MARKET COMMENTARY

Executive Summary

Tim Jones
Senior Investment Manager
Whitechurch Securities Ltd.

Following a broadly positive Q1, returns in April were much more muted, with markets backpedalling on previously higher optimism for imminent interest rate cuts. To add context to the apparent mood swing, just six months ago, as many as seven US interest rate cuts were being touted for the 2024 calendar year, versus just two at the beginning of April, with some commentators now expecting none at all. Multiple factors are to blame – lingering inflation, resilient economic data, and of course, the dreaded risk of central banks simply cutting too early and consequently having to raise them again shortly after. The impact is being felt across both equity and bond markets, with correlation between the two major asset classes seemingly offering negligible diversification during the month, returning -2.4% and -1.7% (all returns in GBP) respectively. One familiar characteristic from Q1 and indeed 2023 that remained prevalent throughout April was global market volatility, which reached a year-to-date peak mid-month.

US Equities

Despite achieving double-digit returns in Q1, US equities registered a -3% loss in April, with small-cap stocks among the notable losers. Whilst it is the case that most major global banks are now broadly supportive of the 'soft landing' narrative for the US economy this year, the fact that the US may avoid recession is rather ironically acting as bad news for equity markets in the short term, given that it is prolonging the higher interest rate environment. The change in sentiment was further compounded by higher-than-anticipated headline US inflation figures released during the month – representing the second consecutive month of rising inflation and the highest reading, at 3.5%, since September. Further market weakness came in the final few trading days of the month following the release of US GDP data, which although indicating a relative slowdown in US consumer spend and coming in below consensus, remained broadly resilient. Both strong retail sales and jobs figures released during the month also boosted the 'higher for longer' base case.

Other Developed Markets

April saw a rare relative win for UK markets, returning 1.8% on aggregate. In a reversal of what we saw in the US, small-cap stocks were among the major contributors despite large-cap markets reaching all-time highs during the month. The UK benefited from several tailwinds, namely a second consecutive meaningful fall in headline inflation, to 3.2% (versus 10.1% a year earlier), and services output expanding for a sixth consecutive month to an 11-month high. Continuing conflict in the Middle East resulted in commodity price increases, which benefited many of the energy names that make up the UK market. The latter, coupled with the diminishing optimism for rate cuts, led to value stocks being favoured over their growth counterparts. European equities returned -1.4% in what was a mixed month. Whilst they too experienced a significant uptick in services activity and a third consecutive decline in inflation to 2.4%, manufacturing output showed a deteriorating picture for both business conditions and new orders. Although a relative year-to-date winner, Japanese equities suffered losses of -3.7%. Whilst some of this can be attributed to profit taking by overseas investors, there is a concern interest rate disparity with the rest of the developed world is weighing on domestic demand and further weakening an already under pressure currency.

Asia & Emerging Markets

After lagging developed markets for a considerable period, both Asian and emerging markets outperformed during the month, both registering gains of 1.3%. Chinese equities are by far the biggest constituent of both regional indices and acted as a major contributor in April, returning 5.8% despite no obvious catalyst for any meaningful improvement in lacklustre domestic growth or a resolution for the longstanding issues in the domestic property market. That said, optimism for a turnaround story, supressed stock market valuations and exposure to commodity-driven names saw increased inflows from foreign investors – particularly from those reducing their overweight allocations to developed markets such as Japan back down to neutral. This offset some poor performance elsewhere, as much of the asset class struggled to shake off the impact of headwinds such as the deteriorating sentiment towards equities generally and the conflict in the Middle East. Among the notable detractors were Indonesia and Korea, as well as frontier and Latin American markets, despite some constituents of the latter recently cutting interest rates. Conversely, India continued its remarkable, now year-long rally with another strong month, returning 3.4% despite concerns over expensive market valuations.

Bond Markets

Fixed income markets continued to be negatively impacted by the change in interest rate expectations, with rising bond yields weighing heavily on prices. As I wrote in January's commentary, any central bank decision and/or absence of any dovish language are materially influencing investor behaviour, and indeed returns. The US Federal Reserve's decision to hold US interest rates at 5.25-5.50% for a sixth consecutive month in April, as well as broadly hawkish language was enough to spook investors at the beginning of the month, with both the US 2 and 10-year Treasury yields finishing the month markedly higher, at 5.0% and 4.7% respectively. Rates in other developed economies have been kept similarly high too, with the European Central Bank looking likely to be the first of the major central banks to be in a position to lower rates, with cuts as early as June still on the table given current inflation levels. The Bank of Japan also opted to hold rates at April's meeting, a month on from a landmark move to positive rate territory. Although there were widespread losses, with all major bond sectors selling off during the month, corporate bonds broadly outperformed government bonds, with UK Gilts among the worst performers. Emerging Market debt and High Yield (lower quality) were among the best performers, with the latter broadly outperforming their Investment Grade counterparts. Elevated rates continue to support lower duration assets, with the risk/reward trade-off at the shorter end of the yield curve remaining attractive.

Other Asset Classes

Commodities returned 2.1% on aggregate during April, with the main headline for the space being the political escalation and conflict in the Middle East. Despite experiencing an initial spike, the price of oil finished the month -5% lower, at $83 per barrel, given the lack of any resolution to the former. There were strong gains elsewhere, with the price of natural gas experiencing double-digit growth whilst the industrial metals space was led by healthy increases in the prices of iron ore and copper, helped in part by the improved sentiment towards China. With the exception of palladium, precious metals also experienced modest gains. Conversely, the real estate sector experienced a particularly bad month, both globally and closer to home, with listed UK property returning losses of -3.3% during the month. Delays in interest rate cuts keeping borrowing costs high have impacted commercial property valuations and demand, with many Real Estate Investment Trusts still trading on large discounts to their Net Asset Value. Indications of major lenders increasing mortgage rates towards the end of the month also saw residential sales prices affected.

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