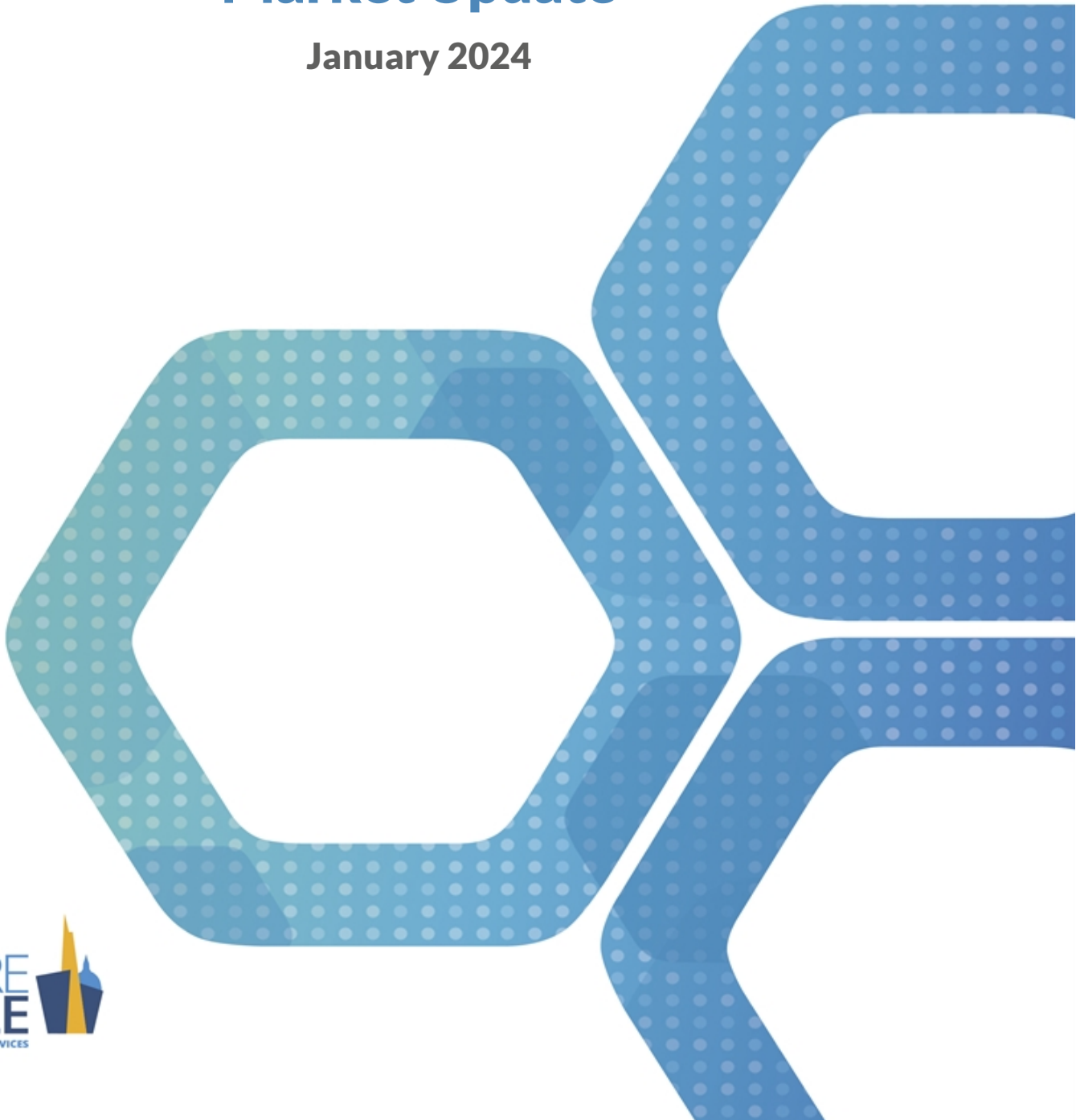


GEMINI

FINANCIAL PLANNING

Market Update

January 2024



Market Update

Macro Backdrop

Whilst at the year's open recession fears were one of the key risks highlighted for 2023 thus far, we have escaped a material downturn. This is despite the fact that we have seen significantly higher interest rates, US and European bank collapses and takeovers and an escalation of hostilities in the Middle East. Importantly, the US, as the world's largest economy, actually experienced a period of quite impressive expansion, with third quarter growth its strongest since 2021. This has been helped by the consumer digging deep and continuing to spend with, if not quite abandon, then at least a level of optimism that seems at odds with general sentiment. Elsewhere however, growth has not been nearly as impressive with the UK and Europe stuttering from month to month and slowing slightly in the third quarter. Further afield, China has disappointed expectations but continued to post positive growth, helped latterly by government and central bank economic intervention, including interest rate cuts. These actions have been prompted by a number of factors, not least weakness in the country's debt laden property market.

The spectre of higher interest rates got a fright towards the end of the year, as inflation in the US and Euro Area slowed to 3.1% and 2.4% respectively in November. This led to anticipation that we have witnessed peak interest rates, a narrative which was further supported by US policymakers stating that they may cut interest rates by 0.75% in 2024. UK inflation fell to 3.9% in November though, unlike the US, the Bank of England (BoE) emphasised that interest rates may need to stay higher for an extended period and could even go higher. Markets still expect UK interest rates to be cut in 2024, responding to the BoE's comments by merely adjusting the likely date of this to June rather than May. Nevertheless, the encouraging inflationary backdrop was enough to allow the US, UK and European central banks to all keep rates on hold in December.

We have been of a view for some time that we are likely at peak interest rates. Indeed, this was why we increased interest rate sensitivity in our portfolios mid-way through last year, which supported portfolio returns as markets subsequently reacted positively to potentially lower interest rates in 2024. Yet, we are not complacent enough to suggest that the war against inflation has been won and a recession has been avoided, especially due to the lagged effects of higher interest rates. This is why we continue to take a balanced stance in our portfolios and retain exposure to quality (in both bonds and equities) and, where appropriate, diversifying funds, which are strategies designed to have a limited relationship with stock and bond markets.

Nonetheless, the prospects for future returns bode well. Bond yields are at attractive levels and so they could materially add value, as we saw in the latter stages of 2023. Furthermore, if peak interest rates are behind us and we avoid a severe recession then there are many parts of the global stock market that could return to form. Much of 2023 was dominated by the performance of a few massive US companies and whilst a slowdown in them may impact the wider market, it has meant that there are many great companies that have been ignored for some time, not least in the UK.

Bond Markets

After a fairly lacklustre first nine months of the year, global bond markets responded energetically to the prospect of not only interest rates peaking, but being cut this year. As such, the returns in the final three months of the year meant we saw gains right across the board in 2023 and, notwithstanding the BoE's more cautious tone, even UK government bond prices rallied and ended the year in positive territory.

Over 2023 we saw credit markets (i.e. corporate debt) outperform government bonds and so yields here are not as striking as they were in January. Regardless, they remain more appealing than they have been for some years and streaks ahead of where they were at the start of 2022.

Bond markets are not immune in a recession and whilst yields are more appealing, we have to be alive to the risks that an economic slowdown presents. We therefore maintain a reasonable level of sensitivity to interest rates, which should fall in a recession and be a positive contributor to bond market returns, as well as quality securities, which have a lower risk of defaulting.

Stock Markets

In sympathy with bond markets, stocks also rose strongly in the final quarter of the year and especially the share prices of medium and smaller companies in December, most notably in the US. For the year itself, it was the US market that finished top of the podium, followed by Europe and then Japan. Though life was very much seen in the UK also, with the largest 100 companies delivering their third consecutive year of positive returns. The economic issues in China led to double digit stock market losses and hampered the returns of Asian and emerging market indices, which trailed Western exchanges.

For much of 2023, US market returns were dominated by just a handful of that nation's largest companies, such as Microsoft and Apple. In 2023 the top 50 largest stocks in the US returned c.20% more than the bottom 2,000, despite a spirited rally from the latter in the last month of the year. This has optically made the US market appear quite expensive, using traditional valuation measures. However, once the top 10 stocks are removed the market is trading at around its long-term average valuation and US smaller sized companies are trading at cheaper levels when compared to their larger colleagues. This is not just a US based theme, for medium and smaller sized participants in many regions have found themselves overlooked in recent years, not least in the UK. Therefore, should markets continue to broaden further beyond a select group of favoured names this could prove supportive to returns.

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In the last three months of the year, we had the Autumn budget which, in terms of direct support for the UK's capital markets, fell short of some expectations. There does seem a greater realisation that a healthy stock market is incredibly important to the economy, and we have rolled over our hope that the Spring budget will provide something more concrete. Regardless, there remain many great businesses in the UK, some of which are more well-known than others, that are delivering positive operating updates. For example, one of our managers updated us recently with "*Experian, RELX and Sage Group continue to benefit from ongoing demand for their software and data analytics services as digitalisation trends continue. PageGroup and Howden Joinery are trading resiliently in difficult end markets, helped by their market leading positions and healthy cash generation. Smith & Nephew's results showed signs that new management's investments are beginning to bear fruit*".

We continue to balance the risks of potential economic weakness and an expensive looking top end of the US market with the view that interest rates have likely peaked and valuations elsewhere are more attractive. We are also aware that 2024 is a big year on the political front, with more than 50% of the world's population going to the polls (at the regional, national and parliamentary level), including the US and potentially the UK towards the end of the year. This is not necessarily a negative for markets, as political parties may try to rally support with vote grabbing giveaways. Although any anti-business rhetoric, from any party, would not be taken well by markets. As such, we are not positioned aggressively in equity markets, but retain what we would term a neutral level of exposure in portfolios.

All data has been sourced from FE fundinfo, Refinitiv and Square Mile.

Important information

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