THORNTONS INVESTMENTS

Markets Review - to end March 2024.

THORNTONS WEALTH

Market Returns

(Returns in £)	1 month	3 months	6 months	1 year
UK Equities	4.2%	2.5%	5.1%	4.3%
Global Equities	3.1%	9.3%	16.5%	20.5%
UK Gilts	1.8%	-1.7%	5.1%	-2.6%
UK Property	0.3%	-0.1%	-0.5%	0.5%
Gold	8.4%	8.2%	15.2%	9.7%
Commodities	6.1%	12.5%	1.2%	11.9%
Sterling	0.2%	1.2%	2.6%	4.5%

Returns to 31st March 2024. Source: Refinitiv

Market Overview

Stock markets in general have had a strong first quarter, buoyed by enthusiasm for a handful of Artificial Intelligence (AI) and weight-loss related stocks, and latterly by slowly improving economic sentiment and lower inflation reports. Many markets recorded new all-time highs in March, although the UK stock market has lagged and is still to make that mark. Early expectations of significant interest rate cuts coming from major central banks have tempered somewhat. Even though the Swiss National Bank cut its interest rate, healthy economic data from the US and signs of a pickup in Europe have pushed out the expected timing of interest rates coming down, undermining the appeal of bonds.

The Bank of Japan celebrated an improving economic outlook and strong wage negotiations with its first interest rate increase for 17 years. Getting inflation up, not down, has been Japan's perennial problem. Their situation has been unique, though an aging society (that Japan was first to face in earnest) is creeping up on many economies in the West and China in particular. China, despite substantial problems in its property market, has just reported their first positive economic survey for over a year. Inflation in the West has eased significantly since last autumn, but is still above target and the last mile might be the toughest with service inflation still high.

Despite buoyant markets, uncertainty and risk remain elevated. Tensions in the Middle East appear to be increasing, rather than easing, and recent long range retaliatory strikes by Ukraine on Russia make the conflict deeply entrenched. The geopolitical disorder adds to the mix ahead of a raft of elections around the world that could throw up some surprises and possibly some shocks this year. The recent jump in the gold price probably reflects the degree of uncertainty.

For the next month or two attention will focus on March end company results reports and whether they concur with an improving economic outlook and to what extent falling inflation might eat into profit margins. The strength of the first quarter is unlikely to be repeated this quarter, but even if markets tread water there are plenty of investments that could play catch up in the meantime.

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The mild winter has left gas reserves at unusually high levels and in the US natural gas prices have fallen to their lowest levels in decades. Although Western Europe still has to secure additional supplies on an ongoing basis. Oil, meanwhile, has been creeping higher, even though global supply and demand look quite well balanced. The situation in the Middle East and Russia have added to worries about supply disruption. Expected economic activity in China remains the biggest swing factor in day-to-day commodity prices, particularly metals, and iron ore has fallen as construction continues to struggle to recover in China. Gold has been the standout beneficiary of heightened uncertainty, even whilst interest rates remain high. Central banks have also been significant gold buyers in a move to reduce foreign currency exposures in their reserves.

The extended shipping times caused by attacks in the Red Sea notwithstanding, transport availability and cost as well as material and component supply are largely back to normal. A reworking of global supply chains, with technology transfer restrictions and international subsidy fights ongoing, is still very much work in progress.

Even though central banks have paused interest rate increases, in the West, yield curves remain inverted (short term bond yields higher than long-term bond yields). This has historically been a harbinger of recession, but a higher proportion of fixed mortgages may be causing an extension of the transmission mechanism of monetary policy, delaying the economic impact. Government bond issuance continues to be very high, whilst central banks continue to sell down their bond holdings from QE.

Although more property funds are winding up, or merging, due to difficulties in offering sufficient liquidity, rental payments remain largely up-to-date, whilst repricing of properties settles down. The bond market turmoil has reduced valuations but many REITs still trade at discounts to restated property values. Listed infrastructure premiums have been replaced with discounts. Renewable energy focused ones no longer benefit from the rising energy prices and face windfall taxes and higher debt costs, but still have plenty of room to grow.

Geopolitics, already drawing up new divisions, is facing a very significant year, with 2024 seeing US elections, European elections, almost certainly a UK election, as well as India, the world's largest democracy. Whilst the outcome of Russian elections last month were no surprise, others may well be. The fragile East-vs-West relationships could be further disturbed and continue to undermine the economic and cost benefits of globalisation, as national security concerns take precedence and new supply chains and relationships are established. Russia/Ukraine, Israel/Iran and US/China's sabre rattling, look set to hang over markets for the foreseeable future.

The heavily predicted recession, last year, failed to arrive in the US, although a small technical one has been recorded here in the UK. Hopes of a 'soft landing' disguise the likelihood that growth will simply be disappointing. Supporting economies through Covid and the energy price spike, have a real cost and take away from other economic activity; the sharp rise in interest rate costs are still working their way through finances. However, the employment market remains firm, real wages are growing again after a long period of erosion and there is a significant cohort who actually benefit from higher interest rates.

Companies have reported mixed results through 2023, with the benefits of reopening weighed against supply and cost problems, but generally managing to maintain profitability and sales. However, there are some clear differences between the pullback in demand for companies that were 'Covid winners' and those with healthy demand following supply restrictions. Companies are reporting a mix of improving supply and cost inputs, but with some demand deterioration, especially where sensitive to higher costs of borrowing.

We are all worried about the conflicts we see daily and the numerous problems we and our investments face. Market volatility has been high and is likely to remain so, but markets are adept at climbing a wall of worry. A well-diversified portfolio should be able to carry you through this turbulence and making knee-jerk decisions on capricious data rarely works well. Keeping calm and trying to pick out the winners and survivors is still the order of the day.

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Market Outlook

Equities	The first quarter of 2024 has been very positive for most stock markets, with many achieving new all-time highs. The UK continued to lag behind, but is starting to look a bit more lively. With a slow improvement in economic sentiment and activity, the performance of markets has started to broaden out from the narrow focus on AI stocks at the start of the year. A lot of enthusiasm, however, has hung on the expectation of interest rate cuts, if these arrive later than hoped markets may well tread water until they become more tangible.
Fixed Interest	Easing inflation and central bank acknowledgement that interest rate cuts are likely this year, caused bond markets to surge into the year end. Market enthusiasm, though, ran ahead of central bank guidance and some of those gains have been given back. The higher levels of yields on bonds re-establishes their secure investment return credentials, particularly if economies hit trouble. However, with most governments continuing to run large deficits, demand will have to be substantial to offset liberal supply.
Commercial Property	The spike in the cost of debt caused a recalibration, downward, of property values, with higher borrowing costs affecting returns and higher yields required to compensate for the more reliable returns offered by bonds. Even after reducing valuations, discounts to assessed value for many REITs still remain, reflecting worries about demand destruction. Rental payments still appear healthy, particularly on industrial property. We have limited exposure, looking for inflation protection and risk diversification benefits.
Alternative Assets	Infrastructure investment funds offer benefits for exposure to physical assets, often with attractive inflation linked contracts, and growth tied to improved connectivity and de-carbonising economies, although build costs are up. Higher debt costs have weighed on the valuations of private equity and infrastructure trusts, with energy related trusts also being hurt by lower market pricing. Absolute Return strategies have shown some defensiveness but generally offer low returns and we continue to choose sparingly.
Cash	The investment return on cash and cash like instruments has likely peaked and should begin to decline as the year progresses.

Thorntons Investments

3rd April 2024

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