2024 – Reasons to be cheerful

The fourth quarter of 2023 saw strong performance for both equities and bonds. Despite continuing conflict in the Middle East, the oil price spike proved temporary. Falls in inflation in the US, UK and Eurozone allowed Central Banks to leave interest rates unchanged and hopes grew for rate cuts as early as March 2024. Looking forward, where are the opportunities for investors?

Equities

After the disappointing returns achieved in 2022, equities produced strong returns in 2023. The so-called mega cap US Magnificent Seven stocks (Alphabet, Apple, Amazon, Meta, Microsoft, Nvidia and Tesla) were responsible for much of the gains, posting on average a 100% rise. It is encouraging to note, however, that breadth within the market now appears to be improving. Small caps rallied in November and December and the US small cap index comfortably outperformed the core market index. This broadening in the leadership of the market often indicates a better environment for active stock pickers, especially given that many areas of the equity market outside the US' Magnificent Seven are currently attractively valued compared to history. Against a backdrop of continuing economic growth, earnings growth expectations remain robust, at 11% in the US, 7% in the UK and 6% in Europe ex UK, according to the FactSet 2024 consensus.

Within equities, thematic investing continues to offer attractive opportunities. We continue to favour three specific thematic areas: technology, healthcare, and the energy transition. Technology stocks will continue to benefit from the adoption of Generative AI and the associated increased demand for microchips, software and cloud computing. Healthcare companies will also benefit from AI, as well as new generation weight loss drugs. The energy transition remains a key theme, with a focus on companies seeking to combat climate change. In particular, after a challenging period for renewable energy stocks characterised by cost pressures and overcapacity, a number of attractive opportunities for investors now exist.

Fixed Income

Bonds provide stability in multi-asset portfolios. The coupon payments provide a regular source of income and, generally speaking, bond prices tend to rise when economic growth slows. The rise in bond yields over the last two years means income is now back in bonds.

November was a very strong month for bonds, with a 5% return for the Bloomberg Global Bond Aggregate*, and the rally accelerated into December with a further 4.2% return, bringing the return for 2023 to 5.7%. Despite this strong performance, bonds remain attractively valued, especially given the expectation of falling inflation and the implication for real (inflation adjusted) returns.

Within corporate bonds we favour higher quality investment grade bonds over the more speculative high yield bonds. While high yield bonds yield more than investment grade bonds, we do not believe that extra income available justifies the additional risk of holding the lower quality debt.

For UK taxpayers, holding a portfolio of UK gilts can provide the benefit of predictable returns for cash flow planning, as well as tax benefits, depending on the investor's personal tax situation.

* Bloomberg Aggregate, returns in US dollars, source FE, as at 11 January 2024

Other Asset Classes

In addition to the main asset classes, both alternatives and structured products have a role to play in portfolios. Uncorrelated alternatives funds such as funds of hedge funds have demonstrated the ability to produce positive returns when both equities and bonds are falling, such as in Q1 2020. Infrastructure and renewable energy funds also offer attractive opportunities, in some cases, the former benefitting from inflation linked revenues.

Structured products can be used either as a diversifier within multi-asset portfolios or as part of a decumulation strategy, when you start drawing from your investment portfolios. Current pricing is relatively attractive with yields available over the next five plus years that are comfortably in excess of current levels of inflation.

Cash

Cash tends to provide superior returns to equities and bonds when interest rates are rising quickly, such as during 2022 and the first half of 2023. However, it tends to underperform asset classes when interest rates are falling, or when corporate earnings are rising and when investors' attitude to risk is improving. Expectations are for rate cuts from the US Federal Reserve, the Bank of England and the European Central Bank at some stage during 2024. This will provide a better backdrop for both equities and bonds when compared to cash.

It is also important to remember that 'timing the market' or trying to find an attractive entry point for initiating investment in equities or bonds is notoriously difficult and generally leads to lower returns over the longer term.

Outlook

The prospects for investment markets have changed significantly in the last 12 months. Interest rates are at or likely close to their peaks for this cycle. The process of taming inflation may well face some near-term headwinds, but the direction of travel appears to be lower for the US, UK and Euro Area. This allows Central Banks to be more accommodative which is good news for equity market valuations, particularly growth equities. At the same time, bond yields remain attractive, and the tax efficient yields for UK investors within UK gilts can be particularly favourable.

This provides a strong outlook for multi-asset portfolios. There are several risks within 2024, such as a multitude of elections across the globe, persistent geopolitical risks and declining economic growth, but with equity valuations near their long-term averages and higher bond yields, investors can allow themselves some optimism for balanced and diversified portfolios for the year ahead.

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Important information

Investors should be aware that the price of investments and the income from them can go down as well as up and that neither is guaranteed. Investors may not get back the amount invested. Past performance is not a reliable indicator of future results. Changes in rates of exchange may have an adverse effect on the value, price or income of an investment. Tax treatment depends on individual circumstances and may be subject to change in the future, so you should seek independent tax advice, as to your own position. The information in this email does not constitute advice or a recommendation and you should not make any investment decisions on the basis of it.

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