Signia Invest Insights

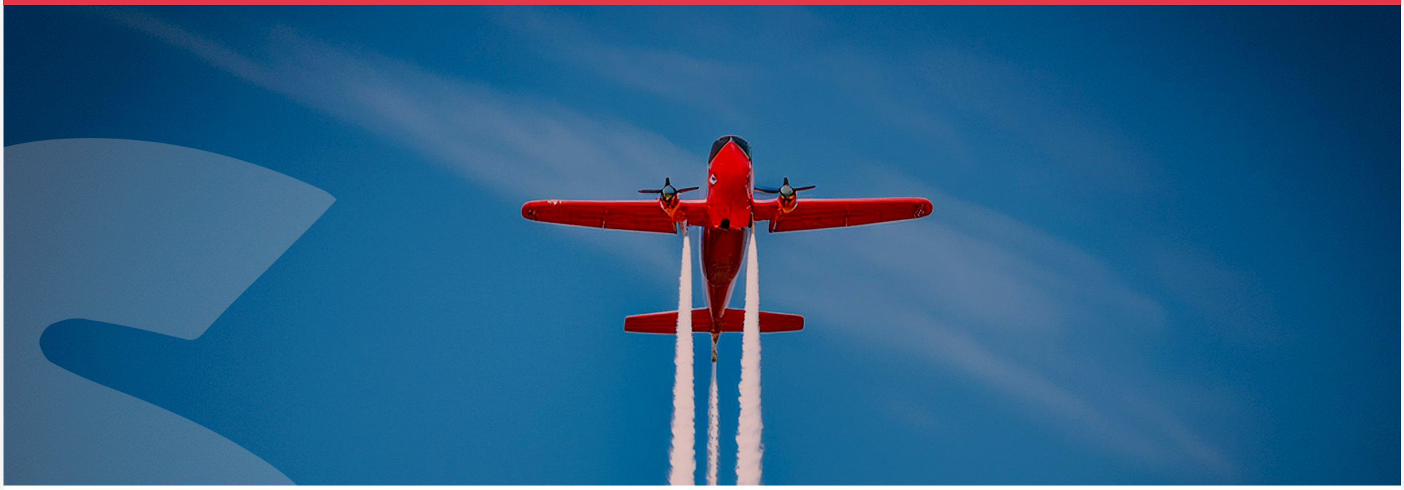
31 December 2024

Signia Invest
One Connaught Place
London
W2 2ET

Contact Us
info@signiainvest.com
+44 (0) 800 756 1094

Website
www.signiainvest.com

MARKET SUMMARY AND REVIEW



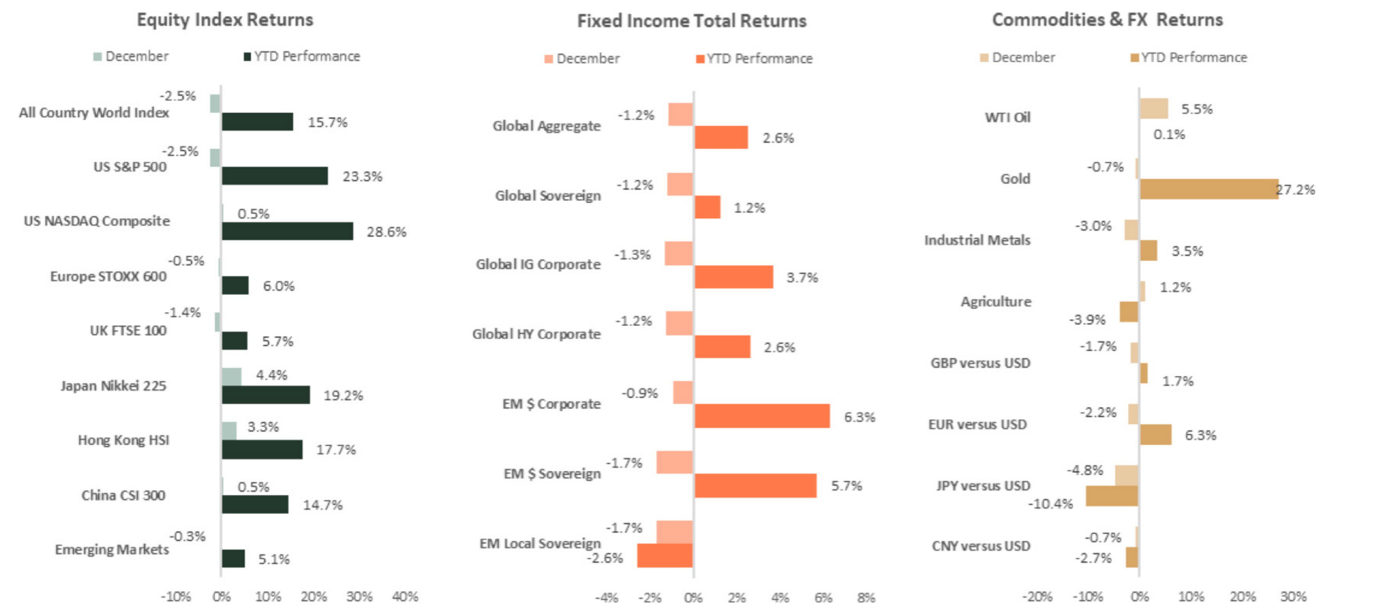
- There are normally certain things you can rely upon in December, however this year a Santa rally was not one of them, as despite a strong year overall that saw world equities gain 15.7%, December ended with a decline of -2.5%. That said, the four seasonal constants, or what I like to call "The Four F's" – Family, Friends, Food, and Forecasts, were out in force in December. None so much so as the latter of these four – Forecasts, which seem to grow in volume every year. It's true that when the news cycle slows into year end and market activity dissipates, people need something to talk about and headlines to grab on to, and there is never a shortage of year end forecasters here to fill the void! There are the 'crystal ballers' who are prepared to predict the future with a high degree of confidence. Then there are those who like to follow a safe and conservative path to maintain credibility. Others just want to be bold and grab attention with their calls. Here at Arbion we don't make year end forecasts, instead, we focus on the here and now, and in particular, the macro factors and market themes that are likely to drive the investment narrative over the coming months.

- The most impactful detractor to last month's equity performance was the 'hawkish' 25 basis point Fed rate cut, which sent the S&P 500 3% lower on the day, effectively putting an early end to any Santa rally, where the Fed ruled out the prospect of deep rate cuts in 2025. However, other markets performed better, the Nikkei rebounded strongly by 4.4%, ending 2024 on a strong gain of 19.2%. Despite better performance towards the end of the year, the Europe Stoxx 600 gained just 6.0% last year, only outperforming the FTSE 100 and emerging markets. The latter was, however, dragged down by Latin America this time as Chinese markets did remarkably well in 2024, with the CSI 300 rising 14.7% and HSI rising 17.7% after a major recovery attempt by policymakers in September.

- Overall, 2024 was broadly another strong year for asset returns, as economic growth surprised on the upside and central banks finally began to cut interest rates. That meant the S&P 500 posted a return of 23.3%, marking the first time since the late-1990s where it's achieved back-to-back annual returns above 20%. The index was powered by further gains for the Magnificent 7 stocks, which significantly outperformed for another year, rising 67%. Other assets performed well too, credit spreads tightened further whilst Bitcoin more than doubled. Moreover, the continued US exceptionalism narrative helped push the US Dollar to its strongest annual close since 2001.

- Yet despite the generally upbeat performance, there were plenty of bumps along the way. Rate cuts took longer than many expected, meaning that sovereign bonds struggled to gain traction. In fact, the 10yr Treasury yield rose for a 4th consecutive year, which is the first time that's happened since the 1980s. Political developments also caused several wobbles, particularly around April as tensions in the Middle East escalated. In France, the country's assets underperformed amidst political uncertainty. And there was huge (albeit brief) market turmoil in the summer, as weak US data and a BoJ rate hike led to the unwinding of the yen carry trade. So with quite a few of these concerns lingering in the background, it was no surprise that gold prices posted their strongest annual gain since 2010, rising 27.2%.

MARKET PERFORMANCE AS OF 31 DECEMBER 2024



Source: Bloomberg L.P., Arbion Ltd.

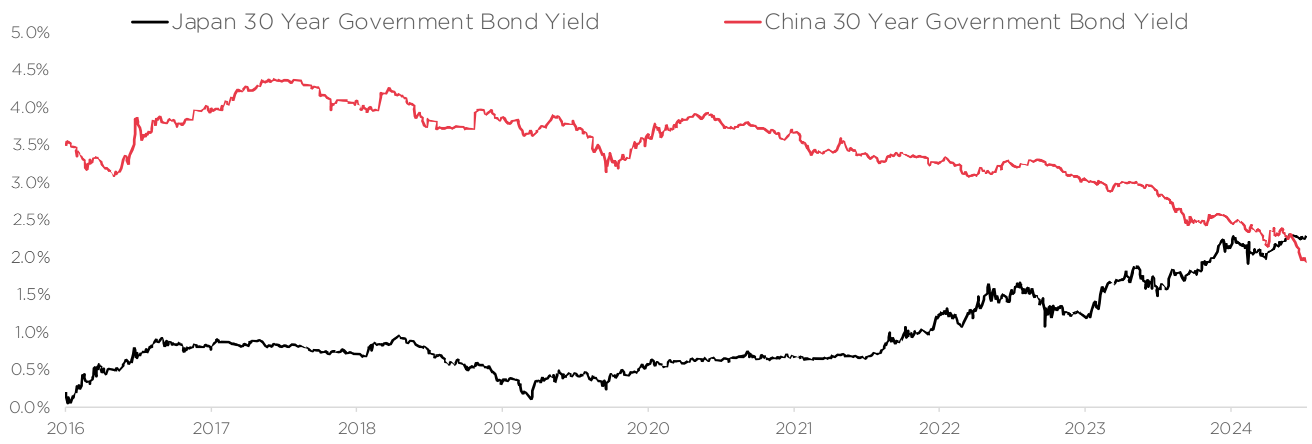
HAPPY NEW YEAR! NOT SO HAPPY GILT MARKET...

- Bonds have started 2025 on a weaker tone, with long-term borrowing costs continuing to move higher across the board. The UK in particular has been in the spotlight, as the 10-year gilt yield has risen to a post-2008 high of 4.9% (above the Truss tantrum levels of 2022), whilst the 30-year gilt yield has hit a post-1998 high of 5.5%. But even though the UK might appear the most striking in terms of when yields last traded at these levels, other countries have experienced a similar pattern too. Nonetheless, the rise in gilt yields reinforces our view that UK growth will likely disappoint this year, leaving the Labour government with marginally negative fiscal headroom.

- Higher borrowing costs are feeding back into a deteriorating fiscal profile and there is a growing sense that the Labour government is quickly running out of ideas. If current moves persist, there is a danger that Rachel Reeves will be breaking her promise not to raise taxes further, less than a month after making this claim. Meanwhile, it is interesting to note the rise of Reform UK in the polls, with Nigel Farage now the bookmakers' favourite as the next Prime Minister after the next General Election, it is striking how the success of Trump in the US is resonating over the pond in the UK.

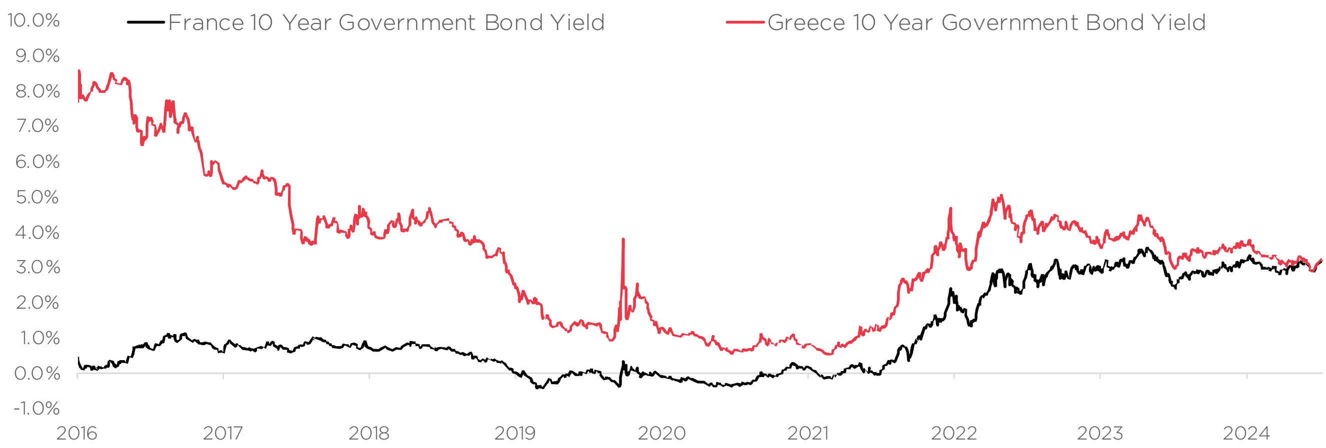
- There's been some debate as to why the UK has found itself the centre of attention in global markets. But a key point is that its twin deficits are the second-largest in the G7, only behind the US, who have the substantial benefit of the world's reserve currency. So UK is reliant on overseas investors, with around 30% of gilts held abroad. On top of that, the combination of sluggish growth and above-target inflation are adding to investors' nerves, and the current pattern of market moves (with yields up and the value of the British Pound down) is reminiscent of previous episodes of market turmoil, albeit this time we are not yet at a point of crisis.

IT'S NOT JUST THE UK, SOVEREIGN YIELDS ARE RE-PRICING ACROSS THE WORLD



Source: Arbion Ltd. Data as at 31.12.2024.

- Investors believe that China is facing the same structural issues and deflationary forces that have plagued Japan for decades, whilst also thinking that Japan is slowly normalising. This has caused China's 30-year government bond yield to decline steadily over recent years, amazingly now below their equivalent Japanese bonds. Not so long ago, this would have been inconceivable!

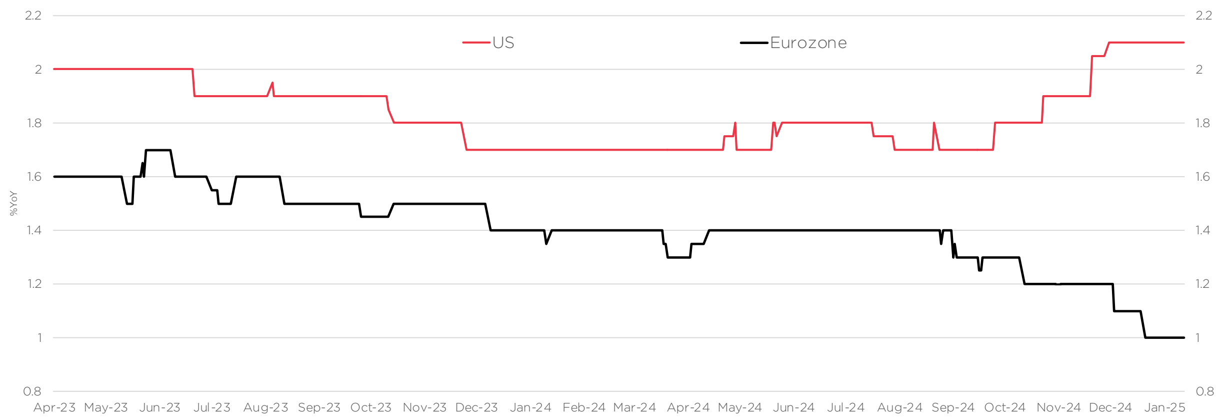


Source: Arbion Ltd. Data as at 31.12.2024.

- An unpleasant mix of ongoing political and fiscal uncertainty in France, culminating recently in the French government losing a no-confidence vote for the first time since 1962, has caused France's 10-year government bond yield to rise towards a declining Greece 10-year government bond yield, despite credit agencies rating French government bonds several notches higher than their Greek counterparts. That said, Greece is now an investment grade sovereign issuer which has made huge fiscal progress since the depths of the Eurozone debt crisis over a decade ago. Again, back then this level of market pricing in line with France would have been inconceivable.

- Indeed, the absolute level of both country's sovereign yields is still low relative to the US, where economic growth and interest rates are expected to remain higher for the foreseeable future. This is most evident in the decoupling of the 2025 economic outlooks for the two regional blocs, with the US economy now expected to grow by 1.1% more than Europe this year, exacerbated by Trump's sweeping election win, and another sign of continued American exceptionalism.

Bloomberg 2025 GDP Consensus Forecasts.



Data as at 31.12.2024. Source: Arbion Ltd

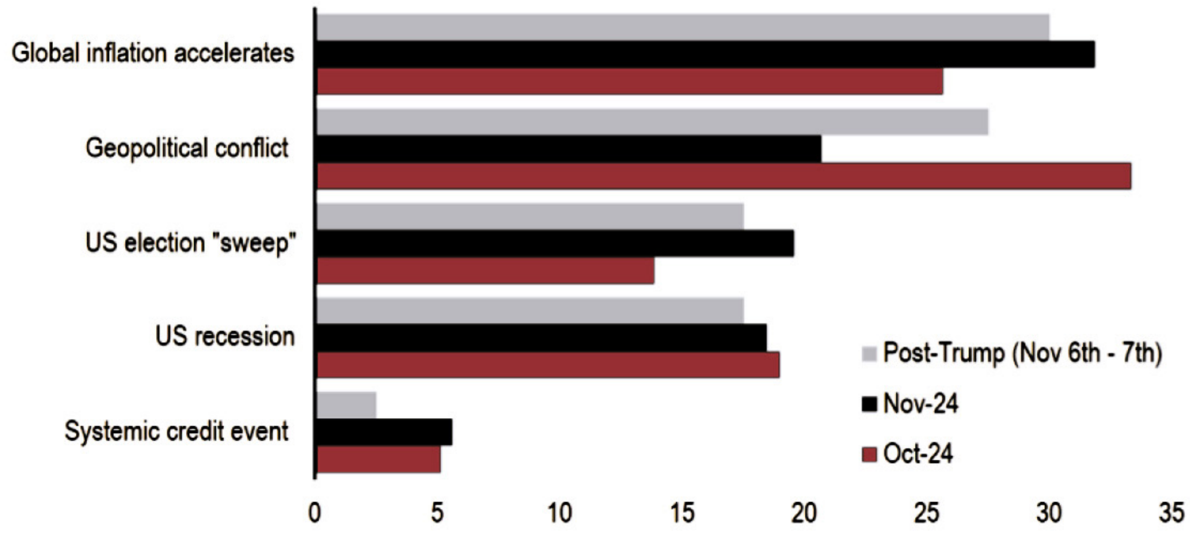
WORLD ECONOMIC DASHBOARD

	GDP (YoY)	2024 GDP Forecast*	2025 GDP Forecast*	Headline CPI	Core CPI	Unemploy-ment Rate	Central Bank Policy Rate	1Y Yield (Implied Path)
US	2.7	2.7	2.1	2.7	3.3	4.1	4.50	4.22
UK	0.9	0.9	1.4	2.6	3.5	4.3	4.75	4.73
Europe	0.9	0.8	1.0	2.4	2.7	6.3	3.00	2.40
China	4.6	4.8	4.5	0.1	0.4	4.0	2.00	1.19
Japan	0.5	-0.2	1.2	3.0	1.1	2.5	0.25	0.45

*Bloomberg full year economic forecasts

Data as at 10.01.2025. Source: Bloomberg L.P., Arbion Ltd. All figures are percentages.

LOOKING AHEAD, GLOBAL INFLATION AND GEOPOLITICAL CONFLICT ARE SEEN AS THE BIGGEST 2025 'TAIL RISKS' BY GLOBAL FUND MANAGERS:



Source: BofA Global Fund Manager Survey. "Post-Trump" indicated only the responses recorded after the US election.

- Despite these concerns, the important thing to note here is that we are not about to return to the high single-digit inflation levels of 2022 and early 2023. Barring another commodity price and supply chain shock, any re-acceleration in consumer price inflation is likely to be much less pronounced and ultimately benign to the global economy and corporate profitability.

OTHER NOTABLE ECONOMIC AND MARKET DEVELOPMENTS

- **US:** Federal Reserve officials conveyed their concerns of the possible impact that President-elect Donald Trump's policies may have on their efforts to lower inflation, minutes from the bank's December meeting showed. While Trump was not explicitly mentioned, the minutes said that "recent higher-than-expected readings on inflation, and the effects of potential changes in trade and immigration policy, suggested that the [return to target inflation] process could take longer than previously anticipated". The Fed had already announced a change in outlook for expected interest rate cuts in 2025, from four to two cuts at its December meeting, where it cut rates by 25 basis points bringing the Fed Funds Rate down to between 4.25% - 4.50%.

- **Canada:** The Bank of Canada delivered a 50 basis point rate cut that took their policy rate down to 3.25%. That's the second 50 basis point cut in a row they have now delivered, but the central bank sounded more cautious about future cuts, saying in their statement that "we will be evaluating the need for further reductions in the policy rate one decision at a time."

- **Germany:** German Chancellor, Olaf Scholz, lost a vote of confidence in parliament, paving the way for early elections on 23 February. For investors, a key focus is on whether there might be any changes to the constitutional debt brake after the election, which in turn could enable a more expansive fiscal stance with more public borrowing. But in economic terms, even if there is a change, any easing in the debt brake would more likely be a 2026 story, given that it normally takes a few months for a government to be formed after coalition negotiations, and it would then take time for those policies to be implemented.

- **Middle East:** Syrian President Assad's reign collapsed as he was ousted by rebel forces, as the government's backers, Russia and Iran, had been distracted by other conflicts on their own doorstep. While many countries will be happy to see the current regime fall, the big question mark is what happens next. The rebels have been led by HTS, who spun out of al-Qaeda in 2016, so there will remain question marks about the succession.

- **China:** The Politburo, comprising the ruling Communist Party's most senior 24 officials and led by President Xi Jinping, announced it will embrace a "moderately loose" strategy for monetary policy in 2025. The body also adopted stronger language on fiscal policy in a readout of its December meeting, saying it will be "more proactive". In another sign of greater resolve to shore up confidence, officials pledged to "stabilize property and stock markets," according to the official Xinhua News Agency. They will also step up "extraordinary counter-cyclical policy adjustment," hinting more tools will be deployed to boost the ailing economy and the threat of a renewed trade war with the incoming Trump administration. Top officials led by President Xi Jinping also vowed to deliver rate cuts and lower the reserve requirement for banks during a two-day huddle of the Central Economic Work Conference in Beijing. China will also increase the issuance of ultra-long special treasury bonds and local government special notes next year, which are important sources for infrastructure investment and other public spending.

- **Japan:** the Bank of Japan left its policy rate steady at 0.25% in an 8-1 vote, with Naoki Tamura voting for a 25 basis point hike given his view that "risks to prices had become more skewed to the upside". However, the tone remained cautious generally, and the statement said that "there remain high uncertainties surrounding Japan's economic activity and prices". With the Fed becoming more hawkish and the BoJ staying on hold, the Japanese Yen weakened further against the US Dollar.

- **South Korea:** President Yoon was impeached following a botched attempt at declaring martial law to combat his political rivals. Yoon remains in office but suspended from his duties until South Korea's constitutional court upholds his impeachment.

SUMMARY AND PARTING THOUGHTS

- It is no surprise that the word Polarisation was recently announced as the Merriam-Webster Dictionary's 2024 Word of the Year, defined as "division into two sharply distinct opposites; especially, a state in which the opinions, beliefs, or interests of a group or society no longer range along a continuum but become concentrated at opposing extremes." The word was used widely across the media landscape this year, in particular when discussing the conflicting ideologies of the 2024 US presidential election. Moreover, with major wars in Europe and the Middle East, and polarising political shifts taking grip across the world, one can be forgiven for feeling nervous about the ongoing equity bull market.

- It's at these moments that investors should focus on the key drivers for markets, and whether these forces remain in-tact. Specifically, a looser financial environment in 2025 with forecasts of 124 rate cuts by central banks taking the global policy rate from 5% to 4%; a strong corporate America and very healthy US economy and consumer; and fiscal policies that are set to ease (German deficit to 3% GDP) or stay very accommodative (US deficit 6-7% of GDP).

- Investors should also take note of valuations, with above-average price-to-earnings multiples in the US and historically tight credit spreads worldwide, seemingly indicating that further outsized gains across financial markets may prove difficult to achieve for a third consecutive year. The average calendar year return for the S&P 500 over the last 100 years has been 9-10%, so perhaps this is a more realistic target this year. Whilst the underlying trends of strong nominal growth and good company performances are still in place, we anticipate some potentially volatile episodes over the coming months driven by politics, and a rising bond yield and bond term premia environment. As a result, we remain fully invested but have put in place some tail hedges across our equity allocations in order to achieve a smoother journey.

Wishing you all the best and a prosperous start to 2025!

ROBERT LEE

HEAD OF MODEL PORTFOLIO SERVICES; 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, Arbion's MPS business, and is portfolio manager for the Arbion Sovereign Opportunities strategy.

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.

CONTACT US
Signia Invest

One Connaught Place,
London, W2 2ET

www.signiainvest.com
info@signiainvest.com