Economic Outlook & Portfolio Review

1st Quarter 2024

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Contents

Economic Outlook & Market Commentary – April 2024

‘It’s the economy, stupid’ – The (Turbulent) Year of Politics Ahead

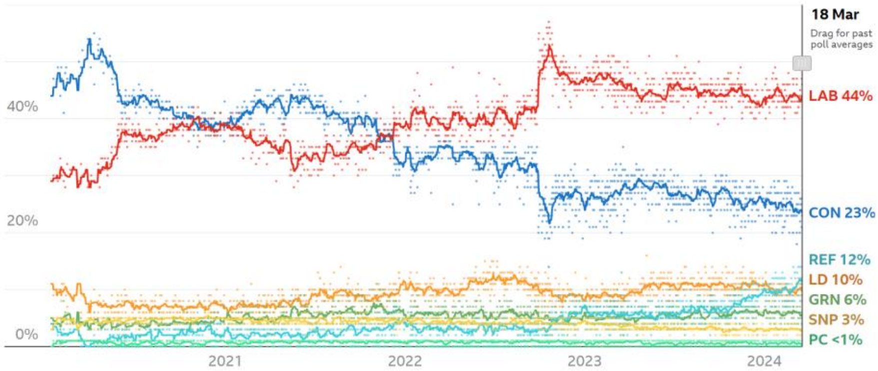
With 2024 well and truly in full swing, investors seem to be breathing a collective sigh of relief for the reprieve from the market turmoil that plagued portfolios this time last year. Despite the US election standing ominously in the latter part of the year, markets seem to have defied tradition and provided a strong performance for the start of the year.

With the record-setting tussle (the record being the oldest Presidential candidates to run for office, officially beating the record that they themselves set in the last election) underway, world markets are waiting with bated breath for each candidate to set out policies on divisive issues. Top of the docket is the economy and cost of living in the US, with Americans tending to vote with their wallets; these will be key issues for the candidates. With markets at all-time highs and inflation falling, Biden’s post-Covid plans seem to be working. However, with Trump leading in the current polls, many investors are cautious about how the markets are set to shoulder the political landscape.

It should be noted that there may be some rocky seas ahead in the US equity markets this year. Whilst markets are normally slow out of the gate in election years, elections tend to cause volatility. However, regardless of the political outcome, returns commonly achieve non-election year levels by the end of the year, illustrating that the eventual ‘clarity’ is more important than the actual outcome for investors. This is effectively shown in the chart below outlining the average U.S. stock performance in election and non-election years between 1928-2023. As always, whilst short-term market movements may scare some, it’s important to keep a long-term view to avoid missing the eventual market returns.

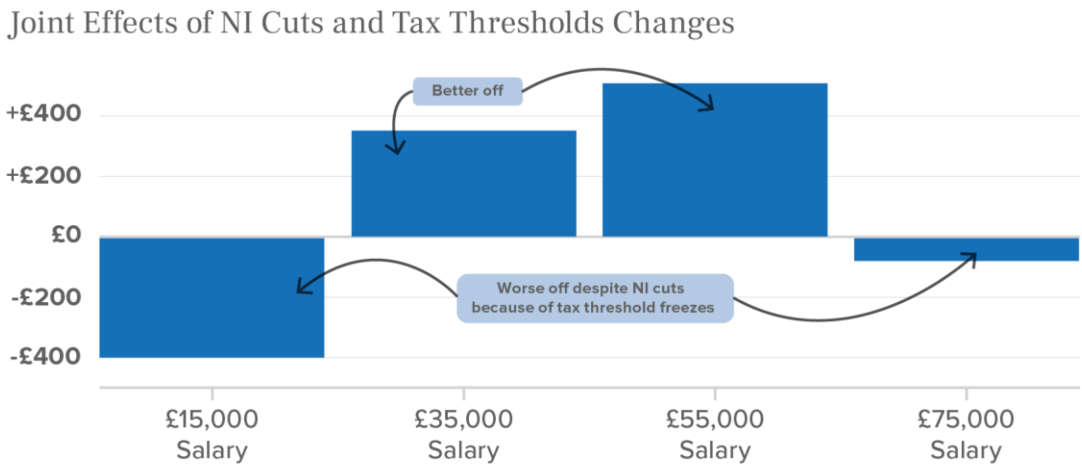
BlackRock (2024) BlackRock Fundamental Equities

The election murmur continues across the Atlantic in the UK, with Sunak predicting that us Brits may be at the polling stations in the latter half of the year. With this backdrop, Hunt delivered his Spring Budget aiming at reducing Labour's current headway in early polls.



BBC (2024)[1]

The budget brought with it many expected announcements, with the current issue of 'stealth taxes' due to freezing of tax thresholds continuing to raise its head for an increasing number of Britons. The headline-winning change was that Hunt plans to cut National Insurance contributions (NICs) for employees (and the self-employed) by 2% from April 2024. Whilst this seems like an easy win in an election year, by cutting direct taxes, as the thresholds for income tax and NICs have remained frozen for another year, more individuals will continue to suffer the repercussions of fiscal drag. This means more Britons will face a higher tax than previous years. The IFS research has even stated that this will be a 'record tax-raising parliament'.[2]



BBC (2024) with Information from: IFS.

There was almost certainly a collective grumble across the nation when Hunt announced the new British ISA. This appears to be a government backed incentive to stimulate the UK equity markets, which will have to be observed tentatively to see if this tactic is eventually successful. Rishi seemed to have learned from his previous faux pas relating to his wife's 'non-domiciled status'; and after (over) 200 years the rule will be abolished as it currently

[1] General election 2024 poll tracker: How do the parties compare? BBC 2024

[2] Households are worse off since the last election, says the IFS. BBC 2024

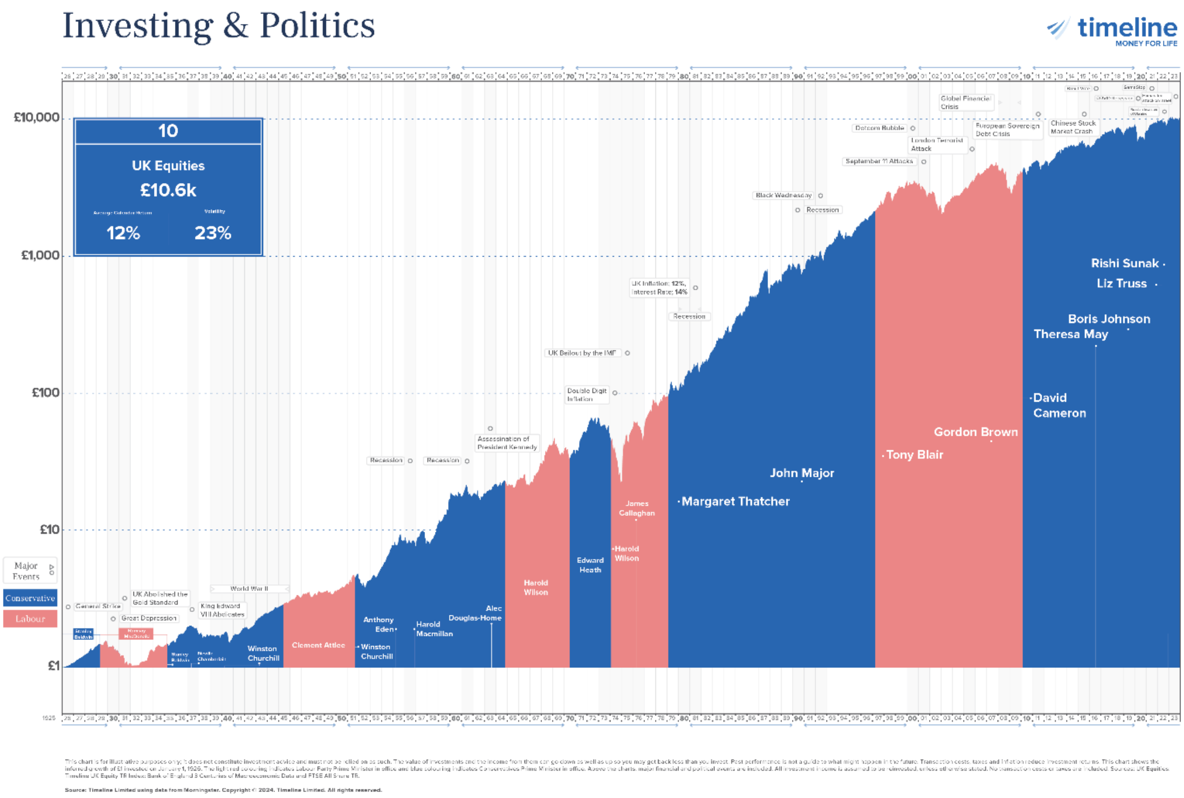
stands. Whilst this rule will have limited effect for the majority of the country, it has been a long-standing point of contention and was received with cross-party support (a considerable breath of fresh air).

Hunt further proposed raising the threshold for the High-Income Child Benefit Charge (from £50k to £60k), which will have a direct effect on families from next month. From April, 170,000 families will now benefit and the average saving for families is as large as £1,260 per annum[3]. Whilst there are still foibles around the tax, namely the need to review whether this is implemented on a household basis in the future, this is an immediate change for many families across the nation.

Whilst there isn't a need to rehash the whole budget, the last notable change that may impact financial advisers and their clients is the potential 'pension pot for life'. With the aim to simplify pensions, the government is taking steps towards reducing the national pension shortfall that is looming on the horizon. In the UK alone, there is over £19bn in forgotten UK pensions[4] with an average savings of £13,000. This pot is designed to make saving easier and prevent individuals from losing pots as they move companies. Whilst on paper this seems like a light bulb moment from the government, there is a potential drawback. With individuals not able to understand which pension pot or scheme is best suited to them, or having the time to research this for themselves, if this single pot isn't the correct choice, it could simply compound an already outstanding issue. This, teamed with the potential abolishment of the lifetime allowance, illustrates that advice is more important than ever for individuals.

These changes from the Budget are yet to be implemented into legislation, and with Labour appearing to already have one foot in the Downing Street door, who knows how long these changes may last? Whilst difficult to implement, the abolishment of the pension LTA will certainly be in their crosshairs for some swift economic action. Despite some reprieve from inflation, the cost of living is continuing to creep up for many Brits, and the upcoming election will be one fought on the economy and what the government can do to help ease the burden. After 13 years of a Conservative government, many are worried about what the future may look like. One thing is for certain, whichever party ends up at Number 10, the markets will continue as they always do.

[3] The Guardian (2024)
[4] Unbiased (2023)



Source: Timeline (2024)

Japan Equity Market Blossoming

Amidst the yearly spectacle of cherry blossoms gracefully adorning Japan's landscapes, there emerges a parallel blossoming, albeit less predictable – that of Japanese equities in the global market. Unlike the reliably annual floral display, the resurgence of Japanese equities comes after a prolonged dormancy, spanning three decades. Japan's recent economic rebound has cast a spotlight on domestic companies, presenting an enticing prospect for strategic investment.

The narrative of Japan's revival as an investment hotspot intertwines with shifts in consumer behaviour and corporate dynamics, fostering an environment ripe for the prolonged growth of domestic equities. An intriguing facet of this resurgence lies in the embrace of inflation by equity investors. Unlike its typically dampening effect on corporate margins and living costs in developed markets, inflation is bringing prosperity to Japan's economy, long plagued by deflation. Japanese companies, at last, find themselves in a position to adjust prices, potentially enhancing margins after years of stringent cost discipline. Additionally, local savers, seeking to safeguard purchasing power, exhibit a newfound willingness to explore assets like equities.

Underpinning this optimistic outlook are government policies aimed at bolstering corporate governance and profitability. This momentum appears poised to persist, powered by moderate inflation, governmental support, and sector-specific competitive edges aligned with prevailing mega forces such as digital disruption and artificial intelligence. Japan's economic resurgence offers a compelling narrative for global investors. Moreover, the diversification inherent in Japan's stock market composition presents an attractive proposition, offering exposure to a spectrum of industries with low correlations to other asset classes.

Fiscal stimuli have bolstered the momentum in the equity market, marking a pivotal shift away from the deflationary pressures that have long troubled the nation. One revelation is that recent returns can be partly attributed to the resurgence of value stocks in Japan vs growth. Notably, payout ratios in Japan are increasing compared to previous years, reflecting a concerted effort by companies to enhance corporate governance and shareholder value. The Tokyo Stock Exchange has also recently introduced a corporate governance reform agenda, aimed at improving listed company price/book ratios, which is a well-recognised indicator of a company's value. All these measures have helped foster an environment for value stocks to thrive.

Furthermore, recent data points to a resurgence in domestic demand, as reflected in Japan's services Purchasing Managers Indices (PMI) reporting higher activity. Simultaneously, Japanese exports have rebounded significantly, buoyed by robust demand in key markets. Exports surged by 9.88% in December, marking the highest level in 12 months, with notable improvements in shipments to the US, EU and China. This resurgence in both domestic demand and export activity underscores Japan's revitalised economic momentum, further solidifying its position as an attractive investment destination.

Perhaps the most definitive signpost of the changing economic waters in Japan has been the Bank of Japan (BOJ) finally ending negative interest rates with its first increase in 17 years[5]. The BOJ raised short-term rates from -0.1% to the range of 0-0.1%, providing a clear signal that they believe that they have managed to combat the country's deflation issue. Part of the reasoning behind this change comes from the recent wage increases, with the nation's

[5] Reuters (2024)

largest companies agreeing to an increase of 5.28% for their workers.[6]

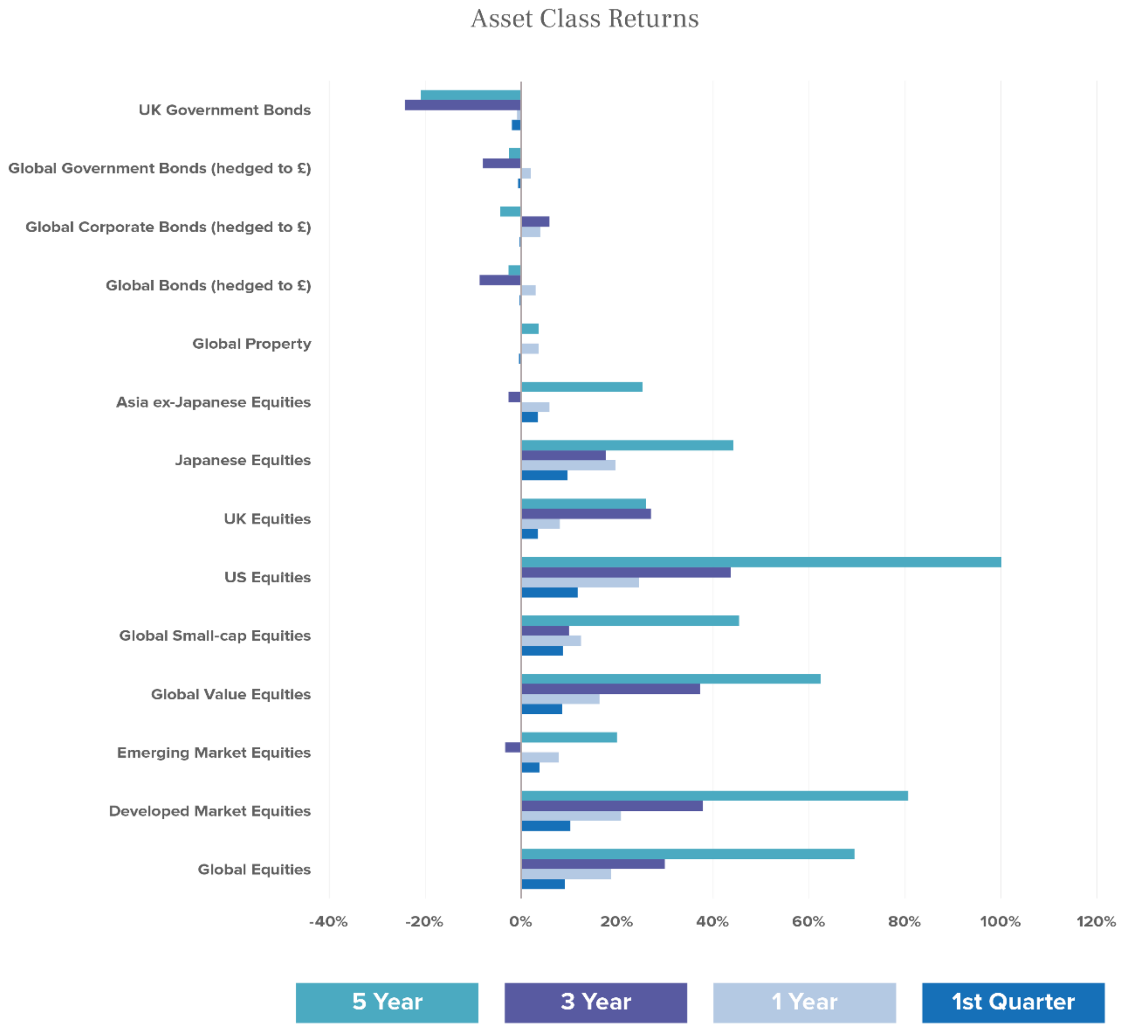
Source: Reuters (2024)

In essence, the resurgence of Japanese equities mirrors the ethereal beauty of cherry blossoms, captivating investors with the promise of sustained growth amidst a landscape of opportunity. As Japan's economic landscape continues to evolve, savvy investors stand poised to reap the rewards of strategic allocations to this resurgent market. This resurgence is a reminder of the importance of a globally diversified portfolio, allowing investors to benefit from returns not in their immediate geographical vicinity. Japanese markets seem to be providing a timely reminder of the power of evidence-based investing. With value stocks leading the charge for the markets, it illustrates that the value premium is still a powerful portfolio construction tool that is far too often overlooked.

[6] BBC (2024)

Asset Class Returns

Across the first few months of the year the markets have generally reacted positively across the majority of asset classes. With the current year of politics and general market indicators, this is a well-received start to the year.



Equities

The Magnificent 7 (or the Sublime Six ex. Tesla?)

The markets have been no stranger to the global mega cap stocks that make up the infamous ‘Magnificent 7’, and 2023 was the year that illustrated the power of ‘market beta’ as the original risk premium. With the recent frenzy for artificial intelligence, the demand for Nvidia’s AI chips has boomed, causing the price to skyrocket with returns of approx. 90% year to date. This has all contributed to the company taking its spot as the third largest stock on the S&P 500[7]. With its large market share, a change in price of approx. 10% could equate to more than $200bn, which is the entire market cap of many large companies (such as Disney and Pfizer). It is truly staggering to see the scale of some of the companies within the top echelons of the market.

The sheer size of this ‘giant’ may seem daunting and may make investors question what could potentially happen should the company’s sales fall. The reality is rather more comforting, with Nvidia’s sales being diversified across a number of geographies (both developed and emerging markets.) The US makes up only 31% of their revenue breakdown, which is considerably lower than other Magnificent 7 members like Amazon (73% of sales are in the US.) With their eggs in a number of proverbial baskets, the future of Nvidia is promising with the continued growth of AI set to increase their relevance in the coming years.

However, it hasn’t been smooth sailing for all; Tesla provided below market returns of -27.49% at the time of writing. With the recent slump in electric vehicle sales, Tesla has felt the brunt of changes in consumer spending in the past quarter. The disparity between these two members of the Magnificent 7 helps to illustrate that even so-called “giants” can still suffer from market trends.

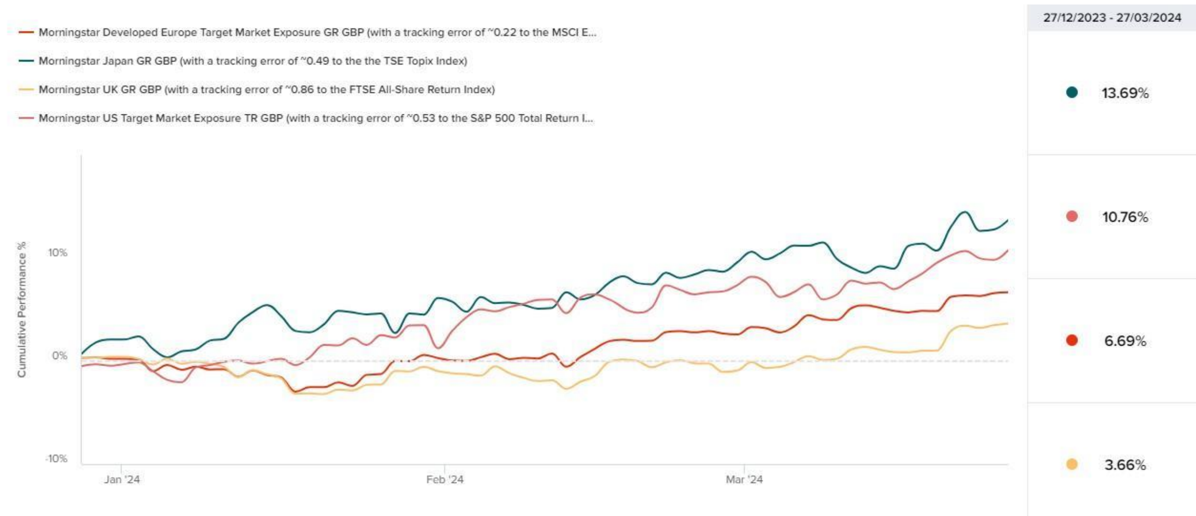
Source: Yahoo! Finance (March 2024)

[7] Forbes (2024)

Global Equities

Finally, the UK markets have also seen some progress, with the FTSE 100 providing the best returns for equities since late 2022[8]. Whilst the start of 2024 was sluggish, March alone had the index return 4.5%, which is a welcome change of pace for many investors. Many hope this performance continues and the record high of 8,000 points is truly within touching distance.

However, the recent rally for the UK is vastly overshadowed by returns from other major stock markets in the developed world. European markets have seen a positive start to the year with returns almost double that of the UK. Again, no surprise for investors that, once again, US markets have continued with their strong track record over the quarter, partly driven by the strong returns of some of the Magnificent 7. Perhaps most surprisingly, given their previous 30-year record, Japan has trumped most markets over this quarter. As we alluded to previously, this is partly due to the resurgence of Japanese value equities with strong earnings as the nation starts to emerge from a prolonged period of deflation and negative interest rates.



Source: Timeline (2024)

Emerging markets have continued to struggle and lag behind their developed markets counterparts this quarter, returning approximately 3.79%. With the continued high interest rates globally, it has stifled growth for the region over the past year, however, the levelling out of the interest rates from the Fed is a positive sign moving forwards. As debt starts to become cheaper in these economies, which is set to occur when the Fed reduces interest rates, companies should experience an increase in funding, helping to increase needed capital expenditure into the next quarter. The Chinese market has also posted some positive economic indicators which has created a ripple effect of stabilisation across the small Asian markets.

[8] Bloomberg (2024)

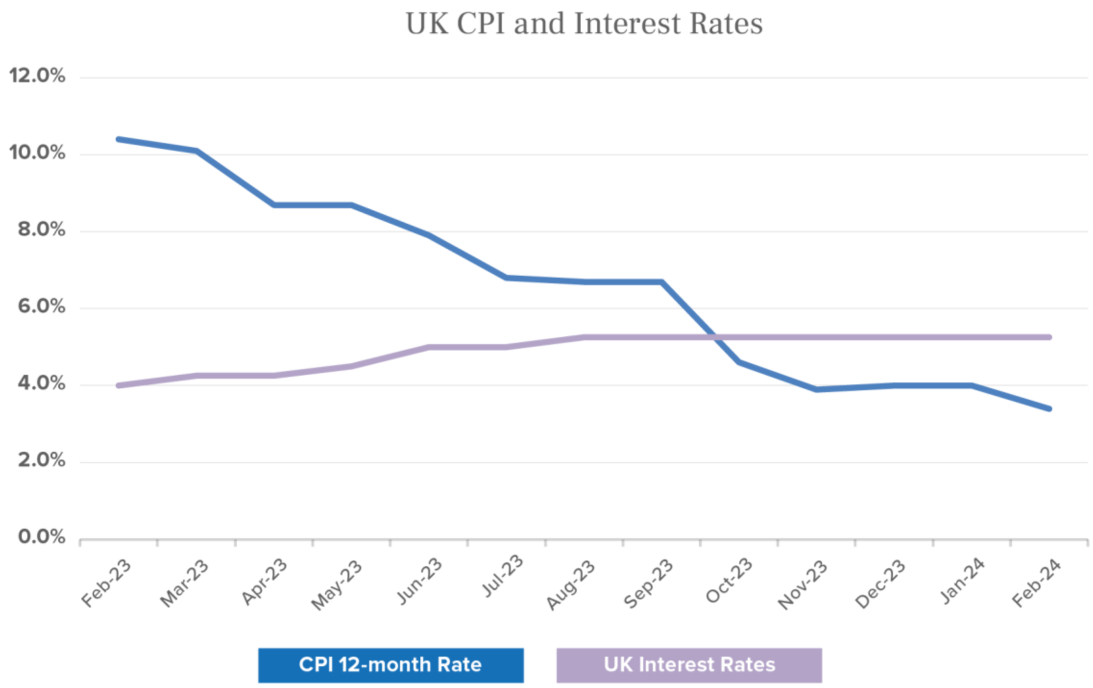
Real Estate

Real estate has continued to lag behind both the equity and fixed income markets globally this quarter, returning -0.5%. The recent years of high interest rates have led to many challenges, but perhaps the area worst hit has been the commercial real estate sector. With Central Banks globally signaling rate cuts later this year, many investors are eagerly awaiting a possible resurgence in property markets. Yet, there are still a number of hurdles which may continue to cause issues before markets see any benefit. Some analysts have cited that companies having to refinance in these high interest rate environments, and others deciding to delay transactions until markets improve, are a continued trend at the moment.[9]

Fixed Income

Interest Rates and Inflation

The Bank of England's decision to keep rates level in March echoed the Fed's own cautious choice to hold rates the previous day. Whilst both countries are reporting promising inflation figures, both Central Banks are hesitant to pull the trigger to lower rates until there is enough evidence that this reduction is more than a temporary blip. With UK inflation falling to 3.4% in February 2024[10], it's a positive sign for the year ahead with a 0.6% drop since January alone.



Sources: ONS (2024) and the Bank of England (2024)

Promisingly, a few countries have already lowered interest rates in the first quarter, including Mexico, Brazil, Chile, Peru and Switzerland.[11] These cuts are signaling that economies are feeling confident in meeting their inflationary targets moving into 2024. The South American countries were quick to increase their interest rates in 2021, compared to the developed world. This has helped these Central Banks begin loosening monetary policy

[9] Reuters (2024)
[10] ONS (2024)
[11] Financial Times (2024)

at the start of this year.

The knock-on effect of continued high interest rates has proved to be a dampener on fixed-income markets, with global bonds returning -0.35% this quarter. Government bonds have also lagged behind returning -0.64%, just behind their corporate counterparts. With rate cuts looming on the horizon, this should create a supportive environment for a fixed income rebound moving forward.

Alternative Assets and Cryptocurrencies

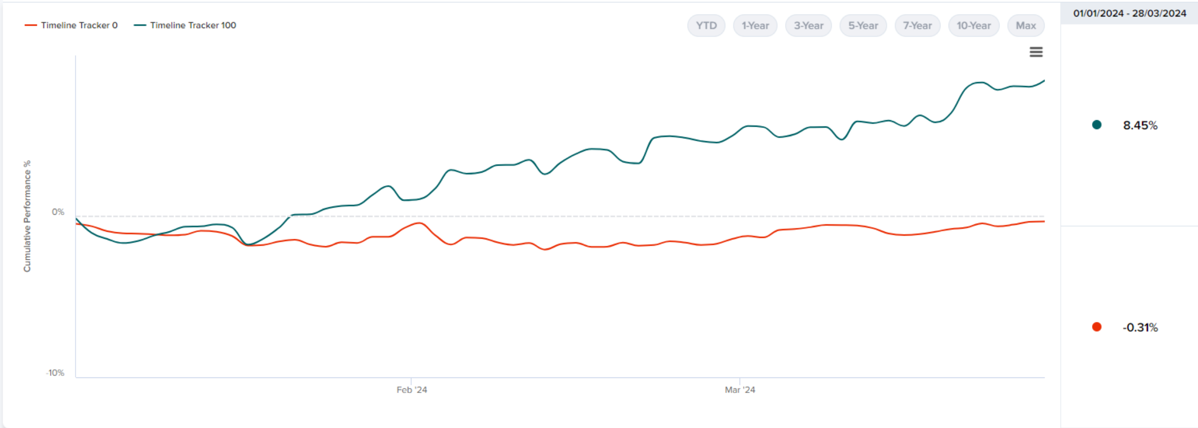
Bitcoin has reached all-time highs after the regulators in the US greenlit the Bitcoin exchange traded fund (ETF). These ETFs allow investors to access an asset class - that was potentially too inaccessible and unregulated before - without having to own the physical underlying asset. Whilst some are heralding this as the beginning of Bitcoin's legitimacy in the mainstream, with fund managers such as BlackRock lending their credibility, this investment is still in its infancy. The volatility of the asset class still makes it almost impossible to view it as a currency and, with no physical asset to tie its value to, it is still a high-risk investment proposition. Year to date, the iShares Bitcoin Trust (IBIT) has had monumental performance, however, it’s clear to see that even in this short amount of time, there is plenty of volatility to be observed.

Source: BlackRock (2024)

Portfolio Performance

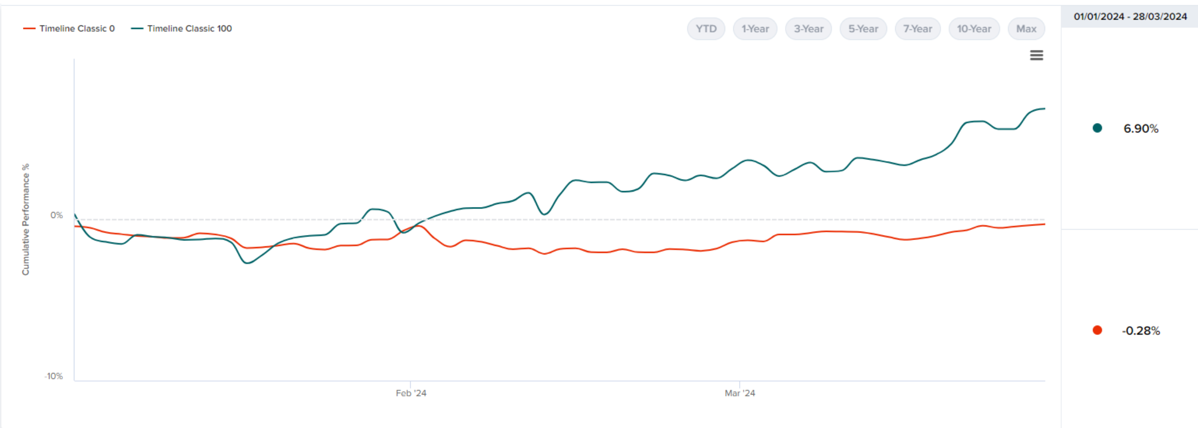
Timeline Tracker

The Timeline Tracker portfolios, designed to closely mimic global market indices, have thrived amidst the strong momentum in equity markets that began last year and continues into 2024. Notably, the Tracker 100 model has delivered an impressive 8.45% return this quarter. However, the Tracker 0 model, fully invested in bonds, has also mirrored the lower performance seen in the fixed income market due to persistently high interest rates, returning -0.31% in Q1.



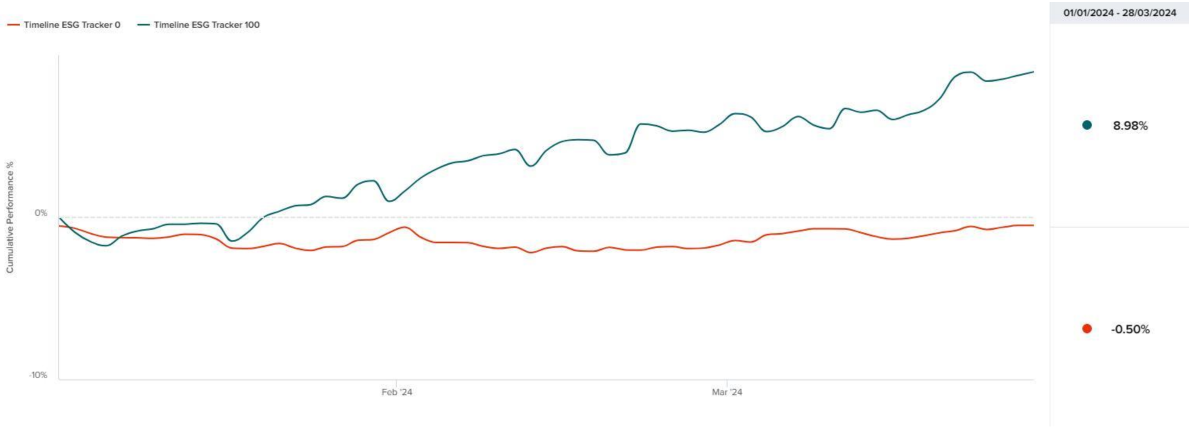
Timeline Classic

The Timeline Classic model maintains a tilt to "small" and "value" stocks, which have faced lower returns than their Tracker counterparts in Q1, with shares of large-cap, technology companies continuing to soar. This trend helps to explain the difference in performance between the Tracker 100 (8.45%) and Classic 100 (6.90%) models. On the fixed-income side, the Classic 0 model has seen a return of -0.28%, in line with the performance of the global bond market this quarter.



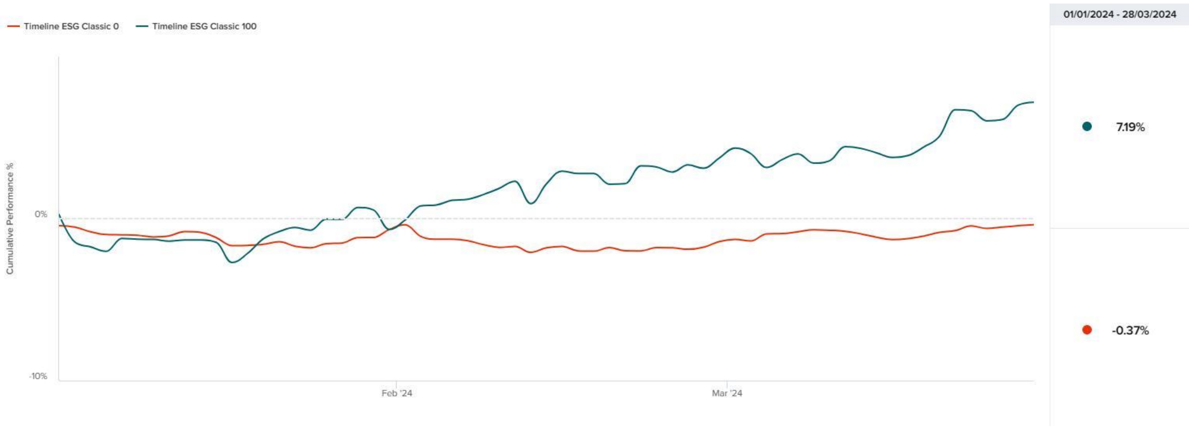
Timeline ESG Tracker

The ESG Tracker portfolios, meticulously crafted for robust diversification and bolstered by strong ESG principles, have demonstrated impressive performance in the initial quarter. This model, engineered to mirror global market trends, has not only outperformed but also enhanced its ESG rating. In this period, the Timeline ESG Tracker 100 model has surged, delivering a return of 8.98%. Conversely, the Timeline ESG Tracker 0 model, characterised by 100% allocation to fixed income, yielded a more modest return of -0.50%.



Timeline ESG Classic

The ESG Classic model, curated for global diversification and fortified with a commitment to sustainable investing, also aims to capture both value and small-cap premiums. During the first quarter, the Timeline ESG Classic 100 model delivered an impressive return of 7.19% driven by its strategic focus on value-oriented stocks. Meanwhile, maintaining comparable exposure to the primary factors influencing bond returns, the Timeline ESG Classic 0 model garnered returns of -0.37%.



Final Thoughts

The start of 2024 has been a tentatively positive one, as economic factors seem to be pointing in the right direction. However, with a year of potential surprises in the form of elections, crypto regulation, and continued cost of living pressures, we would be amiss, given the potential increased volatility ahead, not to remind readers that investing is for the long term. Volatility is synonymous with investing, and it is natural for markets to experience ups and downs over time. Industry research illustrates that timing the market can be a thankless endeavour. Missing just a few key dates in the market can have compounding and long-lasting detrimental effects on an investor's portfolio.

Interest rates continue to be a topic of major discussion, with increases expected in the not-so-distant future. The long-awaited increases could have a ripple effect across both fixed income and real estate asset classes, hopefully providing some reprieve from the low returns of late.

Best wishes,

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