HYMANS ROBERTSON

Market brief

January 2024

January 2024 – highlights

- Strong US growth estimates significantly surpassed expectations again in Q4, amid ongoing resilience in consumer spending. Flat eurozone growth was also better than expected.
- Flash composite purchasing managers' indices (PMIs) also exceeded expectations, indicating activity in the US and UK accelerated on the back of still-strong service sector activity, while the downturn in the eurozone moderated as the manufacturing recession eased.
- December's headline consumer price index (CPI) inflation figures, released in January, came in slightly above expectations in the major advanced economies.
- Amid better-than-expected economic data and resilient inflation, central banks pushed back on the more optimistic market views on the scale and timing of interest rate cuts.
- As a result, market-implied interest rates and sovereign bond yields rose, and prices fell. Meanwhile, equity markets rose on the back of positive economic activity data, despite handing back some of their gains following the US Federal Reserve's less dovish month-end meeting.
- Disruption in the Red Sea prompted a rise in oil prices, while the trade-weighted US dollar rose 1.8% as the market-implied probability of US interest rate cuts fell.

Market performance to end January 2024

UK	Q1 24*	Q4 23	2024
EQUITIES	-1.3	3.2	-1.3
BONDS			
Conventional gilts	-2.2	8.1	-2.2
Index-linked gilts	-4.5	8.7	-4.5
Credit	-0.9	7.3	-0.9
PROPERTY**	n/a	-1.2	n/a
STERLING			
v US dollar	-0.1	4.4	-0.1
v Euro	1.6	0.1	1.6
v Japanese yen	3.6	-1.3	3.6

GLOBAL	Q1 24*	Q4 23	2024
EQUITIES	1.3	9.3	1.3
North America	1.6	11.8	1.6
Europe ex UK	1.9	6.9	1.9
Japan	8.0	1.9	8.0
Dev. Asia ex Japan	-2.9	7.7	-2.9
Emerging Markets	-2.7	5.0	-2.7
GOVERNMENT BONDS	-0.2	5.3	-0.2
High Yield	0.4	6.6	0.4
Gold	-0.8	11.2	-0.8
Oil	5.5	-18.6	5.5

Percentage returns in local currency ($ for gold and oil). All returns to 31/01/2024, *apart from property 31/12/2023 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.

Fixed income markets

Amid better-than-expected economic data, upside inflation surprises, and a subsequent dimming of imminent rate-cut expectations, sovereign bond yields generally rose. Given higher headline, core and wage inflation releases, UK yields rose further.

UNITED STATES

US 10-year treasury yields **rose slightly, to 3.9% pa**

UNITED KINGDOM

UK yields **rose to 0.3% pa to 3.8% pa**

GERMANY

German bond yields **rose 0.1% pa, to 2.2%**

JAPAN

Japanese bond yields **rose 0.1% pa, to 0.7% pa**

Inflation expectations

UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, was little changed at 3.5% pa, as nominal yields rose in line with real yields. Equivalent US breakeven inflation rose 0.1% pa to 2.3% pa as nominal yields rose, and real yields fell slightly.

Credit spreads

Sterling investment-grade credit spreads fell 0.1% pa to 1.3% pa. Despite spread tightening, UK investment-grade credit indices fell given the rise in underlying sovereign bond yields. US speculative-grade credit spreads rose 0.2% pa, to 3.6% pa, while equivalent European spreads fell 0.1% pa, to 3.8% pa.

Moody's expects defaults to peak

Moody's expects the trailing 12-month global speculative-grade default rate, which rose to 4.8% at the end of 2023, to peak at 4.9% in the first quarter of 2024, before falling back to a below-average range of 3.7–4.2% towards the end of the year. The forecast for a benign default cycle is underpinned by healthy corporate balance sheets, limited near-term refinancing requirements and anticipated easing in financial conditions.

Emerging market bonds fall

Hard currency emerging market debt, as measured by the J.P. Morgan EMBI Global Diversified Index, returned -1.0% in dollar terms as credit spreads rose 0.1% pa and treasury yields also rose modestly. Local currency debt, as measured by the JPM GBI-EM Global Diversified Traded Index, returned -1.5% in US dollar terms as index currencies, in aggregate, weakened 2.2% against the dollar, more than offsetting a modest decline in yields.

Global equities

The FTSE All World Total Return Index **returned 1.3%** in January in **local currency terms.**

Growth stocks outperformed value stocks.

Developed markets outperformed emerging markets.

Tech stocks lead the pack

Economic data, particularly in the US, showed ongoing resilience despite elevated interest rates. The technology sector, led by the ongoing rally in the 'magnificent seven' stocks, strongly outperformed, followed by healthcare, telecoms and financials, in that order. Basic materials was the laggard, while utilities, which is often viewed as a bond proxy, also notably underperformed. Despite a rise in oil prices, the energy sector underperformed, while consumer discretionary, consumer staples and industrials all also underperformed.

Japanese equities outperform

Japan's outperformance continued in the first month of 2024, with the region delivering a total return of 8.0% in January as renewed yen weakness lent support to the exporter-heavy index. Europe ex-UK was the next best performing region, perhaps deriving support from signs that the worst may be over for the region's crucial manufacturing sector. Given its large exposure to the outperforming technology sector, the US also outperformed from a regional perspective.

Chinese stocks down

Disappointing economic data, underwhelming government policy support and market interventions led to steep declines in Chinese equities, which also undermined the performance of emerging markets and Asia ex-Pacific stocks. The UK also underperformed, given its above-average exposure to the poorly performing basic materials sector.

Currencies, commodities, and property

Crude oil prices rose 5.5% amid escalating tensions in the Middle East and as Saudi Arabia scrapped plans to increase oil production capacity by one million barrels a day by 2027. The **US trade-weighted dollar rose 1.8%** as expectations of imminent rate cuts in the US were tempered by the Fed. The trade-weighted **Japanese yen fell 3.0%** as lower-than-expected wage growth figures led to doubts about the Bank of Japan exiting its negative interest rate policy in the near term. The equivalent **sterling measure rose 1.1%, while the euro fell 0.5%**.

The MSCI UK Monthly Property Index fell 1.2% in the 3 months to end-December as income was offset by capital value declines. Values fell most sharply in the office and retail sectors, which are down 16.6% and 5.6%, respectively, over 12 months. Industrial values also declined 0.7% in Q4 following seven months of capital growth, resulting in flat growth over a 12-month period.

The global economy

Resilient economic activity prompted upwards revisions to US GDP growth forecasts for 2024, to 1.4% from 1.2%. Equivalent forecasts for the UK and eurozone are much weaker: further downward revisions mean UK real GDP is now expected to rise a meagre 0.2% in 2024, while eurozone growth is not expected to be much better at 0.5%. However, progress on inflation saw further downwards revisions to average year-on-year headline CPI forecasts for the UK and eurozone in 2024, to 2.7% and 2.2%, respectively.

Initial estimates suggest the US economy expanded 0.8% quarter on quarter in Q4. Though a moderation from the 1.2% quarter-on-quarter expansion in Q3, the robust pace of growth once again notably exceeded economists' expectations amid ongoing resilience in consumer spending. While growth is much weaker in the eurozone, it was at least not as bad than anticipated, with preliminary estimates suggesting the economy narrowly avoided entering recession in the fourth quarter, defying the expectations of most economists.

Flash composite PMIs were also better than expected. Surveys suggest that economic activity expanded at a faster rate in both the US and UK, while the downturn in the eurozone moderated. More broadly, there are signs that global manufacturing activity may have reached a turning point, as the US index moved above the no-change 50 mark, for the first time in over a year, and activity declined at a slower rate in Europe and the UK. However, the European and UK manufacturing surveys highlighted a lengthening of supplier delivery times and a rise in input and shipping prices as disruption to critical supply routes in the Red Sea intensified.

December's headline CPI inflation figures, released in January, came in slightly above expectations in the major advanced economies, driven by a rise in volatile energy and food prices. However, the core measure, which excludes both, decreased in the US and eurozone, and remained the same in the UK. Headline year-on-year CPI inflation in the UK, US and eurozone rose to 4.0%, 3.4% and 2.9%, respectively. The equivalent core measures in the UK, US and eurozone are 5.1%, 3.9%, and 3.4%, respectively.

The Fed and ECB once again left rates unchanged, at 5.5% pa and 4.0% pa, respectively, in January. However, amid better-than-expected economic data and upside inflation surprises, the major central banks pushed back against market expectations of imminent rate cuts. In particular, short-term market-implied interest rates rose following the less dovish US Federal Open Market Committee meeting at the end of the month. Markets no longer expect a first rate cut from the US Fed in March.

Chris Arcari
Head of Capital Markets
chris.arcari@hymans.co.uk
0141 566 7986

Ryan Bio-Genfi
Investment Research Analyst
ryan.bio-genfi@hymans.co.uk
0207 082 6052

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