INVESTMENT UPDATE

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Events surrounding the forthcoming US election and their implications pushed and pulled markets during July for the first time in several months. Trading volumes are typically thinner during peak summer as traders and fund managers take their annual vacations, which in some cases leads to higher volatility. As ever, we dig into some of the relevant detail in the update that follows.

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Failings of the US Secret Service were evident at the Donald Trump rally at Bethel Park, Pennsylvania where the former president narrowly escaped assassination. Market reaction was initially muted, but analysis of the implications soon gave rise to equity market volatility. The expectation for Mr Trump to win the November election took a strong boost, further bolstered by President Biden's announcement of withdrawal as an election candidate.

Image courtesy of The Guardian

Of course, markets are an efficient discounting mechanism, meaning Trump policies began to be factored into stocks and bond prices almost immediately. In short, longer dated bond yields rose, giant technology stocks came under pressure whilst smaller and medium sized firms saw a sizeable boost to their valuations. Donald Trump's policies are calculated to promote domestic manufacturing which will stimulate the sector, push down on interest rates via the Federal Reserve helping smaller firms with balance sheet debt, but likely to put a floor underneath disinflation, and be less inclined to promote policies supporting giant technology stocks. Tesla's Elon Musk is an overt Trump advocate, but we witnessed timely pro-Republican positioning from Mark Zuckerberg, at Meta. Quite a repositioning in just a few short weeks.

With 70 companies reporting so far (and 81% of companies beating expectations by 5.66%), the US earnings season is off to a good start. The estimated growth rate for 2nd quarter earnings is now 10% and rising (as it typically does). The breadth of earnings seems good, with all sectors now posting positive and rising year-over-year estimate growth. It's a solid backdrop if the economy is indeed in a soft landing, as it appears to be. We await the "Magnificent Seven" earnings reports which will have the ability to move markets.

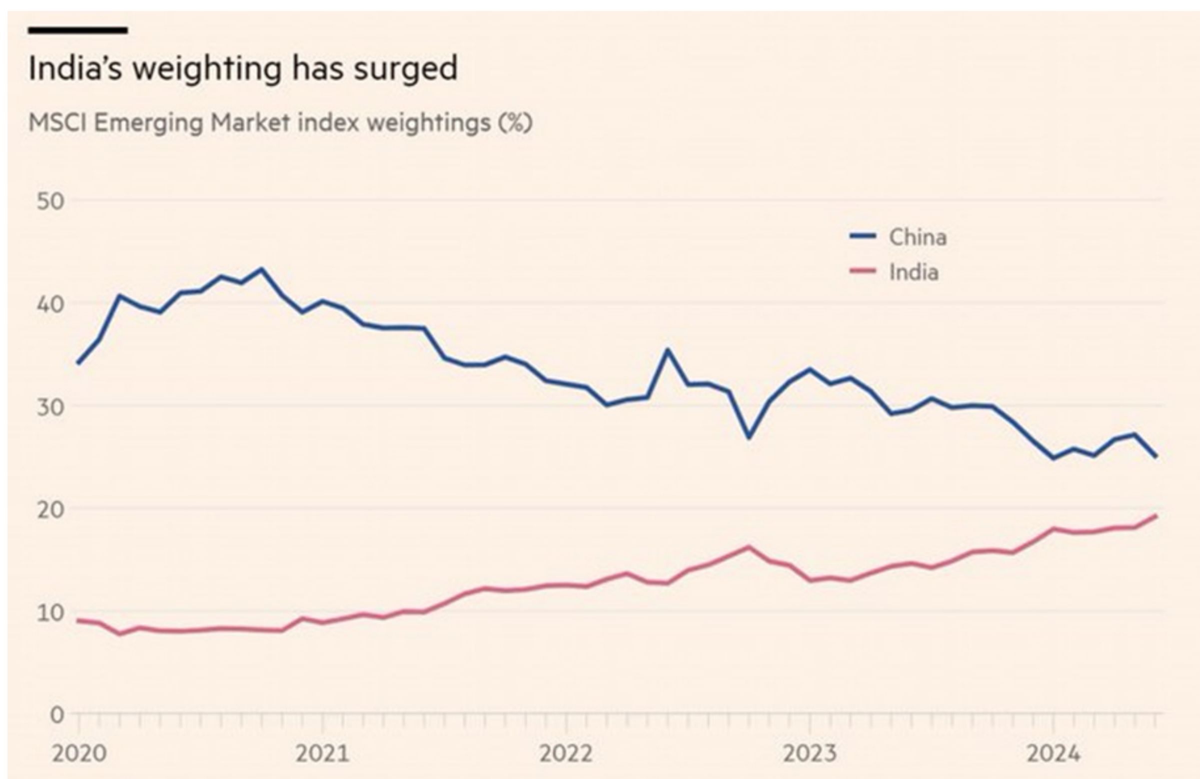
Inflation has continued to come to heel whilst the market anticipates a cut in US interest rates in September. Dollar strength moderated marginally but remains strong overall against currency peers. The US treasury yield curve has begun to normalise.

UK equities in the guise of FTSE 100 has posted a decent 12% return over the past year and the political stance of the prevailing government has only on occasion made a material difference to domestic equity performance. The General Election returned a Labour government based on a narrow support base of 20% of the electorate. Chancellor Mrs Rachel Reeves pledged to deliver a balanced budget within the prevailing fiscal rules, and so markets proved to be unmoved as the election results unfolded.

However, inflation busting wage settlements in the public sector, cancellation of important infrastructure projects to fill an alleged financial "black hole", and hikes in capital taxes aimed at penalising entrepreneurship seem, at least in prospect, to be regressive.

Persuading successful firms to list on the London Stock Exchange has proved difficult – offering an attractive home to business success is a critical plank in building the UK's corporate strength, especially when competing on a global stage. Much of the government's plan rests on delivering economic growth to fund planned spending. GDP growth is a function of demographic growth, debt growth and productivity growth, hinting therefore at plans and likely strategies to follow. Productivity enhancement has proven particularly elusive in the UK. Failure to deliver economic growth will likely see further debt expansion to fund key policies. We anticipate a UK interest rate cut later this year, although outsize wage settlements will not accelerate progress. We travel hopefully but will continue to scrutinise progress in some detail.

Meanwhile in Europe, Mrs Lagarde, Head of the European Central Bank announced a timely 0.25% rate cut back in June. Europe's largest economies have been skirting recession and inflation has fallen significantly over the past year allowing the central bank sufficient scope to loosen monetary policy. A shallow recession has been confirmed for quarter one, but economic growth has recovered marginally to 0.3% for quarter two. Germany's reliance on cheap Russian energy, low-cost labour from other areas of the Eurozone and immigration has failed to build on a strong manufacturing heritage. German manufacturing is in full retreat. Her major export market, China, continues to wrestle with economic stagnation.



Source: MSCI

China, the world's second largest economy is making slow progress to escape the Covid related slowdown and the huge debt mountains linked to the giant state-backed real estate companies. The People's Bank of China has made two modest interest rate cuts to stabilise and promote economic growth. The Chinese currency is being allowed to drift weaker, supporting export initiatives. The results from planned export campaigns have partially succeeded but will take more time to bear fruit. The headwind of trade tariffs, particularly onerous in the United States but less so in Europe, will slow progress. China's notable stockpiling of copper as a key raw material in modern goods has begun to unwind; having imported vast quantities of the metal to support the manufacturing drive in previous months, China is now a net exporter of the metal. This move seriously depressed the monthly copper price globally. At stock market level, India is accelerating in terms of overall value relative to China, which remains subdued.

The Japanese Yen has depreciated quite significantly against a basket of global currencies, but notably against the dollar over the past year or so, reaching a 34-year low point recently. Of course, this has helped exports but has begun to reach extreme levels. We expect the Bank of Japan to intervene further, aiming to support the Yen. Japan's central bank has raised its benchmark interest rate to "around 0.25%" from its previous range of 0% to 0.1%. The Bank of Japan importantly also said that it will reduce the monthly purchases of Japanese government bonds starting in January 2025. Japanese stocks have performed extremely well but currency moves have taken the lustre away from recent performance figures. We continue to scrutinise progress.

The provision of global liquidity, led by the United States, is an important catalyst for risk asset prices. Liquidity in the form of lower interest rates across much of the developed world, ongoing Treasury Bill issuance, reductions and eventual cessation of quantitative tightening will provide support. A weaker dollar will prove stimulative as will reductions in the Treasury General Account and Reverse Repo facility in the United States. The forthcoming Basel IV implementation across developed world banking infrastructure (requiring banks to own more government bonds to bolster balance sheets) will help cater for likely refreshed government bond issuance. In summary, global liquidity will continue for a while longer, the ability to bolster stock prices is likely, but should be balanced against the probability for ongoing earnings growth at corporate level and GDP growth at national level.

In this regard we remain in optimistic mood. Of course, markets never move in straight lines. Geopolitics remains uncertain and volatile, as a counterbalance and new governments around the world have a major role to play in the pursuit of credible policy.

Portfolios remained unaltered during July and delivered credible outcomes given the sudden return of volatility, mentioned earlier. The rotation in favour of smaller companies has been captured at portfolio level and will likely play an important role for a while longer. Our fixed income duration, having been shortened in our most recent portfolio rebalance, has proven to be a wise change. As rate cuts continue to flow through from developed markets we are well situated, and risk remains in line with expectation.

For those heading to the beach, we wish you happy holidays in the knowledge that portfolios are well positioned for what we believe lies ahead.

Written by the Alpha Beta Partners Investment Team.

All sources Bloomberg unless otherwise stated.

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