# Quarterly review

for the three months to 30 September 2024

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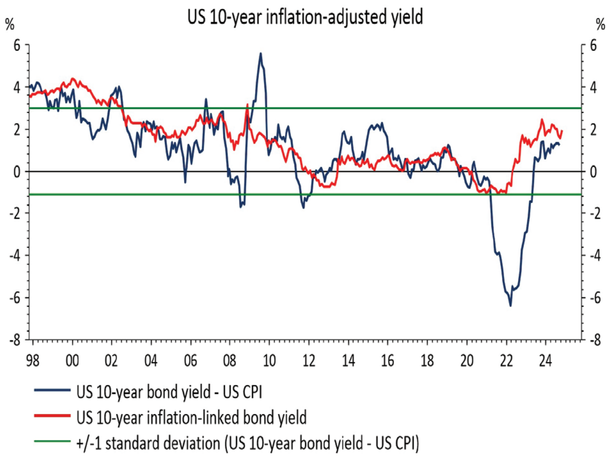
Chief investment officer

Global equities and global bonds rose 0.57% and 0.82% respectively in sterling over the third quarter of 2024 as leading western central banks cut interest rates. Federal Reserve easing weakened the dollar, which fell 5.76% against the pound. This contributed to outperformance by equities in Asia excluding Japan and emerging markets, up 4.18% and 2.61% respectively in sterling.

Lower interest rates and falling bond yields are likely to lead to gains for some areas of the bond market. As the chart below shows, longer-dated US government bonds offered a low-risk inflation-adjusted return of almost 2% in late October.

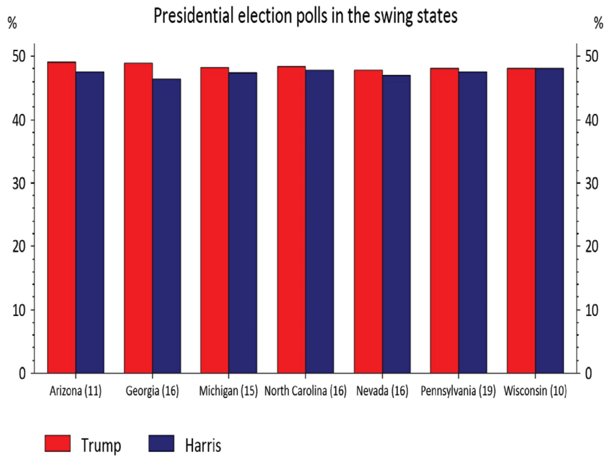



Source: LSEG Datastream

This should provide an attractive buying opportunity for US government bonds, which could also prove a safe-haven if the US economy weakens more than expected or at times of heightened political risk.

November's US presidential election appears too close to call. Recent opinion polls put Kamala Harris, the vice president, and Donald Trump, the Republican candidate, neck and neck in the seven swing states likely to dictate the outcome – see chart opposite showing latest polling and the number of electoral college votes per state. These states account for 93 of the 538 votes in the electoral college. In each of these, the winner of the popular vote gains all the electoral college votes for that state.

A second Trump presidency could prove inflationary because he wants to reduce immigration and raise tariffs. Shorter-dated inflation-linked bonds should provide some protection in such circumstances.




Source: LSEG Datastream, RealClearPolitics 22/10/2024

Chinese stocks rose 16.52% in sterling as Beijing announced measures to stimulate economic growth. These included cuts to the reserve requirement ratios that govern commercial bank lending, lower interest rates and a $114 billion war chest to buy Chinese shares. China's stockmarket ended the quarter still lowly valued compared to history and some other stockmarkets. This latest policy support may, however, not be enough given the economic headwinds from an over-indebted property sector and, in a US election year, bipartisan support for Sino-US trade restrictions. China has also placed restrictions on the profitability of some sectors in the name of "common prosperity" leading to heightened political risk and lower valuations overall. A stronger Chinese economy will, however, boost economic activity across Asia.

Low valuations and a softer dollar may provide an attractive buying opportunity for some emerging markets that are free from the heightened political risks of direct investment in China. Indian equities may justify high valuations because of superior economic growth prospects and pro-business government policies.

In the US, the Fed's preferred inflation measure, the core personal consumption expenditures (PCE) price index, which excludes food and energy, rose marginally from 2.63% in June to 2.68% in August, the latest month for which data is available. Eurozone consumer price inflation fell from 2.5% in June to 1.7% in September while core UK inflation fell from 3.5% to 3.2% over the same period. In the US, UK and eurozone, goods prices were weaker than services

# Quarterly review (continued)

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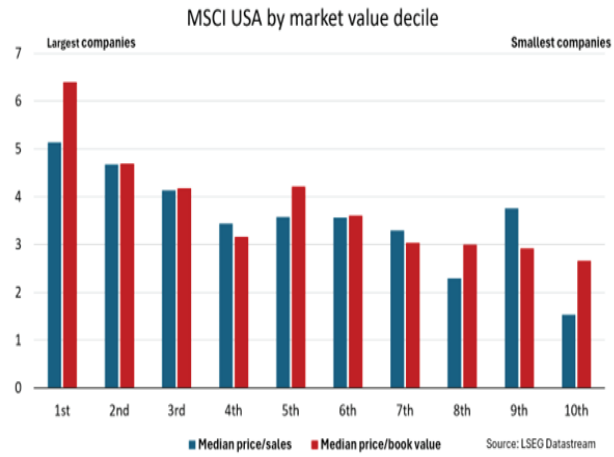
prices. PCE service sector inflation was 3.7% in August but the PCE index for goods showed a 0.9% decline. September figures for the eurozone and UK showed goods prices rising 0.4% and falling 1.4% respectively while service sector inflation was 3.9% and 4.9% respectively. Some economists see goods prices as more accurate predictors of economic trends than service sector prices and this may have contributed to central bank willingness to cut rates. Many believe the US economy is heading for a soft landing, which may mean that a sharper decline in economic activity is not reflected in share prices.

The Fed's first interest rate cut in this monetary easing cycle, announced in September, was a larger-than-expected reduction of half a percentage point to 4.75-5%. The European Central Bank (ECB) cut its official rates in June, September and October, each time by a quarter point. In consequence, the key deposit facility interest rate, the principal means through which the ECB steers monetary policy, has fallen from 4% to 3.25%. In August, the Bank of England commenced its rate cutting with a quarter-point cut to 5%. At the quarter end, all three central banks were expected to cut rates again before New Year.

US stocks fell 0.21% in sterling, with technology stocks, down 4.76%, particularly weak. As the chart opposite shows, the largest US companies, including technology stocks that rank in the top 10% of the market by size, ended the quarter on the most expensive valuations.

This valuation premium may be justified in the longer term because of the growth prospects for companies involved in the commercialisation of artificial intelligence but could also indicate the extent to which passive buyers of the US market have driven up valuations to a point where there is little scope for disappointment. In October, shares in ASML, a semi-conductor manufacturing machinery supplier, fell sharply after it announced disappointing results. AMSL's order books are a bellwether for the cyclical semi-conductor sector and softer demand could lead to falls for semi-conductor stocks and the broader technology sector.




At the quarter end, overall prospects for equities and bonds appeared positive because lower interest rates should be supportive of both major asset classes. In fixed income, longer-dated US government bonds and shorter-dated inflation-linked bonds provide diversification. Within equity markets, markets on lower valuations such as the UK and some emerging markets offer attractive buying opportunities. There are also grounds to be positive about the infrastructure sector, where companies have cashflows that have bond-like visibility. Within the sector, those engaged in electricity supply should benefit from profitable investment opportunities as governments look to private companies to provide the funding to achieve their clean energy targets. Technology stocks have exciting long-term growth prospects but high valuations and signs of a slowing US economy leave such stocks vulnerable to earnings disappointments.



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