HYMANS ROBERTSON

INVESTMENT SERVICES

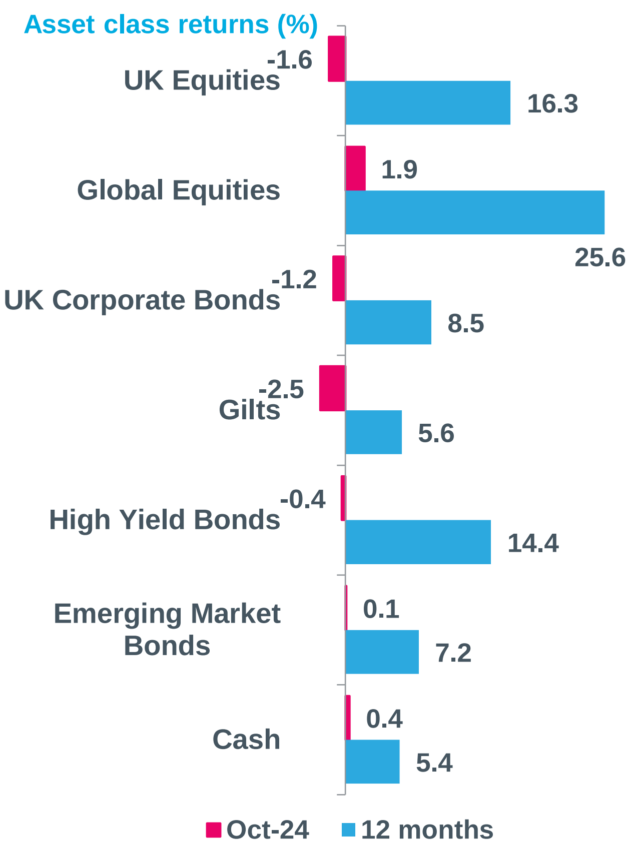
Hymans Robertson Investment Services (HRIS)

Market digest

October 2024

Monthly highlights

- The UK Budget pushed up gilt yields as additional government spending and borrowing is expected to cause inflation to rise in the short term.
- US treasury yields also moved higher as markets started to price in an election victory for Trump.
- On page 3 of this document, we provide market commentary to cover the 12 months to 30 September 2024.



Source: Morningstar. Figures to 31 October 2024. 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 typically invest in a combination of the asset classes shown in the left-hand chart.
- A growing expectation of a Trump victory and an inflationary Budget in the UK combined in October to drive up bond yields for both US treasury bonds and gilts (bond prices fall as yields rise). This continued into November after Trump's victory was confirmed.
- Global equities nudged higher over the month, but this was only as a result of the weaker pound, with the dollar in particular strengthening rapidly. Ignoring currency movement, the equity market was subdued by the effect of higher bond yields.
- China's sharp equity market rally at the end of September started to tail off as stimulus measures announced by the government disappointed.
- High-yield bonds held up better than other bond markets as they are less sensitive to rising bond yields. EM bonds, like equity markets, generated returns only from currency moves.
- At a portfolio level, equities tended to outperform bonds resulting in higher risk portfolios producing greater returns than lower risk portfolios over the month.

Outlook and topical market themes

- Trump's election victory caused a large market reaction in equities, US Treasury bonds, and the US dollar. Volatility continues to be high as global investors digest the reality of a Trump presidency.
- The Bank of England agreed with the Office of Budget Responsibility (OBR) that the Budget is likely to be inflationary. Interest rates are likely to fall more slowly as a result.

Market volatility remains in the aftermath of Trump's election

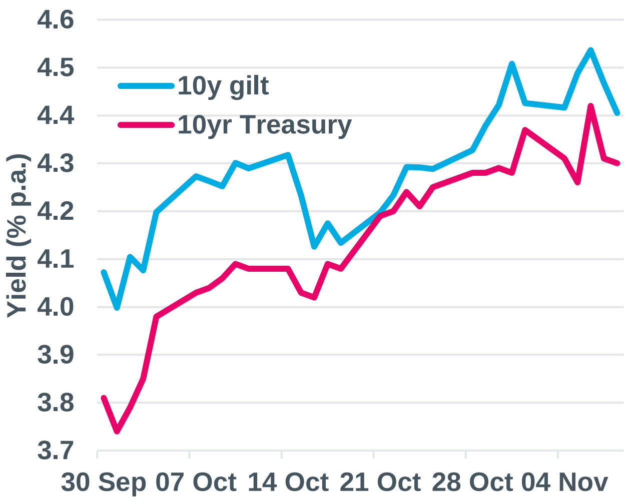
We wrote about the immediate impact of Trump's election victory on markets here. In the days that followed we have continued to see large market moves, especially in the dollar and US Treasury bond yields. There's still a lot of uncertainty as to what a Trump administration will look like. How much was just campaign rhetoric, and what checks and balances there will be, remains to be seen. At the Federal Reserve (Fed) 7 November meeting, Chair Powell stated that the election will have no effect on monetary policy in the near term, as the Fed does not know the timing or substance of Trump's policies. This, alongside some reassurance about Fed independence (Powell stated that Trump cannot fire him), temporarily brought Treasury yields down from their high, but they remain volatile. Meanwhile, the dollar continued to strengthen rapidly as the inflationary and growth outlook for the US evolves higher. To date, the Trump market rally has contributed positively to portfolio performance. We have not made any portfolio changes following the election, our strategic focus means we prefer to look through the short-term speculation, preferring to make decisions based on the actual policies.

The Bank of England agrees that the Budget will add to inflation

With the exception to gilts, the Budget's impact on markets was less than the US election's. Even gilts were calm during the Budget speech, but yields started to rise later that afternoon and the days that followed. This was not so much a loss in confidence like we saw in 2022's mini-budget. Rather, it was reflecting the inflationary impact of the Budget and what this meant for the Bank of England's (BoE) path of interest rate cuts. The key thing was if the BoE agreed with the OBR's assessment that the Budget would add to inflation, reaching a peak impact of 0.4% in 2026. The BoE released updated forecasts for the UK economy following their meeting on 7 November. This showed that the BoE's view on the inflationary impact of the Budget is consistent with the OBR's. From this, it's fair to assume that the BoE will therefore cut interest rates at a slower pace than they would have otherwise. This will probably look something like a 0.25% cut roughly once per quarter.

Chart of the month

The Budget and Trump's victory have led to a sharp increase in gilt and treasury yields respectively



Source: Bank of England, Federal Reserve Bank of St Louis.

Both gilt and US treasury bond yields have been increasing rapidly since September. The anticipation of a large Budget and Trump victory caused yields to rise even before the events.

Both the Budget and election are expected to lead to additional government borrowing and bond issuance. They are also likely to be inflationary, meaning central banks will have to tread more carefully when it comes to rate cuts – hence the pickup in yields to levels last seen around 2008. It's worth remembering that higher yields are often associated with higher forward looking nominal returns for asset classes, something which will bring comfort to long-term investors.

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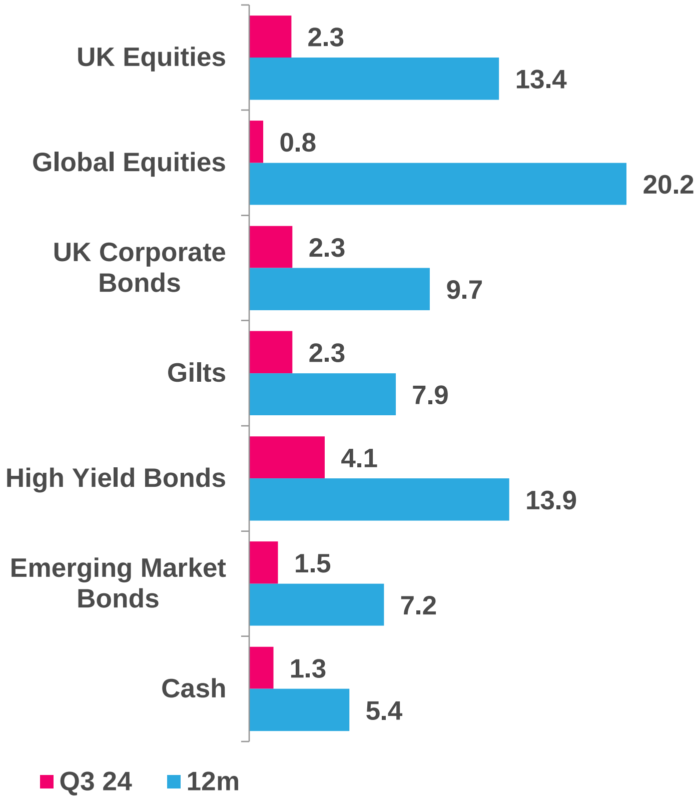
Annual market summary: covering the 12 months to 30 September 2024

Throughout this 12-month period, the US economic growth story gave mixed signals. Recession doubts dwindled for most of the period before a below expectations job report, amongst other data points, brought it back into question. The UK started the period with a technical recession, having shrunk again in Q4 2023. However, the UK is expected to have grown since then with estimated GDP figures of 0.6% in Q1 24 and 0.7% in Q2 24, putting deeper recession fears to bed.

Asset class returns (%)



Source: Morningstar. Figures to 30 September 2024. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

Central banks began to cut rates over the 12 months. The Bank of England held the rate at 5.25% until August 2024 when they cut it to 5%. The Fed followed in September 2024 with a 0.5% cut. The rate cuts were well received by investors with equity and bond prices both increasing. Further rate cuts have been priced into markets for the next 12 months into 2025. The pace of future rate cuts has now become a key talking point for investors with the macroeconomic backdrops far from straightforward. In the UK, headline CPI briefly fell back to the BoE's target of 2.0%. Services inflation caused some caution and was a factor in the BoE deciding to cut just the once over the period. Over the 12 months, UK inflation fell from 6.7% to 2.2%, while interest rates fell from 5.25% to 5.0%.

Geopolitical risk in the Middle East grew, as conflict in Israel and Palestine broke out into Lebanon. The region's importance to global trade and energy markets meant the price of oil increased towards the end of the period. The threat of a reversal in the disinflationary process experienced over the last 12 months was brought further into question.

Bond performance was mixed over the period as expectations on inflation and interest rates were ever changing. Q3 24 saw key central bank rate cuts boost bond markets, ending the 12-month period strongly. Equity markets performed even better, with large US technology driving markets for most of the 12 months. China's announcement of fresh stimulus boosted sentiment for emerging markets, leaving the global equity market with strong returns over the 12-month period. The US market was the best performing region, benefitting from a heavy tech exposure and several companies that gained from exposure to stocks that gain from the growth of Artificial Intelligence, such as chipmaker Nvidia. Emerging Markets and the UK both lagged the global market, with growth prospects looking weak in the first 9 months of the period. They recovered to some extent in Q3 24 as fresh stimulus in China, and the controlling of inflation in the UK, contributed positively to their respective economic outlooks.

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