Signia Invest Insights

30 April 2024

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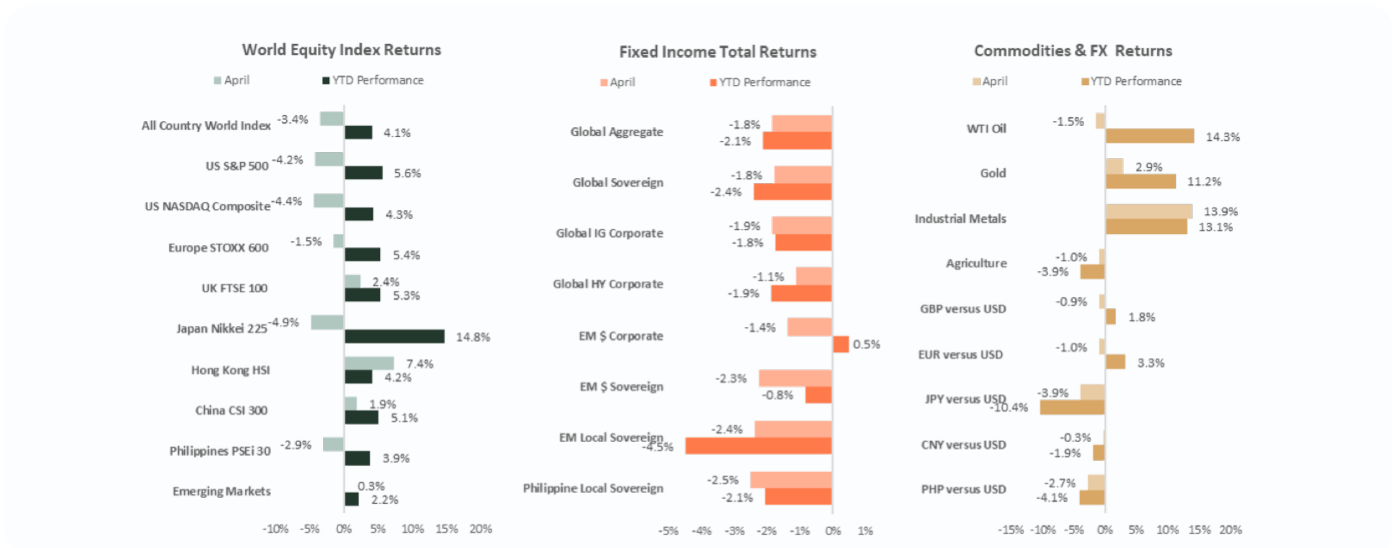
Market Review and Outlook

MARKET REVIEW AND OUTLOOK

- April marked a notable change in tone following a spectacular start to the year in Q1, as investors' concern grew about sticky US inflation and rising geopolitical tensions in the Middle East with direct attacks from Iran and Israel on each other's territories. Although that helped safe haven assets like gold and the US Dollar, it also meant the S&P 500 fell back -4.2% after 5 consecutive monthly gains since October last year. It was actually the index's second-worst monthly performance since December 2022, around the time the S&P had seen a peak-to-trough decline of -25%. Meanwhile, one of this year's best performing stock markets in local terms, Japan, lost almost -5% during the month, reducing this year's gains to 14.8%, on the back of investors taking profits after a record-breaking rally driven by a weakening Yen to 160 versus the US Dollar (weakest since 1990) as the Bank of Japan left their interest rates unchanged in April after raising them in March, and a continued positive outlook overall for Japanese corporations.

- We had expected some profit-taking, and recent news-flow underlining the force of reflationary trends provided the necessary excuse for investors to take some money off the table. As a result, the MSCI All Country World equity index shed nearly half its gains for the year, losing -3.9% in April leaving it up 4.3% for the year. The S&P 500 was amongst the most significant detractors globally during the month, however, some other equity markets came back to life as the FTSE 100 broke out to new highs (finally!), gaining 2.4% against a broader weak market trend leaving it up 5.3% year-to-date. With an index composed of 19% in financials, 16% consumer staples and 14% each in industrials and energy, it did not require any tech stock to move the index out of its misery. In fact, technology and communications only make up 1% and 3%, respectively, of the UK large cap index.

MARKET PERFORMANCE AS OF 30 APRIL 2024:

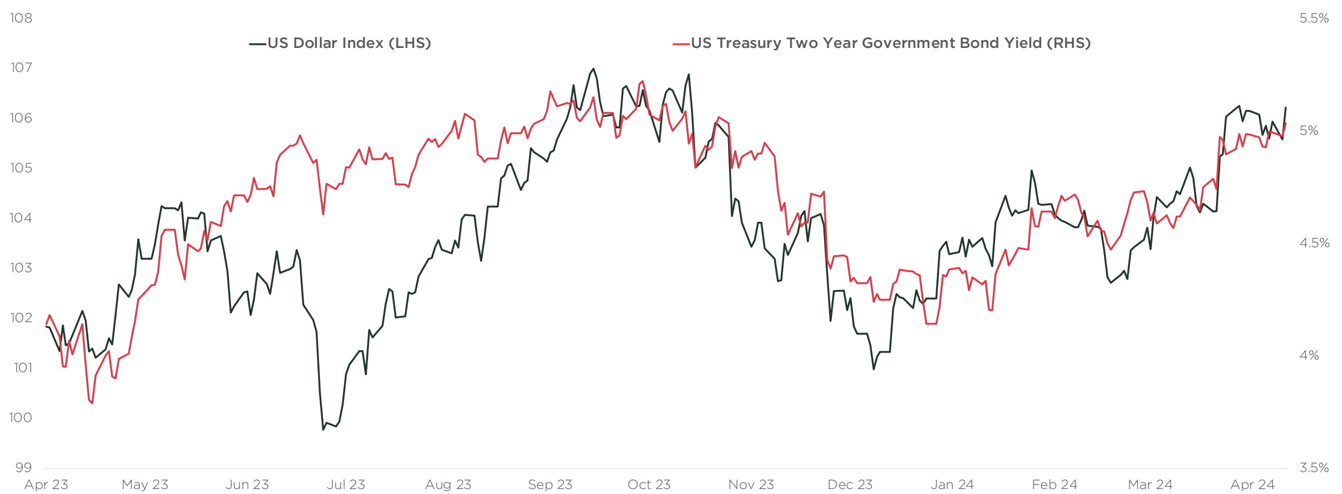


Source: Bloomberg L.P., Arbion Ltd.

- Another unloved and under-owned market that is trying to come back from the dead is China. Hong Kong's Hang Seng index gained 7.4% in April alone and is now back in positive territory for the year, up 4.2%. This is a space to watch as investors have up until now largely given up on emerging markets in general, and China in particular. We are following closely how this potential breakout to the upside evolves as it might be a first step towards a more sustainable trend change, however, we would like to see some technical price confirmation first alongside further stabilisation in economic fundamentals before we take this move more seriously. Notably, several other emerging markets also performed relatively positively last month: India (+1.1%), Russia, local (+4.1%), South Africa (+2.3%) and Argentina (+9.1%).

- In fixed income markets, the 10-year US Treasury yield was up sharply +48 basis points in April, posting their biggest monthly increase since the somewhat scarier days of September 2022. Interesting, this is equivalent to a 2 standard deviation move over the month, which has historically resulted in a circa 5% decline in equity markets, so from a cross-asset class perspective the US bond and equity markets have had a textbook month. A continued rise in commodity prices in April (copper +12.7%, precious metals +3.6%), and another higher than expected inflation print in the US, led to a further repricing out of rate cuts this year with now only a single 25 basis point cut expected by year end, contributing to further upward pressures on the US Dollar.

THE US DOLLAR DXY INDEX (LHS) HAS STRENGTHENED SIGNIFICANTLY IN 2024, DRIVEN BY AN INCREASING OUTLOOK FOR INTEREST RATES, ILLUSTRATED BY RISING US 2-YEAR TREASURY YIELDS (RHS):



Source: Bloomberg L.P., Arbion Ltd.

- The Fed noted in its April meeting that it is not ready to cut interest rates, holding the fed funds rate steady at 5.25%-5.5%. The decision was unanimous and the language in the FOMC statement continued to note that members are waiting for "greater confidence that inflation is moving sustainably toward 2 percent" in order to cut rates. However, there were efforts in the statement and press conference not to also raise the odds of a Fed rate hike. Chair Powell noted that "there are paths to cutting and there are paths to not cutting, it is really going to depend on the data" and importantly that a rate hike was unlikely. Also announced was a slightly larger than expected slowdown in its Quantitative Tightening program beginning, reducing the monthly redemption cap on the sale of Treasury securities from $60bn per month currently to $25bn per month in June, so another slightly dovish move from the Fed to keep markets calm whilst it keeps interest rates higher for longer. Overall, this seems like a sensible strategy for monetary policy to buy time and optionality for the central bank without spooking markets, given the stickiness in the US inflation data set this year (consumer price inflation, personal consumption expenditure, and employment cost index), and rising outlook for rates and the US Dollar, which are causing financial conditions to tighten once again.

- Q1 earnings season saw earnings beats rise and are now running well above average in most global regions. Beats were strong and well above average in the US, Europe and Japan. Emerging markets missed, reflecting China, while ex-China beat at well above average rates. Sales and profit margin beats were also strong in the US and Japan but mixed in Europe and EM. Global earnings growth in Q1 picked up to 6.6% versus Q1 last year, marking a second straight quarter of positive growth after four quarters of negative growth that defined the corporate earnings recession that companies experienced last year, so a cyclical upswing is well in-tact and could well gather further momentum this year to support a longer term bull market in equities and risky assets.

- Further to this notion, longer term bull markets can exist under a long Fed pause, with the current set up being the second longest on record behind the 2006/07 pause. This begs the question how things compared relative to today. As can be seen from the chart below, the pace of the rise in the US stock market is currently in line with what we saw during that period. Moreover, the Fed has some new tools today at its disposal like the Bank Term Funding Program (BTFP) used last year to circuit break the regional banking crisis, which will allow policy makers to hold for longer, but ultimately higher rates, at some point in the future, will most likely start to bite.

THE 2006/07 EQUITY BULL MARKET (BLACK LINE) CONTINUED UNDER A 'HIGHER FOR LONGER' FED RATE ENVIRONMENT, JUST LIKE TODAY (RED LINE):

S&P 500 PROGRESSION DURING THE 2006/2007 AND CURRENT FED PAUSES (INDEXED TO 100)

Source: Strategas, Arbion Ltd

- Looking forward, with some of the market froth from Q1 being taken out of markets, investors are in a somewhat better shape now, technically speaking. Whilst inflationary concerns are still present, recent payroll figures for April indicate that labour markets are beginning to slow and can no longer be seen as 'running hot'. Of course, this should not be extrapolated into a new trend leading to an imminent economic recession and deflation, but at least in the near term it takes some pressure off policymakers and allows markets to re-adjust. US unemployment has been below 4% for 26 consecutive months now, the longest stretch since the early 1970s, but could potentially rise over the next year: the NFIB small business survey showed that US business optimism fell to the lowest level in four years whilst the number of firms looking to raise prices increased substantially. Notably, rising gas prices at the pumps are a big contributing factor here, and pose a substantial risk to President Biden's re-election hopes later this year.

- Despite the market volatility in April, implied market volatility has quickly retraced back towards the lower end of its trading range recently, whilst sentiment measures moderated quickly into a more neutral zone. This appears to paint a picture of a brief correctional phase in markets that is not deeply structurally rooted and could potentially present an attractive buying opportunity in some areas. While we are slowly approaching the summer months, markets are likely to tread some more water before entering the very favourable election period seasonality that historically has boded well for returns in Q3 and Q4. We remain overweight riskier liquid assets in portfolios and overall positive for the outlook for the remainder of this year.

ROBERT LEE

CO-HEAD OF MULTI-ASSET INVESTMENTS, HEAD OF RATES

Robert has been managing the wealth of private clients since 2006 as a portfolio manager and fixed income specialist. He is jointly responsible for the multi-asset investment team, global fixed income strategies, and Arbion's retail funds business. Previously, he worked for Lehman Brothers on the European Capital Markets team, and then Coutts & Co where he was a member of the fixed income and foreign exchange selection committees, responsible for managing the advisory and discretionary portfolios for private clients and institutions.

Robert is a Chartered Financial Analyst and a member of the Chartered Institute for Securities & Investment.

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