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Investment Management

Window on the World

JUNE 2024

Introduction

The burning question in UK politics for months now has been "When will Rishi Sunak call an election?" As we now know the wait is over, the nation goes to the polls on 04 July 2024.

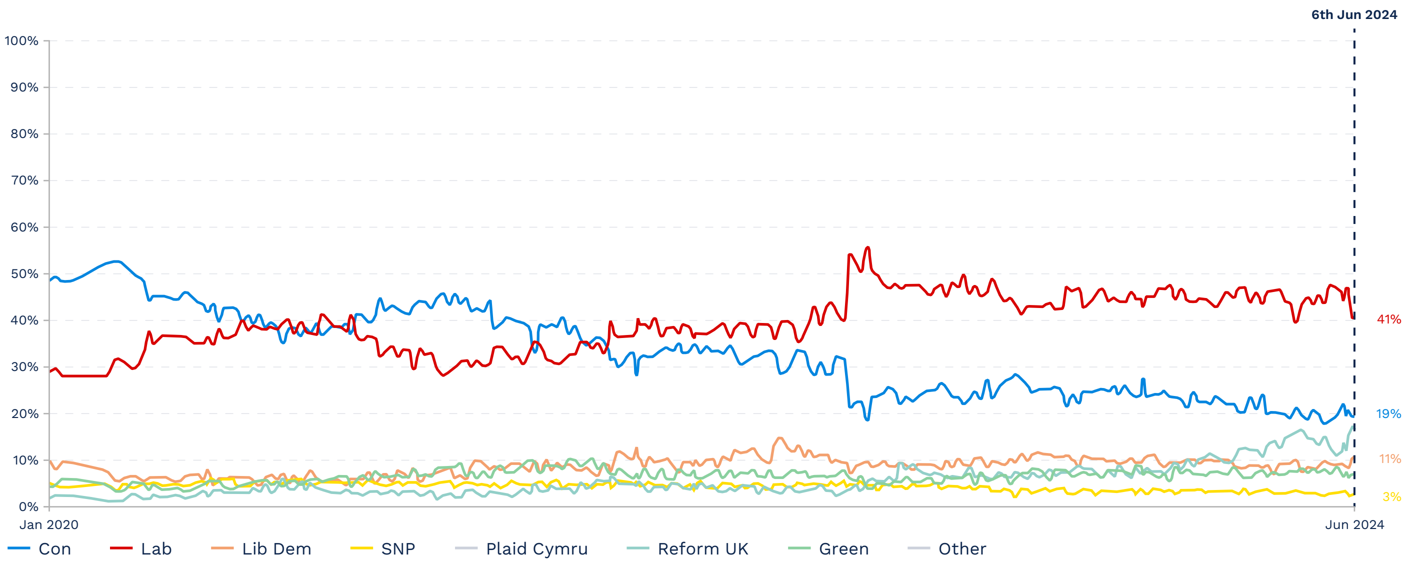
This only leaves a small window for political parties to campaign, which is perhaps a blessing. The other big news in May was that former US President, Donald Trump, has been convicted of 34 criminal charges, which has led to increased focus on the implications of this for the US Presidential Election in November. As far as capital markets are concerned neither event has been meaningful for reasons discussed further in this month's Window on the World. Instead, markets continue to be obsessed with inflation and the outlook for interest rates, eagerly awaiting every new data release and what it means for the economy.

Politics In Play

Rishi Sunak's decision to call a general election for 04 July 2024 was a bit of a surprise, as the expectation was that he would wait until the autumn, hoping that there might be better news for the Conservatives over the summer.

The last time the UK held an election in the month of July was almost 80 years ago, in July 1945, when Clement Attlee's Labour Party won by a landslide, and ousted Prime Minister Winston Churchill. Current polls would indicate a similar fate faces the Conservative Party this July, who continue to trail the labour party by approximately 20 points. The Economist puts the prospect of a Conservative win, based on these polls, at just 1%. It is therefore looking very likely we'll see a change in government in a little under a month.

/ OPINION POLLS CONTINUE TO GIVE THE LABOUR PARTY A 20 POINT LEAD OVER THE CONSERVATIVES, WITH THE GAP REMAINING WIDE FOR OVER 18 MONTHS



Source: YouGov

At times like this investors endeavour to assess the implications of the likely changing of the political guard, which is not always easy, especially when a lot of political rhetoric is used to try and score points. Historically, the prospect of an incoming Labour government has raised concerns around higher taxes and higher spending which was the case in the 2019 election. However, unlike 2019, today's Labour party has a much more centralist policy agenda and appears more fiscally conservative (which given the limited fiscal room the new government will have is important). The limited room for fiscal manoeuvrability has led the party to commit to keeping the three core tax rates – Income Tax, Corporation Tax and VAT – capped for the duration of the next parliament.

There will be other options for a new government such as supply side reforms to stimulate growth, but if the polls are correct perhaps the biggest boost will be the prospect of greater political and policy stability, which should reduce the political risk that has been overhanging the country since 2019. In turn it is reasonable to hope that this would stop the outflows of assets from the UK and generate inward capital investment into the economy. All in all, it seems a changing of the political guard would not be unwelcome by markets, and likely explains the absence of any significant movements in UK assets when the election was announced.

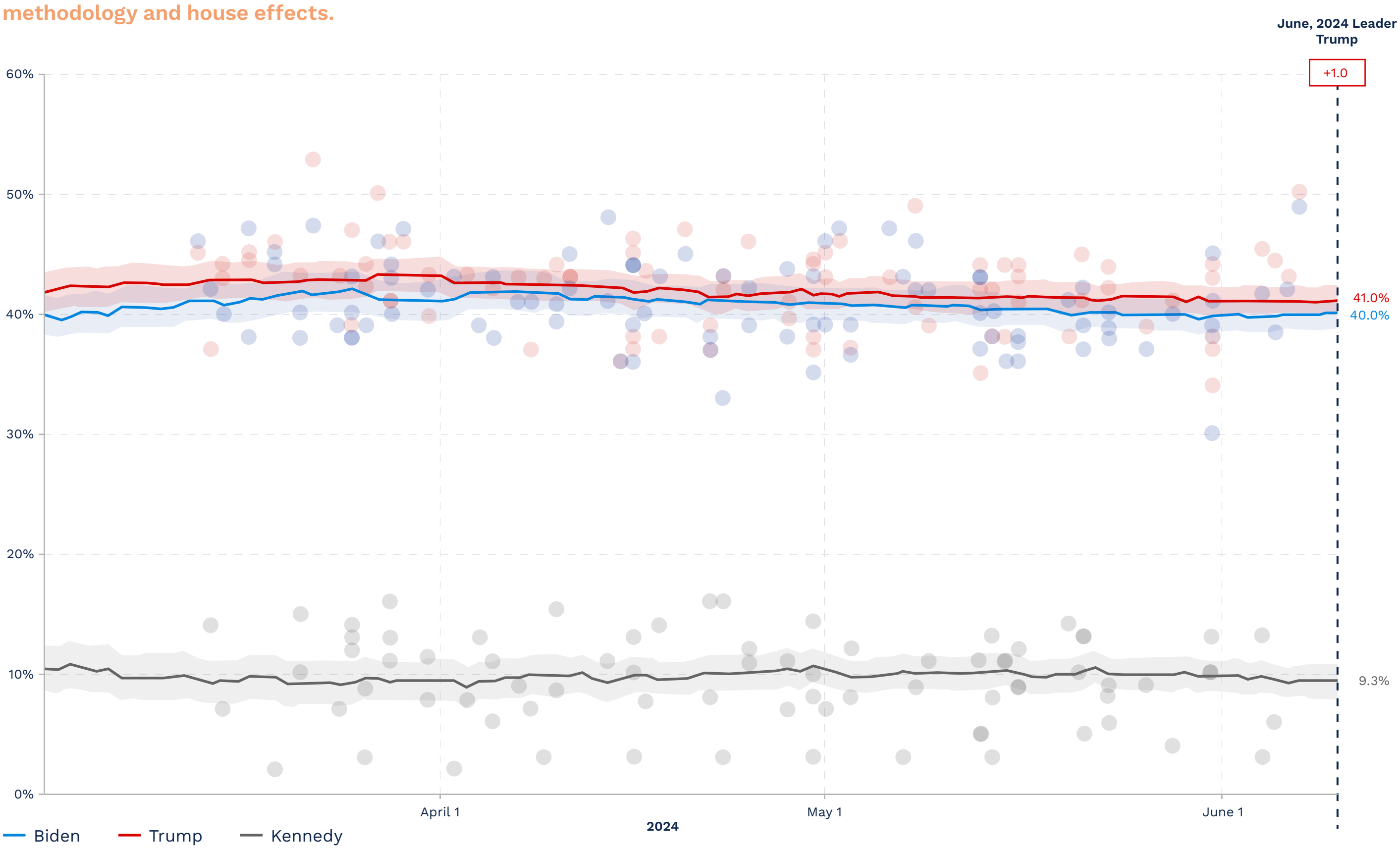
In the US, former US President Donald Trump's conviction will not prevent him from standing for office, which is perhaps a surprise but nothing in the US constitution prohibits a convicted criminal from holding office! This historic conviction – the first time a former or serving US President has been convicted of a crime – sees Donald Trump sentenced on 11 July 2024, just four days ahead of the Republican convention, when he is due to be confirmed as the party's nominee for the November election – no doubt he'll make political capital out of it as he's adept at doing. Although a prison sentence cannot be ruled out, as a first-time offender and given the sensitivity around such a decision, it is not an expected outcome.

Prior to his conviction, Donald Trump had been polling well and it seems unlikely this will change particularly in the Swing States which are likely to dictate the outcome of the election in November. The highly anticipated Presidential debates between Donald Trump and Joe Biden could perhaps prove pivotal in deciding who gets the keys to the White House, (with the first scheduled for 27 June 2024) – but whether these televised scraps will make much difference we will have to wait and see. The US election is still some way off, but as the date draws closer investors will begin to consider the tax, fiscal and inflationary implications arising from the pronouncements and intentions of both candidates – looking for the impacts on and the likely outlook for tariffs and foreign policy.

TRUMP MAINTAINS A SHALLOW LEAD OVER BIDEN IN THE OPINION POLLS

Who's ahead in the national polls?

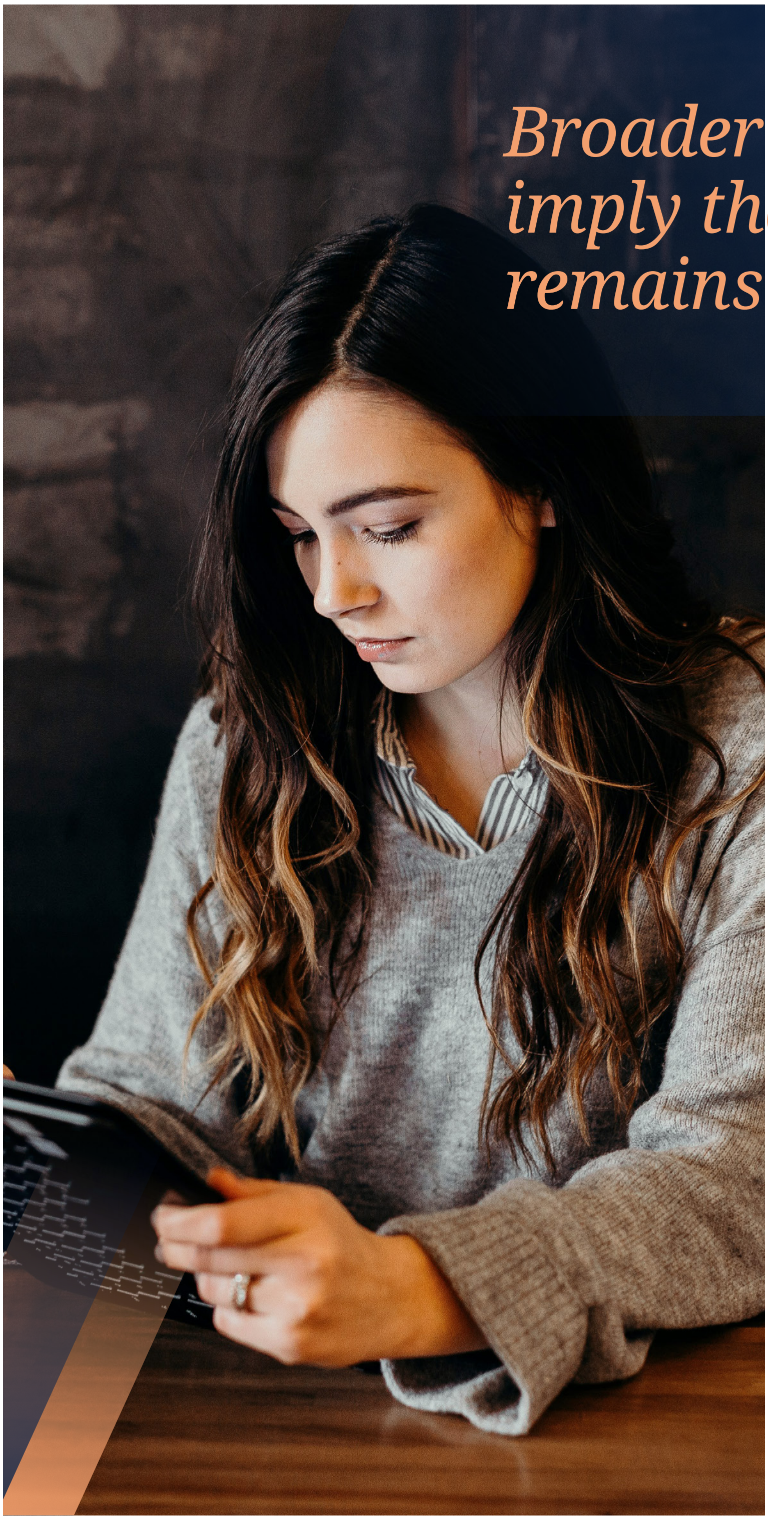
Updating average for each candidate in 2024 presidential polls, accounting for each poll's recency, sample size, methodology and house effects.



Source: FiveThirtyEight

Economic Activity

May's economic data has continued to paint a reasonably bright picture for global economic activity. In particular, European manufacturing and service data has continued to improve, continuing a trend that has been in place for a few months, whilst in the UK data continues to surprise on the upside, indicating that economic activity continues to recover as we approach the halfway point of 2024.



Broader data measures imply that the US economy remains resilient.

Chinese data, which for a long time has disappointed, has been broadly resilient in May, suggesting the central banks economic stimulus measures are beginning to work.

As the number one economy in the world the state of the US's economy is always a focus for investors, ever watchful for signs of things changing - and there are some signs of a moderation in data, with capital spending and home sales trending sideways. Nonetheless broader data measures imply that the economy remains resilient, which company quarterly earnings results support as they were running better than expected.

Predicting the path of inflation (and rate cuts) is not easy and often catches economists out, and as we have said in previous editions of Window on the World, predications for interest rate cuts have gone from six this year to just one. So, at the end of May we face a mixed picture. In the US, inflationary pressures remain sticky, and the first cut in interest rates from the Federal Reserve is not expected until later in the year. In the UK, inflation continues to fall, but not as quickly as economists have expected, but we are confident of at least one rate cut before the end of the year. The disinflationary path in Europe however is clearer, making it likely the European Central Bank will be the first major developed central bank to cut first – (indeed they have now cut by 0.25%). This divergence in monetary policy is likely to be a key dynamic playing out in markets in the second half of this year.

Capital Market Returns

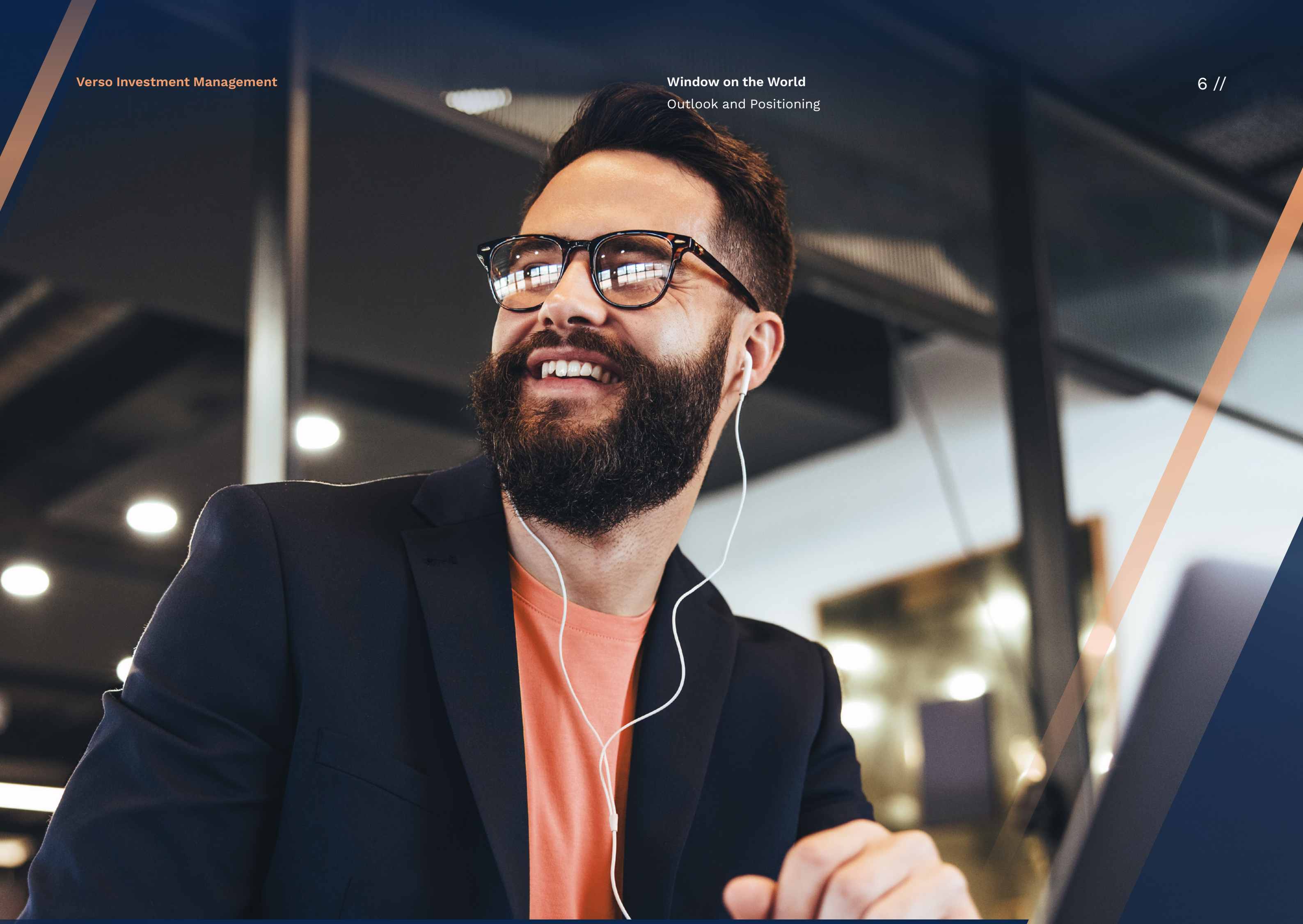
May proved to be a positive month for capital markets, with both fixed income and equities broadly delivering positive returns helped by a reacceleration in economic activity.

One exception was Japan where a weak currency may have impacted consumer sentiment and weighted on Japanese equities, which were lower over the month, whilst emerging market equities gave back some of their recent gains.

In bond markets, yield declined over the month on the back of US data which was the key driver behind positive returns in this space. These declines followed through into credit – both investment grade and high yield which delivered positive returns over the month.

	Total Return (%)			
	1 Month	3 Month	12 Month	YTD
UK Equities	2.0	9.9	15.4	9.0
US Equities	3.1	3.0	24.7	11.6
European Equities	2.2	4.1	21.1	11.2
Japanese Equities	-0.5	-1.0	15.2	6.4
Emerging Market Equities	-1.2	2.7	9.7	3.8
UK Gilts	0.8	-0.6	2.8	-4.2
UK Corporate Bonds	1.0	0.8	8.7	-0.9
UK High Yield Bonds	0.8	1.2	14.6	3.5
US Corporate Bonds	1.8	0.6	4.3	-0.7
US High Yield Bonds	1.1	1.3	11.2	1.6

Source: Bloomberg, total returns in Sterling, as of 31 May 2024



Within equity markets, we have a preference for UK, European and emerging market equities.

Outlook and Positioning

Valuations remain attractive in fixed income, particularly UK governments and high quality short-dated corporate bonds.

The reset (rise) in bond yields which has occurred over the past two years has meant that the role fixed income plays in a multi-asset portfolio has become more important, providing both income and diversification benefits, and protection against any setback in the global economy.

Within equity markets, we have a preference for UK, European and emerging market equities, where fundamentals are improving and valuations are attractive relative to other international markets, such as the US and Japan. Whilst the summer and autumn are likely to dominated by the political theatre in the US, this is unlikely to alter the fundamentals which have underpinned equity markets year to date.

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