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Fourth Quarter 2024

The main event during the final quarter of the year was the US Presidential election in early November, which delivered a return to power for Donald Trump and control of Congress for the Republican party. US markets had tentatively priced in a Trump victory during October, and then rallied strongly in November as his views on lowering regulation and tax levels spurred optimism that the American economy is well-placed to grow more strongly than others next year. This extended the outperformance of US stocks this year, with flows continuing into the large technology names despite some valuation concerns, while most other regions have been somewhat lacklustre. In this way, Q4 represented a continuation of the trends in place during the first three quarters of 2024, as US markets in particular recovered strongly from a weak October. The bellwether S&P 500 gained +2.07% while the technology-focused NASDAQ added +4.74% in local currency terms. By contrast, UK and European bourses had negative quarters while weakness in Korea and India pulled the MSCI Emerging Markets Index into firmly negative territory at –8.15%.

Trump's most controversial economic policy is tariffs. He touted these trade barriers repeatedly during the campaign, but it is unclear whether they are being used as a negotiating threat – particularly against China – to gain leverage in economic or diplomatic discussions or a genuine policy tool that his administration would like to use. There is certainly a risk to other countries that the US might use its muscle in this way, as limiting access to its domestic market is a powerful weapon, though it would almost certainly have an inflationary impact in America just after an election when the cost of living was a key concern for voters.

There were reductions in interest rates announced by the US Federal Reserve (Fed), the Bank of England (BoE) and the European Central Bank (ECB), but relatively little is expected next year with modest falls in rates in prospect as expectations have been pared back. The ECB would seem to have the most scope to cut rates, with inflation low and growth anaemic in the Eurozone. France and Germany are both grappling with political uncertainty due to weak governments, which is unhelpful for sentiment and business confidence throughout the currency bloc.

In the UK, inflation is ending 2024 at 2.6%, above its recent lows, as service sector inflation seems to have troughed at 5% and wages are proving sticky. This limits the BoE's room for manoeuvre, given its sole target is inflation, and it has only been able to reduce its policy rate by 0.50% in total this year with a further cut reasonably likely in February. The Fed has a dual mandate, considering unemployment as well as prices, and at its mid-December meeting it announced a 0.25% reduction in rates but also sounded uneasy about the risk of stronger growth prompting a rise in inflation. A sharp sell-off in equity and bond markets ensued, as investors adjusted to the likelihood that the Fed will be reluctant to lower rates much in 2025. For the quarter, 10yr US Treasuries fell in value with yields rising 79 basis points, with a drop of a similar magnitude for the 10yr UK gilt market. The Fed decision also extended the US dollar's rally during the quarter, with a gain of 6.8% against the pound and more against other currencies over the final three months of the year.

The geopolitical landscape remains highly unstable, with the fall of the Syrian government adding further uncertainty in the Middle East. Perhaps surprisingly, outside some knee-jerk responses in the oil market, there has been little impact on financial assets and perhaps some relief that Russia and Iran appear less emboldened than they have for some time.

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Outlook

Our view on Fixed Income investments is little changed from last quarter, when we pointed out that expectations of interest rate cuts from the Fed looked rather stretched and difficult to justify without a more marked slowdown in economic activity. With US growth now expected to accelerate in 2025, rate cuts are likely to be modest and we may have to navigate initial weakness in bond markets. However, we still feel that this represents a reasonably good environment for fixed income investments, as coupon levels remain attractive and there remains some scope for capital gains should growth disappoint expectations. We also feel that bond markets are likely to offer higher returns than parts of our Alternatives allocation, which have been mixed in 2024 but still possess defensive characteristics which may be valuable should the market environment change in the new year.

The outperformance of US equities compared to other regions has been impressive, and it is likely that the American economy will be relatively strong in 2025. Corporate earnings – particularly of the largest companies – have been very impressive but valuations appear stretched, and we are uncertain whether share prices there will continue to rise. We favour geographical diversification to mitigate this risk, while also increasing weightings to 'value' strategies within our equity allocation as these look less vulnerable to a shift in investor sentiment. We remain positive on markets, but our approach emphasises care on valuations as this is a key determinant of good long-term returns which remains our primary objective. On that topic, there is change afoot in China with the government showing signs of realising that it must encourage consumer and business sentiment after three years of unhelpful policies. These have worsened companies' returns on investment capital but with the Chinese equity market appearing quite cheap and capable of positive spillover effects in the region, we are optimistic that Asian assets could do well over the coming quarters. Much will depend on the domestic mood but also on the path of the dollar and how the US proceeds with its potential tariffs once Trump is in power. In this sphere it seems prudent to take the President's threats seriously but perhaps not literally, though much remains uncertain.

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