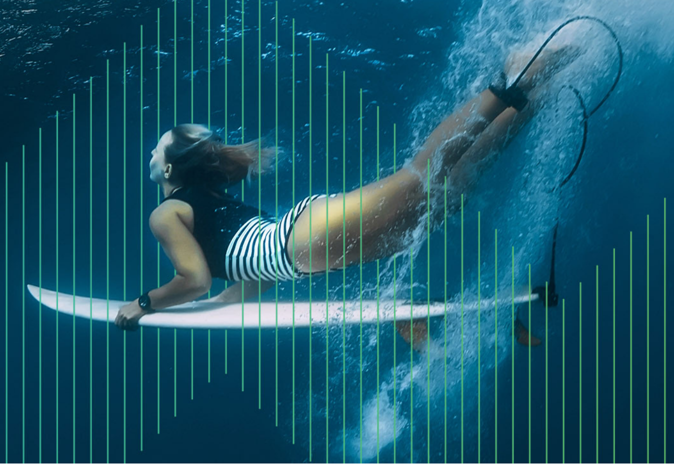

HYMANS ROBERTSON

Market brief

May 2024

May 2024 – highlights

- First-quarter growth in the US economy was revised lower again in May, but the data still highlighted decent domestic demand, with the downside surprise owing largely to falling net exports and inventories. Meanwhile, the eurozone economy officially exited recession, as Q1 GDP was confirmed at 0.3% quarter on quarter in May.
- US flash composite purchasing managers' indices (PMIs) exceeded expectations in May, while European PMI data indicated that activity improved. The UK PMI continues to suggest robust growth, despite slipping back in May.
- Year-on-year US headline CPI inflation edged lower in April and equivalent UK inflation fell significantly, albeit less than expected. Eurozone inflation, meanwhile, was revealed to have risen in May.
- Despite ongoing signs of sticky inflation, the US Federal Reserve's pushback against the suggestion of further rate rises prompted US bond yields to fall. UK yields fell modestly, while eurozone yields rose.
- A decline in bond yields and a slate of better-than-expected earnings supported global equities, with the FTSE All World Total Return Index rising 3.7% in May. Technology was the best-performing sector, supporting growth stocks more broadly.
- Credit spreads generally continued to tighten and gold rose further in May, reaching fresh all-time highs. Meanwhile, oil prices fell amid supply-cut doubts and demand forecasts.
- The US dollar made its first monthly fall this year amid softer inflation and a decrease in market-implied interest rates, while the UK pound and euro rose. The Japanese yen continued to weaken, despite a relative rise in Japanese yields and policymakers confirming they had intervened to support the currency in April.

Market performance to end May 2024

UK	May	Q1 24	2024
EQUITIES	2.4	3.6	8.7
BONDS			
Conventional gilts	0.8	-1.6	-3.7
Index-linked gilts	1.4	-1.8	-4.0
Credit	0.8	0.1	-0.9
PROPERTY**	n/a	0.6	1.1
STERLING			
v US dollar	1.7	-0.9	-0.1
v Euro	0.1	1.4	1.6
v Japanese yen	1.5	6.4	11.3

GLOBAL	May	Q1 24	2024
EQUITIES	3.7	9.5	10.6
North America	4.7	10.2	10.7
Europe ex UK	3.6	9.5	11.8
Japan	1.0	18.7	18.8
Dev. Asia ex Japan	0.1	3.2	1.6
Emerging Markets	1.0	4.1	7.5
GOVERNMENT BONDS	0.5	0.2	-0.6
High Yield	1.2	2.0	2.5
Gold	1.5	7.2	12.8
Oil	-7.0	12.5	5.3

Percentage returns in local currency ($ for gold and oil). All returns to 31/05/2024, *apart from property and hedge fund data 30/04/2024 Source: DataStream and Bloomberg. FTSE Indices shown: All Share, All World, W North America, AW Developed Europe ex-UK, W Japan, AW Developed Asia Pacific ex-Japan, Emerging, Fixed Gilts All Stocks, Index-Linked Gilts All Maturities, iBoxx Non-Gilts, S&P GSCI Light Energy, Crude Oil BFO, ICE BofA Global High Yield, Gold Bullion LBM, MSCI UK Monthly Property and BBG Aggregate Government Total Return.

The global economy

US Q1 GDP was revised lower in May, to an annualised quarterly pace of 1.3%, compared to the blistering 3.4% pace set in the last quarter of 2023. However, the data suggest that private-sector demand remains strong, with consumer spending, residential and non-residential investment still expanding at a decent pace. Volatile business inventories and higher-than-expected imports were the main drags on the headline figures. The eurozone and UK exited technical recessions in Q1, with quarter-on-quarter GDP rising 0.3% and 0.6%, respectively. The UK expanded at its fastest pace since 2021. Japanese GDP fell by more than expected, at -0.5% quarter on quarter.

Survey data suggest global growth momentum improved in Q2. After indicating a couple of months of slower growth, the flash US composite PMI suggests activity expanded at the fastest pace in over two years in May, as service sector activity rose sharply and manufacturing showed stronger growth. Eurozone PMIs point to continued recovery in activity, and the UK survey suggests robust growth, despite slipping back in May. While services continue to be the engine of growth in the current expansion, the upturn in the global manufacturing PMI gathered pace in May, with rates of expansion in output and new orders both strengthening. Input cost pressures eased in the UK, eurozone and Japan but rose at faster rates in the US, driven by rising prices in the manufacturing sector.

Owing largely to energy prices, and their interaction with the Ofgem energy-price cap, year-on-year UK headline inflation fell by a meaningful 0.9% in April, to 2.3%. However, this was still less than the expected decline to 2.1%. Core CPI, which excludes volatile energy and food prices, remained at 3.9%, while services inflation fell modestly to 5.9% year on year. Following several months of upside surprise, US headline CPI inflation eased modestly, to 3.4% year on year in April, while the core measure eased to 3.6% year on year. Meanwhile, the flash release suggests eurozone headline and core inflation both rose more than expected in May, to 2.6% and 2.9%, respectively.

While noting in its May meeting that it needs to see more progress on disinflation before embarking on rate cuts, the US Federal Reserve pushed back against the notion that the next move in rates could be higher. The European Central Bank (ECB) also suggested that it's still on track to reduce rates in June, despite the recent setback in inflation data. Near-term US interest-rate expectations are little changed, with the market still expecting just one 0.25% pa cut in 2024, but longer-term expectations eased slightly. A similar pattern was observed in the UK, with markets continuing to expect one 0.25% rate cut in 2024. Given the weaker inflationary pressures, markets still anticipate that the ECB will act earlier, delivering two or three 0.25% pa cuts in 2024.

Fixed income markets

SOVEREIGN BOND YIELDS

US and UK sovereign bond yields fell, while Japanese and eurozone bond yields rose.

INFLATION EXPECTATIONS

Inflation expectations, as implied by bond markets, moved slightly lower across geographies.

CORPORATE CREDIT

Credit spreads generally ground even tighter, but US high-yield spreads rose modestly.

EMERGING MARKET DEBT

Local-currency emerging market sovereign bond yields fell, and index currencies strengthened versus the US dollar.

Sovereign bond yields were mixed

US 10-year bond yields fell 0.2% pa to 4.5% pa and equivalent gilt yields eased very modestly to 4.3% pa, as inflation fell in both countries. Sovereign bond yields generally rose in Europe, as higher-than-expected inflation releases weighed on rate-cut expectations, with German 10-year bond yields rising by 0.1% to 2.7%. Equivalent Japanese yields rose by 0.2% pa to 1.1% pa, as markets bet on further interest-rate increases, which some market commentators have suggested might be deployed to defend the beleaguered Japanese yen.

Inflation expectations eased slightly

UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, was little changed at 3.8% pa. Equivalent US and German implied inflation both fell very marginally, to 2.4% pa and 2.1% pa, respectively.

Credit spreads remain historically tight

Credit spreads generally ground tighter in May amid decent economic data and yield-driven demand. That said, US speculative-grade credit spreads bucked the broader trend, rising marginally. Global investment-grade spreads eased slightly and remained around 0.9% pa, with little regional dispersion. However, while European speculative-grade credit spreads declined by 0.2% pa to 3.3% pa, their US counterparts rose slightly to 3.2% pa. US and European leveraged loan spreads declined 0.1% pa and 0.2% pa, to 4.9% pa and 4.8% pa, respectively.

Moody's expects defaults to fall

Moody's 12-month speculative-grade default rate rose by 0.1% to 5.2% in April from March's upwardly revised rate. With global growth expected to stabilise at only modestly lower levels in 2024, and with the prospect of interest-rate cuts on the horizon, the ratings agency forecasts that the default rate will decline to 3.6% by the end of 2024, below long-term averages. This forecast is underpinned by healthy corporate balance sheets, limited near-term refinancing requirements, anticipated easing in financial conditions and low speculative-grade credit spreads.

Emerging market debt delivers a positive return

Hard-currency debt, as measured by the JPM EMBI Global Diversified Index, returned 1.8% in dollar terms, as a 0.4% pa fall in the underlying treasury yield spreads more than offset a modest widening in credit spreads. Local-currency emerging market debt, as measured by the JPM GBI-EM Global Diversified Traded Index, returned 1.6% in dollar terms as yields fell modestly and index currencies, in aggregate, strengthened 0.7% versus the dollar.

Global equities

Growth stocks outperform value

The FTSE All World Total Return Index rose 3.7% in local-currency terms in May. US first-quarter earnings reported to date have beaten expectations by a wide margin and, more importantly, forecasts for full-year global equity earnings per share growth of around 10% in 2024, made at the start of the year, remain largely intact with the Q1 earnings season almost over. Technology was the best-performing sector, as lower US yields benefited valuations, and utilities and financials were the only other outperformers. Energy was the worst-performing sector, as oil prices fell. More value-oriented sectors – such as consumer staples, basic materials and industrials – materially underperformed. Growth stocks outperformed value stocks by a wide margin in May.

US stocks hit new highs amid lower bond yields and strong earnings

Despite all major regions having a positive absolute return, North American equities were the only outperforming region, given the market's above-average exposure to the outperforming technology sector, which benefited from falling bond yields and strong earnings releases.

Emerging and Asian markets, including Japan, underperformed

Emerging markets were the worst-performing region, as very weak inflation prints highlighted the fragility of the Chinese economic recovery, causing the rally there to falter. Japan was the next-worst performer in May. While yen weakness has typically been viewed as a positive for the exporter-heavy Japanese market, policymakers and investors are growing concerned about the impact of yen weakness on the spending power of consumers and importers. UK stocks also underperformed, given below-average exposure to the outperforming technology sector, and above-average exposure to the underperforming energy sector. Europe ex UK only underperformed modestly, despite below-average exposure to the technology sector, as the region benefited from positive earnings surprises.

Currencies, commodities and property

The US trade-weighted dollar fell 0.4% in May, as softer inflation and a decrease in market-implied interest rates pushed the currency into its first negative month of the year. The UK trade-weighted pound rose 0.7%, as higher inflation pushed back expectations of an interest-rate cut next month. The Japanese trade-weighted yen slipped -0.5%, despite increasing expectations that the Bank of Japan might raise interest rates further and confirmation that policymakers had intervened to support the yen in April. Gold rose a further 1.5% in May to reach all-time highs, supported by geopolitical tensions, while crude oil fell 7.0% as traders questioned the durability of OPEC+ supply cuts and cast doubt on the strength of demand forecasts.

The MSCI UK Property Total Return Index rose 0.5% in April, while capital values rose for the first time in a year – though very marginally. The 12-month total return to the end of April was 0.2%, as income offset a 5.3% fall in capital values. Over the 12 months, capital values fell most sharply in the office sector, declining 16.0%. Over the same period, retail capital values fell by 5.7%, while industrial values rose a modest 0.4%. Aggregate annual nominal rental growth fell to 3.6% pa in April, but real rental growth rose as year-on-year inflation fell more sharply. Structural demand continues to support rental growth in the industrial sector, where nominal rents increased by 6.5% over the 12 months to end April. Annual rental growth remains much weaker in the office and retail sectors, at 2.3% and 0.8%, respectively.

For and on behalf of Hymans Robertson LLP

If you'd like to discuss anything covered in this publication, please get in touch with your usual Hymans Robertson Consultant or one of our authors below.

Chris Arcari
Head of Capital Markets

chris.arcari@hymans.co.uk
0141 566 7986

Ross Rausch
Investment Research Analyst

ross.rausch@hymans.co.uk
0121 212 8109

Additional Notes

Important Information

This communication has been compiled by Hymans Robertson LLP® (HR) as a general information summary and is based on its understanding of events as at the date of publication, which may be subject to change. It is not to be relied upon for investment or financial decisions and is not a substitute for professional advice (including for legal, investment or tax advice) on specific circumstances. It contains confidential information belonging to Hymans Robertson LLP (HR) and should not be disclosed to any third party without prior consent from HR, except as required by law.

HR accepts no liability for errors or omissions or reliance on any statement or opinion. Where we have relied upon data provided by third parties, reasonable care has been taken to assess its accuracy however we provide no guarantee and accept no liability in respect of any errors made by any third party.

Please note the value of investments, and income from them, may fall as well as rise. This includes but is not limited to equities, government or corporate bonds, derivatives, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of investments. As a result, an investor may not get back the full amount of the original investment. Past performance is not necessarily a guide to future performance.