bordier | 1844

Investment review – End Q2 2024

June 2024

We have reached mid-year with some solid returns under our belts right across the portfolio risk spectrum. Despite widespread expectations last year of a global economic slowdown in 2024, this has not really materialised. On the contrary, we are now looking at improving data and raised economic forecasts compared to a few months ago, whilst at the same time the deflationary trend, in the main, continues.

Most of the quarter has been spent, however, recovering from April's wobble in market confidence, caused by more robust US inflation data and the likelihood of there being delayed, and fewer, cuts to US interest rates. That unsettled period now seems to be behind us, with both bond and equity markets subsequently responding well in May and June to more moderate inflation data and recovering most, if not all, of April's retrenchment. Larger US companies, particularly those centred around technology and artificial intelligence ('AI') have, once again, led the rebound in markets. Staying invested during this twitchy period has, therefore, been the right thing and whilst overall returns in the second quarter have not been as great as the first, we are still pleased with the progress made in the year to date as a whole.

A more favourable backdrop

Forward-looking US economic data have been slightly conflicting of late, but the economy is still expected to grow at a faster pace than Europe. That said, the UK and eurozone economies do seem to be picking themselves up from the floor. The economic growth from these developed economies continues, however, to be eclipsed by the stronger growth found in many emerging Asian economies.

Helped by the use of excess savings accumulated during the pandemic, and some strengthened financial discipline, many households have coped better than expected (particularly in the USA) with the period of high interest rates, meaning recessionary conditions were mild and brief. Consumer spending in advanced economies may still be somewhat subdued and global economic growth could still be slightly below trend this year, but that should actually help, rather than hinder, central banks' next steps. Geopolitical tensions still have the potential to upend the expected economic, inflation and monetary policy trajectory, but currently the market risks associated with ongoing conflicts do appear to have dissipated.

Overall, the outlook does appear to be quite favourable for most regions and most asset classes going forward from here.

"We have reached mid-year with some solid returns under our belts right across the portfolio risk spectrum."

bordier | 1844

Bond markets finally beginning to respond

We have wanted to be ready for this changed inflation and monetary backdrop, yet until now our early positioning has been frustrated somewhat by conflicting data. At last the stars seem to be aligning, with bond yields beginning to fall back a little and prices appreciating in the past few weeks. One catalyst for this more positive mood was the European Central Bank ('ECB') becoming the first key policy-making authority to get its feet wet, announcing a 0.25% cut in interest rates. Although warranted by weaker inflation data, it was also symbolic, showing to other major central banks that it would soon be time, and safe, to come off the fence. For now, both the US Federal Reserve ('Fed') and Bank of England ('BoE') are keeping their powder dry, but still seem on course to make their first moves to relax interest rate policy in the third quarter.

For those mandates where fixed interest investments are relevant, we are pleased to have already raised the exposure and lengthened its maturity profile in order to participate more in the expected recovery – we are beginning to see signs of bond markets becoming more confident about the inflation and interest rate backdrop, and believe that the more benign conditions will become increasingly positive for this asset class in the second half of the year. That said, we are also retaining commitments to certain alternative investments, again where relevant to the risk mandate: they act as a valuable counterbalance in an economic and market environment that still contains several trip hazards, not least policy error by central banks.

Kicking around the UK election

We close the second quarter and begin the next with UK politics and, for soccer fans, the Euros dominating the headlines and our conversations. By the time this update goes to press, the UK political party leaders' shin pads will have taken some hard knocks on the media trail and voters will be warming up to head to the polls to determine who governs next; meanwhile, the sporting campaign in Germany will be getting down to the business end of proceedings.

Unless the pollsters' data are totally off target (or we have an injury-time drama), the winner of one contest seems fairly certain: a brand-new political team, in all likelihood with a very big majority, will soon be assembled to take the UK forward. The new government's precise positioning, particularly in relation to its tactics on taxes and spending, and how this will impact the economy and financial markets, will take months, not minutes, to unfold. Although we have several clues about the initiatives and changes a new line-up would introduce, currently we just have blurred-edged pledges, not clear policies, to contemplate and factor in to our decision-making – that is not a sensible position from which to devise or modify any investment strategy. So we see little need to tinker with our UK market allocation or positioning at present, if indeed change will be required at all once the election dust has settled.

UK economy out of the doldrums

In the meantime, it is good to see some confidence returning to the UK market, helped by improved economic data. The economy grew by 0.6% in the first quarter of 2024, above consensus forecasts, ending the recessionary period it entered last year.

"...we are beginning to see signs of bond markets becoming more confident about the inflation and interest rate backdrop..."

bordier | 1844

UK services inflation remains higher than desired, not helped by higher airfares, hotel accommodation costs, and phone and broadband contracts which are facing 'inflation plus' contractual increases. But at least we now have Consumer Price Inflation ('CPI'), finally, down to the BoE's target of 2%. Their most recent decision to hold interest rates at 5.25% was clearly influenced by the higher price rises in the services sector, but the chance of an August rate cut is still very much on the cards. Furthermore, and as long as the broad deflationary trend continues, there is scope for some bigger cuts to interest rates next year. Current forecasts suggest that monetary policy will settle at a level which reflects a more balanced economy, retains some debt discipline, but most importantly does not restrict consumption, business investment or put economic growth under undue strain. That is the equilibrium point all central banks are hoping to engineer. As things currently stand, we are hopeful that the prudent path the UK authorities are currently taking towards policy normalisation will see them arrive safely at that destination, even though it may have taken a little longer than initially anticipated. Hopefully, any changed political regime will not put a spanner in the works.

Whomever wins the election will inherit some helpful economic tailwinds, including lower levels of inflation and a more favourable interest rate backdrop. Operating within a tight fiscal framework will remain a challenge, but the prospect of improved business investment should be positive for the economy generally. As noted, we are maintaining our current exposure, mindful that it is still quite generous when viewed on a world market capitalisation basis – the UK stockmarket is just 4% of the global valuation pie, compared to the US market's 70%, for example. Our UK market exposure is still tilted towards medium- and small-sized businesses which remain cheaply valued and we believe will be the bigger beneficiaries of looser monetary policy and fresh economy-boosting initiatives.

Paying more attention to global politics

Returning to politics, this is a topic we may need to pay a little more attention to in the future. By the end of this year, more than 50% of the world's population from countries representing more than two thirds of global gross domestic product ('GDP') will have gone to the polls to elect new leaders. Relying too heavily on the polls can be quite dangerous, as witnessed in the recent Indian elections where the unexpected loss of Narendra Modi's parliamentary majority led to a 6% one-day fall in the Indian stockmarket. Generally speaking, however, the potential for political change is an ever-present risk priced within market values and not something that typically one can do much about. Even when political outcomes are known there is unlikely to be any need for knee-jerk action given that the impact of political policy change is quite a long-term game: new regimes must maintain the status quo until finance bills and executive orders are signed and the detail of pre-election bluster and pledges can be turned into action.

The looming US election later this year seems much more finely balanced, despite the real possibility of a convicted felon being installed in the White House for a second term. But at this stage it would be foolhardy to position for one outcome over another, even if there were some really obvious differences to exploit, which there do not appear to be. Political risk is ever-present in financial markets, but it does seem that the stakes have become a little greater during a period when more of the world's GDP is exposed to political change. It is therefore something we may need to be more mindful of than usual as time moves on.

"...as long as the broad deflationary trend continues, there is scope for some bigger cuts to interest rates next year."

bordier | 1844

Political divisions in Europe, but data are improving

European markets have seen a good uplift so far this year, but sentiment is also now being impacted by politics: in France, the established order of President Macron's centre right party faces a significant test in the coming weeks from the extremes of both the far right and, increasingly, the far left, both of which have growing popularity in the polls. France is already spending well beyond its means and has a budget deficit almost double the level set by the EU's rulebook, so Macron's surprise decision to call a parliamentary election has raised both eyebrows and the economic stakes, with the potential to throw the country into both political and economic disorder. If other European elections see voters make similar shifts in protest to the status quo, then the likes of the ECB may have more than just inflation to think about when deciding its next policy steps.

All this potential political upheaval does, in the near term at least, need to be balanced by some improving economic data emanating from the eurozone – GDP growth has picked up and forward-looking indicators in both the services and manufacturing sectors are indicating expansion rather than contraction in the bloc. The region benefits much less than the US from AI growth, but still houses many quality growth companies and reliable compounders of earnings, many trading on relatively cheap valuations. We need to be mindful that, structurally, European equity markets are more sensitive to international trade and wider monetary policy uncertainty, plus their economies are not devoid of structural issues regarding productivity, public debt and investment (politics, too, could now be added to this list). At present, though, we believe the positives outweigh the negatives and it is worthy of an allocation that can introduce greater sectoral diversification and a different opportunity-set to the more richly-valued markets like the US.

Asia on the rebound

Asian markets have also made some solid gains this year, having been somewhat left behind last year and heavily influenced by China's fortunes. Around 60% of the world's GDP growth is expected to come from emerging Asian countries such as China, India and Indonesia, together with the dynamic Asian economies of Hong Kong, Malaysia, Singapore, Thailand and Vietnam. Overall, the rate of economic growth in the region is expected to be more than double that of most developed economies, so Asia's share of the global economy is unlikely to shrink in the near term. China's weaker economic performance has been a restraining influence on Asian market returns and capital flows, but there are now more encouraging data from both the manufacturing and services sectors which suggest that the easing of monetary and fiscal policies is taking effect. This backdrop has improved the sentiment towards investment in the region as a whole, but it does of course comprise a wide collection of economies and markets which do not necessarily respond in unison. That said, it is still pleasing to see some double-digit returns from a number of our active Asian managers this year. This includes managers who are seeking out the very attractive dividend yields that can also be found in the region, which is a boon for income-seeking clients.

"...it is still pleasing to see some double-digit returns from a number of our active Asian managers this year."

bordier | 1844

Embracing AI

Companies at the forefront of the AI revolution, including so-called 'big tech' have, once again, been a big influence on market returns this quarter. Recently, NVIDIA, the designer and supplier of the processing units and programme interfaces that make AI and data science possible, had single-handedly contributed around a third of the US stockmarket's return this year. Briefly, it became the most valuable company in the world when its market capitalisation rose above $3.4 trillion in mid-June, its value exceeding that of the entire German, French and UK stockmarkets, respectively. Since then, it has lost some momentum, but is still representative of the growth and enthusiasm for anything AI-related in recent months. It also illustrates the influence this sector is having on overall market returns.

Our dedicated AI-theme in client portfolios, accessed by a specialist fund, continues to perform very well – at the last count it was up around 35% since we introduced the theme into clients' portfolios last October. Its largest holding is NVIDIA, followed closely by Microsoft and a string of other dynamic companies at the leading edge of AI enablement or adoption. We intend to run with this theme, not just because it gives access to today's AI winners, but increasingly, as an actively-managed fund, we expect the managers to adapt its portfolio as the emphasis of AI changes from the current enablers to the adopters and disruptors that will gradually become centre stage. That transition will not take place overnight, but we want our clients to participate in that evolution. Other, less-specialised, managers will undoubtedly help us along that journey as they spot other exciting growth opportunities in their stock universes that are linked to this broad theme.

More diversified US exposure

As far as the US market in general is concerned, our exposure remains the largest slice of our overall stockmarket allocation. It also gives a strong emphasis to the US dollar, a currency we believe will retain fundamental support through its dominance on the international trade scene. Our US market allocation is augmented by the exposures to AI noted earlier, along with other US assets contained within global infrastructure, environmental and sustainable energy investments also held within different client mandates. Our collection of dedicated US investment funds still has good commitments to higher growth sectors like information technology, but not in the same concentration as represented by mainstream US stockmarket indices. Our exposure is more focused right across the market capitalisation spectrum on those businesses that still represent the future, but are not necessarily today's somewhat expensive and 'in-vogue' heavyweights. If the US market does pause for breath or retreat, the dominating 'mega-cap' technology or AI-related stocks will be responsible. We feel our positioning can continue to participate in the growth of this huge economy and the investment opportunities it creates, which should soon have the helping-hand of a lower interest rate backdrop. Overall, our US allocation gives more diversified exposure to the US and global economy, generally meaning less-demanding valuations. This should be a better place to be during any reality check for the US market, if or when it occurs.

"Our dedicated AI-theme in client portfolios, accessed by a specialist fund, continues to perform very well..."

bordier | 1844

A game of two halves

Like the well-worn sporting pundits' truism, this year will still be a game of two halves. The first has delivered solid returns for investors, with some star performances from 'big tech' in particular flattering the half-time scoreline. But we believe the second half of the year offers just as much, if not more, promise as central banks put their well-publicised strategies into action, allowing better contributions from all assets on the investment playing field, not just a select few.

Risk warnings

This document is issued and approved by Bordier & Cie (UK) PLC ('Bordier UK'). Incorporated in England No: 1583393, registered address 23 King Street, St James's, London, SW1Y 6QY. The company is authorised and regulated by the Financial Conduct Authority ('FCA').

Bordier UK is a specialist investment manager dedicated to providing portfolio management services. We offer Restricted advice as defined by the FCA, which means that if we make a personal recommendation of an investment solution to you, it will be from Bordier UK's range of investment propositions and will reflect your needs and your approach to risk.

This document is not intended as an offer to acquire or dispose of any security or interest in any security. Potential investors should take their own independent advice to assess the suitability of investments. Whilst every effort has been made to ensure that the information contained in this document is correct, the directors of Bordier UK can take no responsibility for any action taken (or not taken) as a result of the matters discussed within it.

CL10040/20240627/1.0