May, only to fluctuate again in June. This mirrored trend of volatility across developed markets reflected a shared sentiment, as investors anxiously awaited announcements of rate cuts. More than once, optimism was tested by reports of rising wages and persistent inflationary pressures, sending mixed signals about central banks' willingness to adjust rates soon.

Growth, albeit sluggish, persisted, with indices such as the S&P 500, FTSE 100, and MSCI Europe reaching all-time highs this quarter. While high valuations do not necessarily preclude short- or medium-term stock performance, an overvalued market has less cushion for downside risk if earnings growth or economic conditions fail to meet investor expectations. For now, elevated valuations have been favourable for growth investing. With soaring P/E ratios for leading technology giants like Nvidia, the multi-quarter trend of growth stocks outperforming value stocks has continued this quarter.

The expected rate decisions in developed economies have introduced uncertainties into emerging markets.[13] High interest rates in developed markets typically spell trouble for emerging markets. They make debts, often priced in U.S. dollars, more expensive and can trigger capital outflows as investors seek better returns elsewhere.

Chinese stocks have made little progress this quarter, remaining at multi-year lows. Japanese share prices fluctuated in the second quarter following a market uptick in the previous one, during which the Nikkei 225 index surged 25% to a historic high. Since late March, however, the index has pulled back around 5%. One exception is the Indian market, which maintains its momentum from a multi-year bull run. The NIFTY 50 rose more than 4% this quarter, 10% since the start of the year, and has more than doubled its market cap over the past five years.

United Kingdom

A welcome surprise this quarter was the performance of the UK equity, which, although still relatively cheap compared to other developed markets, has steadily recovered. Despite a tumultuous June, both the FTSE 100 and the FTSE All-Share Index have risen more than 3% since March and are up over 6.5% since the start of the year. By comparison, in the first half of 2023, the FTSE 100 rose only 1%.

Improving macroeconomic conditions at home, such as inflation falling to the 2% BOE target in June, have contributed to the gain. However, there is still a long way to go to fully restore investor confidence in the UK market, as evidenced by the continued outflow from UK equity investment funds, which reached £8 billion between January and April and continued in May.[14]

13 FT Adviser, 2024
14 Financial News, 2024.

Global Fixed-Income

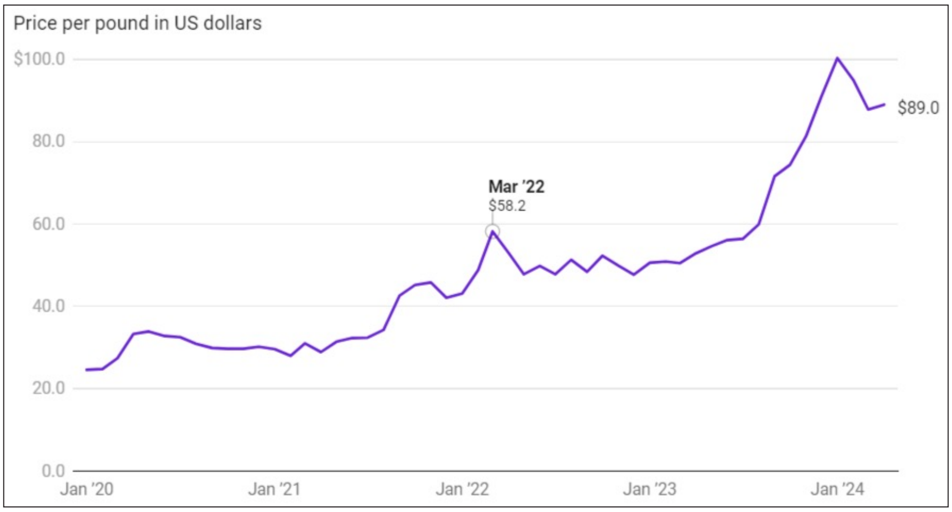
In the second quarter, the global fixed-income market faced both challenges and opportunities. Persistent inflation and varying economic signals have influenced global central bank policies, leading analysts to push back expectations for rate cuts. U.S. inflation is easing slowly, but core inflation remains above target, prompting the Fed to maintain a cautious stance. The Bank of England has kept its base rate at a 16-year high of 5.25%, despite domestic inflation hitting the 2% target in May. In Europe, the ECB just started cutting rates in June. Banks are wary of cutting too soon and needing to raise again in the short term.

The delay in rate cuts has kept yields of fixed-income assets high. While this has negatively impacted bond funds in the past two years, it is important for investors to recognise that long-term investing will benefit from higher yields.[15] This quarter, high-yield bonds and investment-grade corporates performed relatively well, with spreads tightening and yields remaining attractive. Emerging markets have seen positive returns due to resilient demand. Inflation-linked bonds and short-term government bonds are also favoured, reflecting a strategic approach to managing macroeconomic risks.

Alternative Asset: Uranium

Recent developments in uranium investment have underscored a significant surge in interest, driven by the global shift towards greener energy solutions and enhanced energy security. Uranium prices have approximately doubled over the past year, hitting a 16-year high above $100 per pound in February before stabilising around $90 by late May.[16] This spike is attributed to supply constraints, geopolitical tensions—including the potential U.S. ban on Russian uranium imports—and production issues in key regions such as Niger and Canada.

Uranium price 2020 - 2024



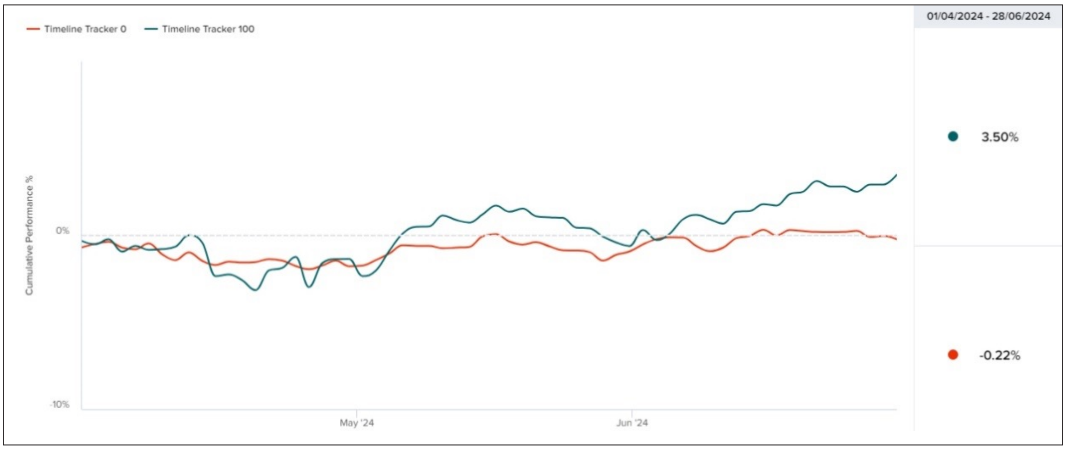
Source: CNN, Cameco (2024)

15 Vanguard, 2023
16 Nuclear Engineering International, 2024

Portfolio Performance

Timeline Tracker

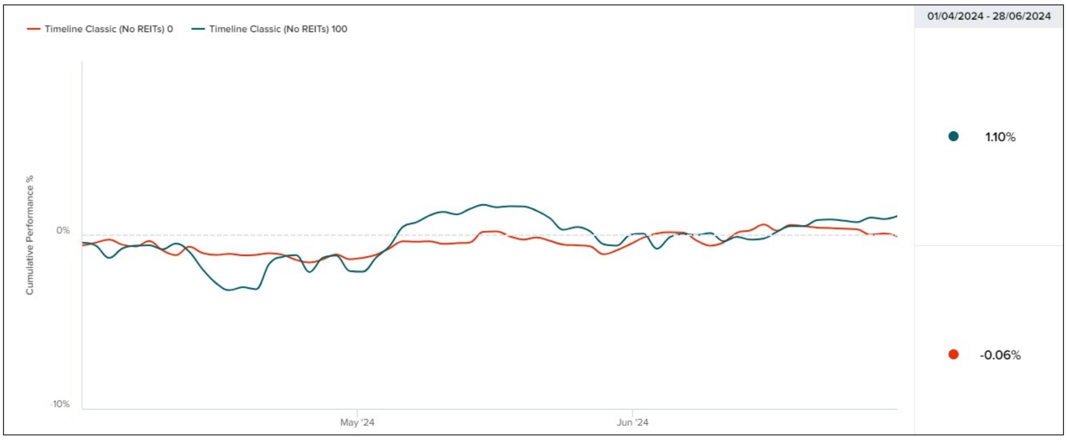
The Timeline Tracker portfolios, designed to emulate global market indices, have shown robustness amid shifting market conditions. The Tracker 100 model achieved a 3.50% return this quarter, leveraging continued favourable trends in the equity markets. Conversely, the Tracker 0 model, which is fully invested in bonds, recorded a modest loss of -0.22%, reflecting a slight uptick in the fixed income market despite the headwinds of high interest rates.



Source: Timeline (2024)

Timeline Classic

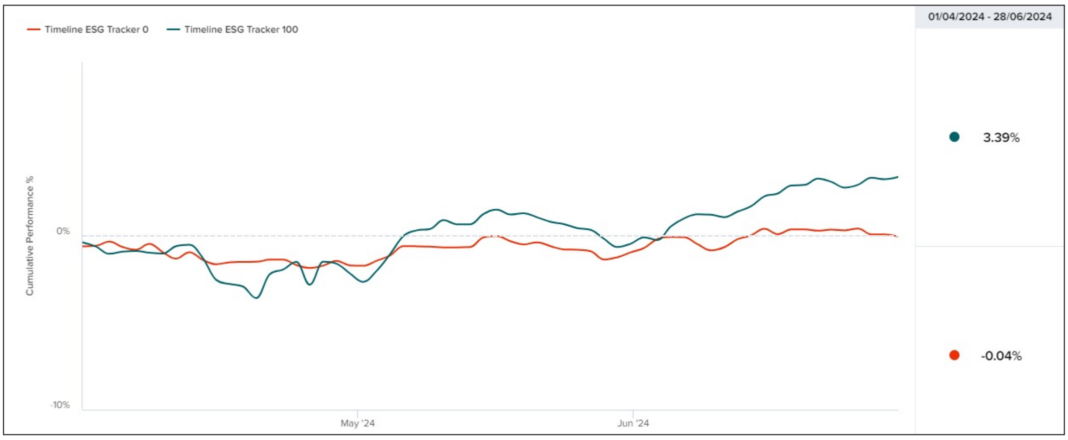
The Timeline Classic model, which focuses on "small" and "value" stocks, continued to face challenges this quarter, underperforming compared to its Tracker counterpart. The Classic 100 model posted a modest return of 1.10%, reflecting the slower growth of smaller and value-oriented stocks relative to the strong performance of large-cap, technology companies. On the fixed-income front, the Classic 0 model achieved a return of -0.06%, aligning with the steady performance observed in the global bond market this quarter.



Source: Timeline (2024)

Timeline ESG Tracker

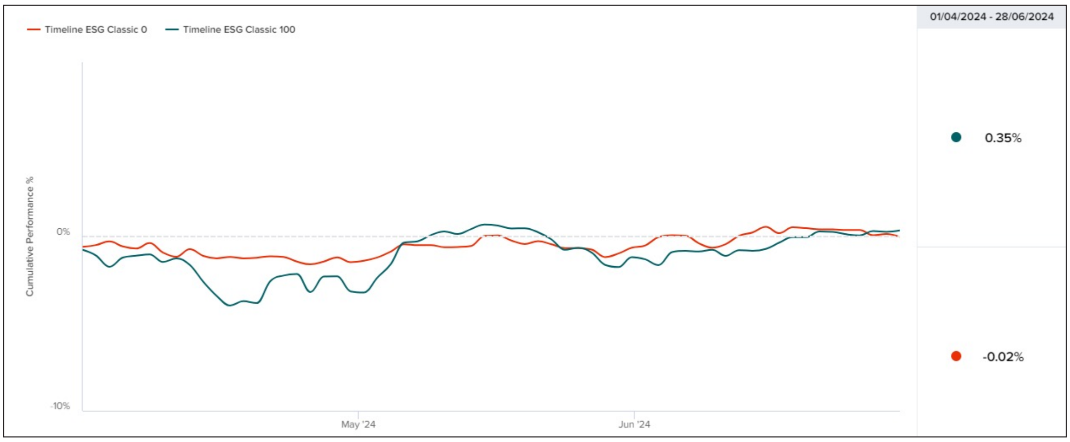
The ESG Tracker portfolio kept up its momentum in the second quarter. The Timeline ESG Tracker 100 model, which is fully invested in equity, delivered a return of 3.39%. The Timeline ESG Tracker 0 model, with its 100% allocation to fixed income, posted a modest return of -0.04%, largely due to the ongoing high-interest rate environment.



Source: Timeline (2024)

Timeline ESG Classic

The ESG Classic model, on top of tracking the market, also aims to capture both value and small-cap premiums. During the first quarter, the Timeline ESG Classic 100 model delivered a return of 0.35%. Meanwhile, maintaining comparable exposure to the primary factors influencing bond returns, the Timeline ESG Classic 0 model garnered returns of -0.02%.



Source: Timeline (2024)

Final Thoughts

As we move into the second half of 2024, the economic landscape shows signs of optimism amidst a backdrop of potential challenges. The record-breaking FTSE 100 and promising inflation figures signal positive momentum, yet the market faces a complex environment with the recent and upcoming elections, geopolitical tensions, and the ongoing cost of living crisis.

Political events, while often correlated with market movements, are not causational. History has shown that markets tend to power forward despite election outcomes and associated policy changes. It is crucial to maintain a long-term perspective and avoid reactionary decisions based on short-term political shifts. Geopolitical risks continue to be a focal point with significant attention on US-China relations, Russia-NATO tensions, and Middle Eastern conflicts. These uncertainties underscore the importance of diversification and resilience in investment strategies. Despite the volatility, there are opportunities for nimble and adaptable companies, particularly within the small-cap sector, to thrive.

The global equity market has shown increased volatility with significant fluctuations, particularly in major indices like the S&P 500 and European markets. Despite this, major indices reached all-time highs, indicating persistent, albeit sluggish, growth. The UK market outperformed expectations, boosted by improving macroeconomic conditions and a notable drop in inflation. Fixed-income markets continued to face challenges due to high interest rates, but there were positive signs with high-yield bonds and investment-grade corporates performing well.

Reflecting on the past quarter, it is essential to remember that volatility is an inherent aspect of investing. Our research emphasises that attempting to time the market can be detrimental. Staying invested and maintaining a long-term perspective is crucial for achieving financial goals.

Best wishes,

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