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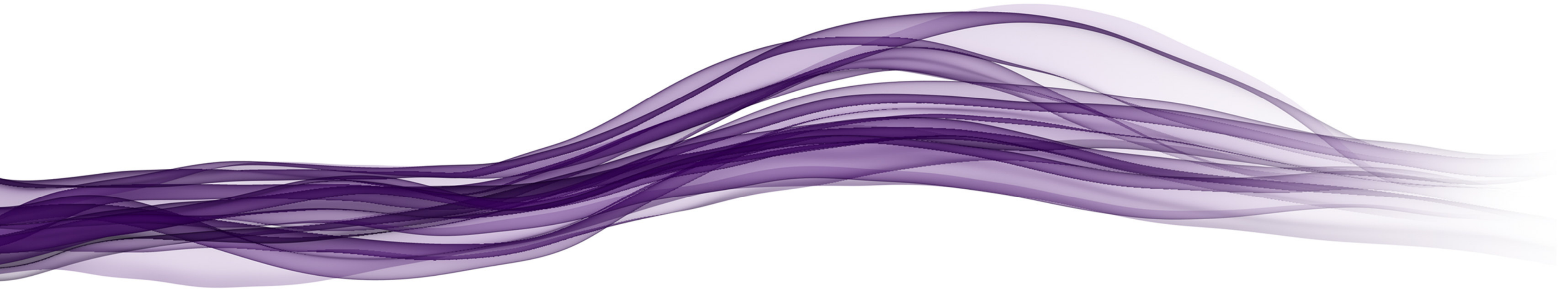


GMAPs

Quarterly Overview

31 March 2024

ROYAL LONDON
ASSET MANAGEMENT

Overview

Market overview

A key theme to emerge during the quarter was indication of a more favourable global macro backdrop. Despite some mixed signals, the US economy remains resilient, while Europe and the UK show signs of gradually exiting their recessions. Activity in China also seems to be stabilising. At the same time, core central banks are still confident that the disinflation trend remains intact, despite some recent setbacks in inflation prints. Policymakers have often highlighted that they are in no rush to cut rates – with markets now generally pricing the start of the easing cycles to begin this summer. The Federal Reserve, European Central Bank and Bank of England all left interest rates unchanged over the quarter.

One major development over the quarter is that markets have recalibrated their pricing for expected central bank cuts over this year. At the end of last year, markets were pricing in an aggressive rate cutting cycle, but then swiftly move to temper those forecasts. This re-pricing contributed to negative returns for global government bond markets over the quarter. Despite the belief of many that it was the anticipation of a 'Fed-pivot' that contributed to the rally in equity markets in late 2023, equity markets proved to be immune to this bond market sell-off as global growth and business confidence showed signs of resilience and investors focused on the potential offered by AI.

Data released in the first quarter confirmed that the UK experienced a technical recession in the second half of 2023 but painted a picture of stronger economic activity in the first quarter, with falling inflation and more signs of softening underlying domestic inflationary pressure. Fourth quarter GDP fell 0.3% quarter-on-quarter in real terms after falling 0.1% in the third quarter. Meanwhile, CPI inflation fell a bit further to 3.4% year-on-year in February from 3.9% for the November release. Core inflation fell to 4.5% year-on-year from 5.1% over the same period. By the end of the quarter (the January data release) regular pay growth figures were showing more sign of slowing, at 6.1% (3M/Y) for the 3-months to January (from 7.2% three-months earlier). Consistent with falling – but still above target – inflation, but with activity and labour market data relatively resilient, the Bank of England continued to keep rates on hold at 5.25%. The Budget saw the Chancellor present further tax cuts, adding net stimulus near term but with the projections for future years still implying sizeable real terms spending cuts for unprotected government departments.

The US Federal Reserve continued to keep rates on hold at 5.25-5.50% over the quarter against a still resilient labour market backdrop, and after a couple of stronger than expected inflation prints. As of their March meeting, the median forecast of participants still had 75bps of rate cuts in or 2024, but with the number of cuts pencilled in for 2025 being reduced from four cuts to three. Over the quarter, CPI inflation was broadly stable, at 3.2% year-on-year in February, from 3.1% in November (briefly 3.4% in December). However, core CPI inflation rose a stronger than expected 0.4% month-on-month in both January and February. The core PCE measure of inflation fell over the quarter in year-on-year terms, but came in above 0.2% month-on-month in both January and February. Fourth quarter GDP recorded a strong 3.4% quarter-on-quarter annualised, weaker than in the third quarter but still well above trend. More timely economic activity indicators were broadly consistent with reasonable growth in the first quarter. Real personal spending grew. Non-farm payroll gains were above 200K in January and February, but the unemployment rate jumped two-tenths in February.

Over the first quarter, the European Central Bank kept rates on hold. As of the March meeting, the staff inflation forecasts were more consistent with sustainably hitting the target and President Christine Lagarde continued to emphasise that they wanted more data, more evidence, before cutting rates. She said that they would know a “little more in April, but we will know a lot more in June.” Various ECB speakers have signalled that they think a rate cut is likely/possible in June. Euro area CPI rose in December, but fell back to 2.6% by February. Core CPI fell gradually over the same period too to 3.1% year-on-year. The euro area economy (GDP) was flat in Q4 at 0.0% quarter-on-quarter. Business surveys, however, were consistent with the economy remaining in (mild) recessionary territory, even if the composite PMI improved over the quarter.

For the first quarter, the MSCI World and MSCI All Countries World Index (ACWI – which also includes 26 emerging markets) produced positive returns for the quarter in US dollar terms. Looking at national MSCI indices, the strongest market was Ireland, while the weakest was Portugal. In terms of style, the MSCI World Growth Index produced stronger returns versus the MSCI World Value Index.

Government yields rose in all the major markets. In the US, 10-year treasury yields rose from 3.88% to 4.21%, while German 10-year bunds similarly saw yields rise from 2.01% to 2.30%. Mirroring this backdrop of rising yields, UK government bonds produced a return of -1.62% (FTSE Actuaries) over the first quarter, with the benchmark 10-year gilt yield rising from 3.54% to 3.94%. Global corporate bonds saw mixed effects during the quarter. In the US, euro zone and UK, the negative impact of rising underlying government bonds was offset by credit spread tightening and positive carry, to leave returns roughly flat (local terms).

The price of WTI crude oil gained 15% over the quarter to $83 a barrel, reversing the losses of the prior quarter amid attacks on Russian refineries and OPEC signalling production cuts. Copper futures meanwhile gained 2.85% in US dollar terms.

Overview

Performance and activity

Asset allocation overview

At the tactical asset allocation level, we maintained an overweight position in equities over the quarter, a position which continued to benefit us as it did for most of 2023. In the regional template, we added value from an overweight position in Japanese equities, funded from an underweight in UK stocks. With much uncertainty around the macroeconomic environment, we continue to see great benefits in a well-diversified multi asset approach which aims to deliver positive risk-adjusted returns over the medium to long term.

Equities

Global equity indices ended the quarter at all-time highs. Resilient macro data, strong corporate earnings results, and expectations of policy loosening this year all contributed to market optimism. Our Investment Clock moved into equity-friendly Recovery phase and technical factors remained supportive, which saw us continue to hold an overweight equity position. Our overweight position added value over the quarter.

Bonds

One major development over the quarter saw markets aggressively change their pricing for expected central bank cuts over this year. At the end of last year markets had expected 1.7% of cuts from the BoE, three months later and markets now only expect just over 0.7%. This re-pricing saw negative returns for bond markets over the quarter. We started the quarter at a neutral position but moved moderately underweight and benefitted as yields started to rise.

Equity regions

The best performing region over the quarter was Japan, which recorded close to 20% return over the quarter, moving to all-time highs for the first time in 34 years. Japanese equities have been benefitting from a weaker yen, loose monetary policy and improving corporate profits. We benefitted from a continued overweight allocation to the region. Elsewhere, we benefitted from an underweight tactical allocation to UK shares, which lagged other regions over the quarter.

Equity sectors

The US technology sector, which led gains last year on the back of the hype around AI and hopes for steep 2024 rate cuts, continued to outperform over Q1. This was followed by a broadening in performance, with cyclical sectors in the likes of industrials, financials and energy also posting double-digit returns. We continued to prefer growth sectors over the quarter, given supportive macro environment, but lost value amid underperformance of the consumer discretionary sector.

Property

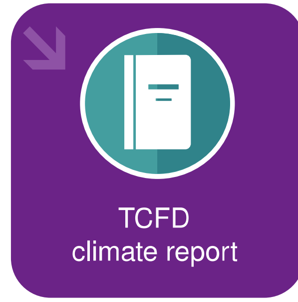
We remain positive on the long-term prospects for property within a diversified multi asset portfolio. However, in the near term, we see downside risks to the asset class as growth slows. We remained tactically underweight property over the period; commercial property was flat, with rental income offsetting losses on capital values. Lingering recession fears and the sluggish UK economy have continued to weigh on property relative to other risky assets, while hints of potential BoE rate cuts this year are seen as a positive signal for the asset class.

Outlook

While we expect headline inflation to continue to fall, we are not expecting a return to the previous disinflationary world. We see a more normal new regime characterised by periodic spikes in inflation and short boom-bust cycles. Tactical asset allocation is important when business cycles are shorter given inflation causing more movement in interest rates. We have benefitted from an overweight position in equities so far in 2024 as the macro backdrop has proved more resilient than expected. Macro conditions remain supportive, with the prospect of interest rates cuts boosting hopes of a recovery in activity. We remain vigilant. More defensive positioning could be necessary later this year. Geopolitical risk or disappointment around the number of interest rate cuts this year could cause a correction.

Further Information

Please click on the links below for further information:



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