HYMANS ROBERTSON

Market brief

June 2024

Q2 – highlights

- Data released in Q2 showed US Q1 GDP growth slowed more than expected but pointed to still-decent domestic demand. Meanwhile, the eurozone and UK officially exited technical recessions in Q1.
- US composite purchasing managers' indices (PMIs) exceeded expectations in May, and June's data point to robust growth in services and manufacturing at the end of Q2.
- Outside the US, the J.P. Morgan Global composite PMI suggests global growth slowed at the end of Q2 across sectors and regions, including the eurozone and UK, but is still consistent with a solid pace of expansion. Crucially, the J.P. Morgan Global manufacturing PMI held close to a two-and-a-half year high in June, signalling improving operating conditions for the past five months in a row.
- While it remains stubbornly above target, at 3.3%, US headline CPI inflation edged lower in April and May. Equivalent UK inflation returned to the Bank of England's (BoE) target for the first time in almost three years, but inflation unexpectedly to 2.6% in the eurozone.
- Despite the recent inflation setback, the European Central Bank (ECB) reduced rates 0.25% pa, to 3.75% pa, in June. Amid still-elevated core and services inflation, the US Federal Reserve (Fed) and BoE held rates steady. Markets still expect fewer rate cuts in 2024 than they did at the start of the year.
- Sovereign bond yields rose on decent growth and sticky inflation data, while credit spreads changed little over Q2. Resilient growth and AI optimism saw equities post positive returns, with global growth stocks outperforming as US technology stocks surpassed earnings expectations.
- Commodities also performed well. Gold reached all-time highs and industrial metal prices rose as Chinese economic data improved and surveys pointed to a nascent recovery in global manufacturing.
- The trade-weighted US dollar rose 2.2% as markets further reduced their rate-cut expectations in 2024. The Japanese yen fell by a further 4.5% in Q2 as markets continued to bet on a wide interest-rate differential between Japan and its advanced-economy peers.

Market performance to end June 2024

UK	Q2 24	Q1 24	2024
EQUITIES	3.7	3.6	7.4
BONDS			
Conventional gilts	-0.9	-1.6	-2.5
Index-linked gilts	-2.1	-1.8	-3.9
Credit	-0.1	0.1	-0.1
PROPERTY**	1.0	0.6	1.7
STERLING			
v US dollar	0.1	-0.9	-0.8
v euro	0.8	1.4	2.2
v Japanese yen	6.4	6.4	13.1

GLOBAL	Q2 24	Q1 24	2024
EQUITIES	3.5	9.5	13.3
North America	3.9	10.2	14.5
Europe ex UK	0.6	9.5	10.1
Japan	1.4	18.7	20.4
Dev. Asia ex Japan	0.6	3.2	3.8
Emerging Markets	6.9	4.1	11.3
GOVERNMENT BONDS	-0.9	-0.8	-1.6
High Yield	1.4	2.0	3.4
Gold	5.1	7.2	12.6
Oil	-1.1	12.5	11.2

Percentage returns in local currency ($ for gold and oil). All returns to 30/06/2024, *apart from property and hedge fund data 31/05/2024 Source: DataStream and Bloomberg. FTSE Indices shown: All Share, All World, North America, AW Developed Europe ex-UK, 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.

Fixed income markets

SOVEREIGN BOND YIELDS	INFLATION EXPECTATIONS	CORPORATE CREDIT	EMERGING MARKET DEBT
Sovereign bonds yield rose across regions	Inflation expectations, as implied by the bond market, eased	Credit spreads were contained	Local-currency emerging market sovereign bond yields rose

Sovereign bond yields rose

US and UK 10-year bond yields both rose 0.2% pa over the quarter, to 4.4% pa and 4.2% pa respectively, amid robust economic activity and signs of stubborn underlying inflation pressures. Despite the ECB's rate cut, German sovereign bond yields also rose 0.2% pa to 2.5% pa, as the Governing Council struck a cautious tone on inflation and future rate cuts. French 10-year yields rose 0.5% pa, with the spread between French and German government bonds rising sharply. Investors feared that the prospect of dysfunctional politics, flagging growth, and a rising debt burden could dent France's attractiveness to foreign investors, who hold a large proportion of French debt.

Inflation expectations eased slightly

UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, eased 0.1% pa, to 3.6% pa. Equivalent US and German implied inflation also eased very slightly, to 2.3% pa and 2.0% pa, respectively.

Corporate credit spreads stayed at historically tight levels

US investment-grade spreads edged up to 1.0% pa, while UK and euro investment-grade spreads rose very slightly to 1.2% pa. US speculative-grade spreads edged up to 3.2% pa, while their European counterparts declined to 3.5% pa. Despite little change in credit spreads, UK investment-grade credit markets recorded negative total returns as income was offset by a rise in underlying sovereign bond yields. Speculative-grade markets outperformed, supported by income return and their lower duration profile, and thus lower sensitivity to changes in underlying sovereign bond yields. Euro and US high-yield bonds delivered total returns of 1.5% pa and 1.1% pa, respectively. Floating-rate US loans produced a total return of 1.9% pa.

Income drove emerging market hard-currency returns while local currency returns were negative

Hard-currency debt, as measured by the J.P. Morgan EMBI Global Diversified Index, returned 0.3% pa in dollar terms, as income more than offset increasing yields and spreads. Local-currency emerging-market debt, as measured by the J.P. Morgan GBI-EM Global Diversified Traded Index, returned -1.6% pa in dollar terms. A rise in yields and a weakening of index currencies, in aggregate, against the US dollar, more than offset returns from income.

Global equities

Technology firms led growth stocks to outperform value at a global level

Amid resilient growth and ongoing optimism for all things AI, global equities delivered another quarter of positive returns, with the FTSE All World Total Return Index rising 3.5%. US Q1 earnings comfortably beat expectations and stocks tied to AI continued to benefit from this trend. Despite cautious forward guidance, earnings releases were strong enough to prompt modest upgrades to full-year estimates for global earnings growth. For 2024 and 2025, estimates are 10.0% and 13.4%, respectively. Technology was the clearly outperforming sector, delivering a return of 13%. Utilities were the only other, albeit modest, outperformer. All other sectors underperformed, with value-oriented sectors seeing the worst underperformance: industrials, basic materials and consumer staples all underperformed, in that order. Consumer discretionary also underperformed, as did the energy sector as oil prices fell. While healthcare, telecoms and financials underperformed too, they did still manage to eke out positive returns.

Emerging and Asia ex-Japan led gains, followed by North America and the UK

The Chinese authorities moved to support the real estate sector, which boosted Chinese equities, while the AI-exposed Taiwanese stock market also delivered strong returns. Combined, these developments have helped emerging market Asia Pacific ex-Japanese equities enjoy the strongest regional performance in Q2. Despite higher bond yields, strong Q1 earning releases and above-average technology exposure meant that US equities outperformed. An improving domestic economic environment also helped UK equities outperform modestly.

European ex-UK and Japanese equities underperformed

Despite 'value' outperforming 'growth' stocks in Europe ex-UK and Japan, both regions underperformed, in that order. The snap election in France and subsequent market concerns about the possible outcome introduced significant volatility. The French equity market fell in June and detracted from the Europe ex-UK equities performance, which delivered a modest return of 0.8%. Japan was the only other underperforming region. While yen weakness has typically been viewed as a positive for the export-heavy Japanese market, policymakers are growing concerned about the impact of yen weakness on the spending power of consumers and importers.

Currencies, commodities and property

The US trade-weighted dollar rose 2.2% over Q2 after recording a first negative month in May this year, following softer inflation and a modest increase in market-implied interest rates. The UK trade-weighted sterling rose 0.7% as the BoE held rates steady. Markets have come to expect only one 0.25% pa rate cut this year, while the equivalent euro measure softened a little as the ECB lowered rates. The Japanese trade-weighted yen fell a further 4.5%. Despite expectations that the Bank of Japan might increase interest rates, and efforts by policymakers to prop up the yen, monetary policy remains comparatively accommodative, and markets continue to bet on wide interest-rate differentials between Japan and its major developed-market peers.

Gold rose 5.1%, reaching all-time nominal highs in May, supported by geopolitical tensions and central banks' buying activity. Industrial metals prices rose 8.6%. Copper prices increased due to forecast supply shortages and increased demand, which drove the rise in industrial metals. Oil prices fell 7.0% in May as traders questioned the durability of OPEC+ supply cuts and cast doubt on the strength of demand forecasts. But they recovered in June to end the quarter down 1.1%.

The MSCI UK Property Total Return Index rose 1.0% through March to May as aggregate capital values increased month on month for the first time since 2022 in March this year; they rose modestly in both April and May. The 12-month return to end-May was 0.3%, as income more than offset a 5.3% fall in capital values. Capital values continued to fall in the office sector, down 15.6% year on year, though the pace of decline has eased in recent months. While retail capital values have plateaued in recent months, they are still 5.6% lower than their level 12 months ago. Industrial capital values, which have risen a very modest 0.2% over the last 12 months, have also stabilised. Aggregate annual nominal rental growth slowed to 3.6% pa in April and May, but real rental growth rose as year-on-year inflation fell more sharply. Structural demand continues to support rental growth in the industrial sector, but it remains much weaker in the office and retail sectors.

The global economy

Backward-looking data confirmed that the US economy slowed more than expected in Q1 to an annualised quarterly pace of 1.4%. While this marks a sharp pullback from the blistering 3.4% pace set in the last quarter of 2023, the slowdown was mainly due to volatile business inventories and higher imports, with the economy still exhibiting decent, if slowing, domestic demand. Quarter-on-quarter eurozone and UK GDP increased by 0.3% and 0.7%, respectively, in Q1. The expansion was larger than was expected in both regions and means both economies officially exited technical recessions in Q1. The Q2 UK GDP data release marked the fast quarterly pace of growth since 2021, largely driven by services growth. In Asia, China's 1.6% quarter-on-quarter expansion was larger than most economists expected, while Japan's economy contracted by a larger-than-expected 0.5% quarter on quarter.

After April's downside surprise, US composite PMI data exceeded expectations in May and June, indicating that activity expanded robustly at the end to Q2. Outside the US, the Global Composite PMI, which aggregates global activity across both the manufacturing and service sectors, suggested the global growth upturn had eased as expansions in output and new orders slowed. While the weaker pace of expansion was broad-based across sectors and regions, including the UK and eurozone, the index is still consistent with a solid pace of expansion in global GDP. A further increase in the global employment PMI suggests the underlying fundamentals are resilient. Crucially, the JP Morgan Global manufacturing PMI held close to a two-and-a-half year high in June, signalling better operating conditions in the sector for the past five months in a row.

At a global level, composite input and selling price PMIs are generally consistent with slowing, but still elevated, inflationary pressures. The UK composite PMI highlighted wage increases, higher shipping costs and rising raw material prices contributing to rising costs, suggesting that underlying inflation is likely to remain sticky for a little longer.

UK year-on-year headline CPI slowed meaningfully, returning to the BoE's 2% target for the first time in almost three years in May. However, the decline was still slightly smaller than expected and is largely due to declines in energy prices and their interaction with the Ofgem energy price cap. Core CPI, which strips out volatile components like energy and food prices, also slowed but, at 3.5% year on year, highlights stubborn underlying inflation pressures. This is further illustrated by services CPI which, though slowing, remained at 5.7% year on year. US headline CPI fell to 3.3% in May after rising more than expected in March, while core CPI eased to 3.4%.

Meanwhile, in the eurozone, headline and core CPI measures rose to 2.6% and 2.9%, respectively, in May as prices rebounded for energy and services. June's flash release suggests headline inflation eased to 2.5%, in line with forecasts, while core CPI remained unchanged at 2.9%, compared to forecasts of 2.8%.

Despite the recent setback in inflation data, the ECB delivered a widely expected 0.25% pa reduction in its deposit facility interest rate, to 3.75% pa. However, the ECB raised its inflation outlook for 2024 and 2025, highlighting stickier-than-expected service-sector inflation, with markets expecting only one further cut in 2024. Amid still-elevated core and services inflation, the Fed and BoE held rates steady, at 5.5% pa and 5.25% pa respectively, and markets continue to expect fewer rate cuts in 2024 than they did at the start of the year.

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Additional Notes

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