

- ▶ Data released in Q4 showed the US economy continued to grow strongly in Q3, at annualised pace of 3.1%, while eurozone GDP rose a more modest 0.4% quarter-on-quarter and the UK economy stagnated.
- Timelier Composite Purchasing Managers' Index (PMI) data suggest transatlantic disparity continued in Q4: Surveys indicate US activity expanded at its fastest pace in three years in December but point to contraction in the eurozone and stagnation in the UK, as service-sector expansion was offset by manufacturing weakness.
- In November, year-on-year headline CPI rose to 2.7%, 2.6% and 2.3% in the US, UK and eurozone, respectively, owing to a smaller drag from energy prices. Core inflation, which excludes volatile energy and food prices, remained at 3.3% and 2.7% in the US and eurozone, respectively, but rose to 3.6% in the UK.

DECEMBER HIGHLIGHTS

- ➤ Central banks looked through the rise in headline inflation, as the US Federal Reserve (Fed) and European Central Bank (ECB) both reduced rates a cumulative 0.5% pa, to 4.25–4.5% pa and 3.0% pa, respectively. Given signs of more persistent inflation, the Bank of England (BoE) reduced rates less, cutting 0.25% pa to 4.75% pa.
- Despite interest-rate cuts, sovereign bond yields rose as inflation, and interest rate, expectations crept up, and markets anticipated heavier bond supply. Nonetheless, global credit spreads continued to grind tighter.

- ▶ Global equities fell in December as yields rose, but still gained 1.3% in Q4. Japan outperformed as ongoing yen weakness supported the export-heavy market. The US also outperformed as domestically focused stocks were buoyed by President-elect Trump's expected policy agenda of tax cuts and deregulation.
- Expectations of higher-for-longer US rates than elsewhere saw the trade-weighted dollar rise a further 6.4%, while equivalent yen, sterling and euro measures fell 4.5%, 1.5% and 2.0%, respectively. Gold prices fell 0.3%, after hitting new highs in October, amid dollar strength and profit-taking by investors.

Market performance to end December 2024

UK	Dec 24	Q4 24	2024	GLOBAL	Dec 24	Q4 24	2024
EQUITIES	-1.2	-0.4	9.5	EQUITIES	-1.5	1.3	20.6
BONDS				North America	-2.5	2.8	25.0
Conventional gilts	-2.2	-3.1	-3.3	Europe ex UK	-0.2	-3.4	8.2
Index-linked gilts	-4.3	-6.0	-8.3	Japan	4.1	5.4	20.6
Credit	-0.6	-0.5	1.7	Dev. Asia ex Japan	-2.1	-3.8	3.4
PROPERTY**	n/a	1.7	5.9	Emerging Markets	1.4	-3.8	17.4
STERLING				GOVERNMENT BONDS	-1.3	-2.1	0.0
v US dollar	-1.5	-6.6	-1.8	High Yield	-0.2	0.5	8.9
v euro	0.5	0.6	4.8	Gold	-1.3	-0.3	27.1
v Japanese yen	3.1	2.6	9.5	Oil	2.1	3.9	-3.8

Percentage returns in local currency (\$ for gold and oil). All returns to 31/12/2024, *apart from property 30/11/2024 Source: DataStream and Bloomberg. FTSE Indices shown: All Share, All World, North America, AW Developed Europe ex-UK, Japan, 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.

Fixed income markets

Sovereign bond yields rose significantly

US 10-year sovereign bond yields rose 0.8% pa, to 4.5% pa. Strong US economic data, expectations that Trump's policy agenda of tax cuts and tariffs will be inflationary, and anticipation that issuance will remain high to fund the large fiscal deficit contributed to the rise. UK 10-year sovereign bond yields rose 0.6% to 4.6% pa, jumping after the Autumn Budget. The budget was expected to be inflationary, which raised interest-rate expectations, but the market also reflects the risk of higher future gilt issuance. As a result, term premia (the additional amount required by investors to hold a long-term instrument versus a short-term deposit) also rose.

French 10-year government bond yields rose 0.3% pa to 3.2% pa, as the government's failure to pass a budget, and its subsequent collapse, saw Moody's downgrade France's debt rating. Equivalent German yields also rose 0.2% pa to 2.4% pa. Japanese 10-year government bond yields rose 0.2% pa to 1.1% pa, as investors expect the Bank of Japan (BoJ) to continue to raise interest rates.

UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose by 0.1% pa, to 3.5% pa. The equivalent US measure rose 0.2% pa, to 2.3% pa.

Credit spreads continued to grind tighter

Credit spreads fell over the quarter, continuing the year-to-date trend. Global investment- and speculative-grade credit spreads fell 0.1% pa and 0.2% pa, to 0.9% pa and 3.1% pa, respectively, remaining close to historic lows. Low credit spreads reflect both strong yield-driven demand and benign default forecasts (consistent with a soft economic landing) made by the major credit-rating agencies.

Rising yields and a stronger dollar hampered returns from emerging market debt

Despite a 0.3% pa decline spreads, hard-currency debt, as measured by the J.P. Morgan EMBI Global Diversified Index, returned -1.9% in dollar terms, as US Treasury yields rose sharply. Local-currency emerging market debt, as measured by the J.P. Morgan GBI-EM Global Diversified Traded Index, returned -7.0% in dollar terms, as yields rose and index currencies, in aggregate, weakened significantly against the US dollar.

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Global equities

Japan and North America outperformed

The FTSE All World Total Return Index rose 1.3% in local-currency terms in Q4, despite a sell-off in December as the Fed's hawkish rhetoric after its rate cut weighed on sentiment. US equities outperformed, given strong growth and expectations that President-elect Trump's tax cuts and deregulation will lend further support. Domestically oriented stocks outperformed in the aftermath of the election result, buoyed by anticipation of the impact on domestic demand from tax cuts. At the same time, large-cap tech stocks continued to produce strong returns.

Having been the worst-performing region in Q3, Japan was the best-performing region in Q4. Yen weakness boosted expected earnings from the export-heavy market, while sentiment also improved following reassurances from the BoJ that it would closely consider market stability in future policy decisions, given the sharp sell-off in Q3. The region was also boosted by positive dealmaking news and increased share buybacks.

All other major regions underperformed

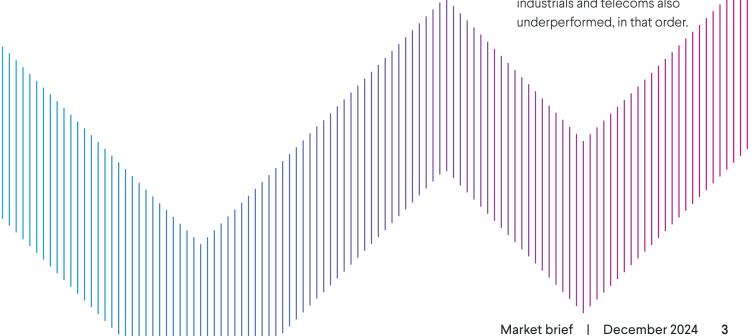
Trump's return to the White House didn't augur well for equity returns outside the US. The prospect of increased trade frictions, expectations of higher-for-longer US interest rates and a stronger US dollar all weighed on market sentiment. Emerging market and Asian equities declined the most, having also been impacted by an underwhelming stimulus packaged announced by the Chinese authorities, given ongoing property challenges and low consumer confidence.

Europe ex-UK equities also underperformed due to concerns over US trade policy, ongoing weakness in the region's crucial manufacturing sector and increased competition from low-cost Chinese imports. Fragmented politics in France and Germany, and weak demand for exports from China, also weighed on the region more broadly. The UK underperformed due to below-average exposure to the outperforming technology sector.

Consumer discretionary was the best-performing sector

Sectoral performance was influenced by expectations about Trump's presidency. Consumer discretionary led, supported by strong US macroeconomic data and the expectation that personal tax cuts will be extended. Technology stocks continued to outperform, despite a drop off in December as investors cashed in the large gains of 2024. Financials also outperformed, benefiting from expectations of a lighter regulatory approach and an expected pick-up in dealmaking, as well as higher-for-longer interest rates, which boost net-interest income and earnings.

Basic materials was the worstperforming sector, weighed down
by weak economic data from the
eurozone and subdued Chinese
activity, and a subsequent decline in
industrial metals prices. Healthcare
stocks followed closely, declining
after Trump's presidential election
win, due to expectations the new
administration may be more hostile
towards the pharmaceutical industry.
Consumer staples, utilities, energy,
industrials and telecoms also
underperformed, in that order.



Currencies, commodities and property

Expectations that US interest rates will remain higher for longer and the potential impact of tariffs on the competitiveness of other countries' exports saw the trade-weighted US dollar rise 6.4%. Equivalent sterling and Japanese measures fell 1.5% and 4.5%, respectively, as some prior gains against the dollar unwound, while the euro fell 2.0%.

Oil prices rose 3.9%, but remain relatively low, at \$75 per barrel, as the potential supply impact from ongoing conflict in the Middle East was weighed against soft demand due to subdued Chinese activity and global manufacturing weakness. Despite reaching new highs in October, gold prices fell 0.3% due to a stronger dollar and profit-taking by investors, given gold's rally this year.

The MSCI UK Property Total Return Index rose 1.7% quarter-to-date to end-November, driven by income and a rise in capital values. The 12-month total return to end-November edged up to 5.4%, as declines in capital values moderated. Capital values continued to fall in the office sector month on month, but, given rises in industrial and retail capital values, the aggregate decline eased to 0.5% over the 12 months to end-November.

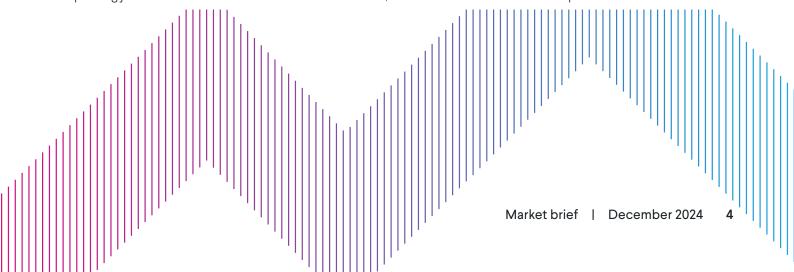
The global economy

US GDP data released in December confirmed robust annualised growth of 3.1% in Q3, above earlier estimates of 2.8%, and ahead of the 3% pace set in Q2. The US Flash Composite PMI suggests private sector activity expanded at its fastest pace in nearly three years in December, driven by strong demand and a surge in new orders. Business optimism improved significantly, reflecting reduced uncertainty following the election and anticipated growth-friendly policies from the new administration. However, this growth stayed heavily weighted towards the services sector, with the manufacturing sector continuing to contract, owing partly to weak export demand.

The UK economy slowed from H1's above-trend pace to unexpectedly stagnate in Q3. The December Flash Composite PMI remained slightly above the neutral 50 mark, representing a marginal increase in output, despite the manufacturing sector PMI figure hitting an 11-month low. The eurozone economy grew 0.4% in Q3, matching estimates and improving on H1 2024, despite the largest contraction in exports since Q2 2020 weighing on activity. The eurozone PMI showed a contraction in output, amid ongoing manufacturing sector weakness. Business surveys in both regions cited falling new orders, rising input costs and waning confidence for the year ahead.

As forecast, US and UK headline CPI inflation continued to rise to 2.7% and 2.6%, respectively, in November, while the eurozone's headline CPI rose less than expected, to 2.2%. The increases reflect a smaller negative impact from energy prices relative to last year's sharp declines. Year-on-year core inflation, which excludes volatile energy and food prices, remained at 3.3% and 2.7% in the US and eurozone, and rose to 3.6% in the UK.

Central banks looked through the rise in headline inflation, as the Fed and ECB both reduced rates a cumulative 0.5% pa, to 4.25–4.5% pa and 3.0% pa, respectively. Given signs of more persistent inflation, the BoE reduced rates less, cutting 0.25% pa to 4.75% pa. The Fed signalled a slower pace of easing in 2025, while policymakers also raised their inflation estimates for next year. The BoE also lifted its 2025 and 2026 inflation projections following October's UK budget, where spending and borrowing were increased more than expected. At the end of December, markets were expecting just two rate cuts from the BoE and Fed in 2025, down from five at the end of September.



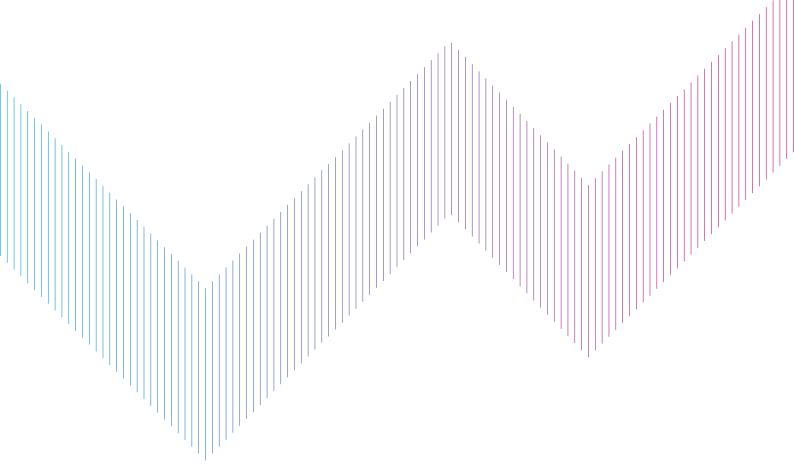
For and on behalf of Hymans Robertson LLP



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



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T 020 7082 6000 | www.hymans.co.uk

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