MARKET COMMENTARY

Tim Jones

Senior Investment Manager

Whitechurch Securities Ltd.

Executive Summary

After 2023 ended with a bang, January offered somewhat of a reality check. Even during December, there was a sense that the widespread rally had an element of too good to be true about it. To put this into context, many funds, regardless of asset class, saw more gains in the final month of the year than they had in the preceding 11 combined. Whilst January's returns were not as sobering as some had feared, they were modest enough to temper the widespread market rally and with that any risk of investors getting too carried away after December's delirium. January also saw more of a divergence between asset classes, with global equities returning 0.7% (all returns in GBP) versus -1.3% for their global bond counterparts. In contrast, both asset classes gained in lockstep during December, both registering strong returns of 3.4% and 2.8% respectively. The inflation and interest rate story continued to dominate headlines, with major central banks striking a cautionary note for those banking on imminent rate cuts amid generally strong economic data. Despite the relative tempering of optimism, a 'soft landing' remained very much the prevailing narrative on the table.

US Equities

In the US, the dominance of 'growth' stocks continued, as did the relatively consistent flow of upbeat economic data. The latter included a strong Nonfarm Payrolls jobs report which highlighted that 216,000 new jobs were added in the US during December, as well as wage growth of 6.8% (compared to December 2022) – representing the biggest increase since June. The report was comfortably ahead of market expectations, which was a theme throughout the month and was epitomised by January's release of Q4 2023 GDP figures, which reported 3.3% growth versus a forecast 2%. Investors saw the so called 'Magnificent 7' (that is; Amazon, Apple, Google, Meta, Microsoft, Nvidia, and Tesla) return an aggregate of 14% during the month, driving markets to record highs and raising hopes that a widely touted recession may not come to fruition. However, January ended on a more muted tone for equity markets, with the US Federal Reserve (Fed) adopting a more hawkish (associated with rising rates) stance, suggesting that rates are unlikely to be cut at the next meeting. This was largely in response to the latest US inflation figures, which ticked up to 3.4% in December, representing the first monthly increase since the summer. Core inflation (which excludes energy and food prices) however, eased slightly, although still came in slightly above expectations. On aggregate, US equities finished the month 1.7% higher.

Other Developed Markets

Elsewhere, after being the top regional performer the month before, UK equities returned -0.9% in January. Economic data was relatively bullish, including a two-year high in consumer confidence surveys and an increase in both manufacturing services and output. However, winter retail sales fell well short of expectations, reminding investors of the slowdown risks posed by the higher cost of living crisis and unfavourable borrowing conditions. Also weighing on UK equity markets was an upside surprise for headline UK inflation, which recorded its first increase in 10 months, to 4%. After a very strong December, mainland Europe also stuttered to a -0.2% return (although 1.6% higher in euro currency terms). As with the UK, there was some encouragement for both manufacturing and services output, with the general economic picture appearing slightly rosier than before, albeit from a low base. Germany remains a notable exception however, with 37% of German manufacturers reporting a lack of orders versus 21% this time a year ago. Eurozone inflation remained significantly lower than the UK's, at 2.9%, fuelling hopes of an imminent rate cut from the European Central Bank. In contrast to December, Japan was the best performing developed region, with equities returning 2.8% (or 6.5% in yen currency terms), rallying to 35-year highs, largely driven by significant inflows from foreign investors and inflation falling to its lowest reading since July 2022, at 2.6%.

Asia & Emerging Markets

If we look back to market outlooks at the beginning of 2023, many were suggesting that the lion's share of last year's returns would be driven by Asian and emerging markets, at the expense of the developed world. As we saw, this was simply not the case, and now, 12 months later and without a list of clear and obvious drivers, this showed no signs of reversing at the start of 2024 either. Both asset classes registered a weak January, with Asian (ex-Japan) and emerging market equities edging -5.3% and -4.5% lower, respectively. China, which dominates both indices with a 31% and 27% share, started the year how it spent much of last year – a struggling property sector, below par economic activity, and a raft of measures from the government aimed at stimulating growth seemingly falling short. Although fairly well-documented, China's demise should not be underestimated, given its losses during the last 36 months equate to circa 65% relative to global equities. Elsewhere in emerging markets, Latin America – so often the saving grace for the asset class as a whole and a major winner of last year, also registered a disappointing January. However, disinflationary activity is firmly underway, with major constituents, namely Brazil and Chile, opting to cut rates.

Fixed Income

After a disastrous 2022, last year was widely predicted to be 'the year of the bond', however the asset class only managed an aggregate annual return of -0.25%. Before December's bullish hunger for risk assets, this was more like -3.6%. The constantly evolving balancing act between inflation and interest rates continues to manifest in market volatility, with central bank decisions ominously influencing returns. January's shift away from dovish (associated with lowering rates) language from major central banks weighed on fixed income markets throughout the month. Given the inverse relationship between a bond's yield and its price, any rate cut would have, in theory, brought bond yields down and prices up. Essentially, markets are now anticipating less rate cuts for 2024 than they were just a few months ago. Should a series of cuts occur in the US and/or UK, rates still have a good chance of finishing 2024 above the 4% level – high relative to recent history. This remains a major factor in forecasts for economic pain to come, with the anticipation that employers may not be able to continue to keep pace with rising costs also adding to recessionary fears. In fixed income markets, corporate bonds generally outperformed their government counterparts, whilst high yield (lower quality and seen as relatively higher risk) finished the month ahead of investment grade (higher quality). Regionally, the US was a standout performer, returning 0.3% on aggregate, with UK gilts at the other end of the scale, unable to back up their exceptionally strong December, returning -2.6%.

Other Asset Classes

Being more economically sensitive, smaller companies generally lagged mega and large-cap stocks across markets, whilst other asset classes, such as global real estate, also felt the return of central banks' hawkish rhetoric. The future prospects of property markets can be highly influenced by the direction of travel of interest rates and thus the return of the 'higher for longer' narrative stalled any significant recovery progress during January. This was evident in the UK too, with listed property assets declining -3.8%. Returns in commodity markets were mixed, with positive contribution from the energy component but weaker returns from agriculture and metals. Uncertainty over supply amid ongoing conflict in the Middle East and damage to a Russian refinery saw the price of oil increase 5.4%, to finish the month just above $80 per barrel, whereas there was also a modest 1% gain in the price of natural gas. With the Fed signalling that any meaningful interest rate cutting programme may well have been temporarily put on ice, January saw alternative and renewable energy indices give up all of December's impressive gains. Within metals, despite a marginal increase in the price of copper, industrial metals registered a -1.4% decline, as the prospect of an economic slowdown and associated reduction in demand for goods continued to weigh on prices. Precious metals outperformed on aggregate, despite losses for gold, silver, platinum, and palladium.

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Registered in England and Wales No: 1576951.
Correspondance Address: The Old Chapel, 14 Fairview Drive, Redland, Bristol, BS6 6PH
Registered Office: C/o Saffery Champness, St Catherine's Court, Berkeley Place, Bristol, BS8 1BQ
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