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Investment Management

Window on the World

AUGUST 2024

Introduction

July proved to be an eventful month on the political front, with the UK General Election, elections in France and key developments in the US Presidential race.

It was a volatile one for markets more generally, with a backdrop of softer inflation data and expectations of rate cuts driving a rotation within markets. This volatility persisted into early August, driving a pullback in stocks from their recent highs.

Political Developments Remain Front and Centre

Both the UK General Election and French parliamentary elections were held during the month. In the case of the UK, the Labour Party recorded a landslide victory, as predicted by the polls. This ushers in a period of potential political stability, and attention will rightly turn to the budget, which will be held at the end of October.

Market reaction to the election outcome was muted, with the result predicted well in advance. Closer analysis of voting patterns shows that Labour secured around one third of the popular vote, arguably meaning that policy will remain moderate – and three areas of focus in the near-term are planning and labour market reform as well as trade relations with the European Union.

In France, the parliamentary elections concluded with no single party obtaining a clear majority. In a surprising outcome, the Far-Right party, which won the first round, finished third, with Macron's centrist party coming second. A caretaker government has been put in place, which will remain in place until mid-August at the latest. Europe's second largest economy finds itself in political limbo ahead of the presidential elections in 2027.

In the US, attention remains focused on the US presidential election. The attempted assassination of Donald Trump added impetus to his campaign, although the subsequent decision of President Biden to step out of the race and endorse Vice-President Kamala Harris has seen this reverse to a degree. The odds of a Trump win have come back from around 65%, to 50%. With three months to go, it is likely to remain a source of investor focus.

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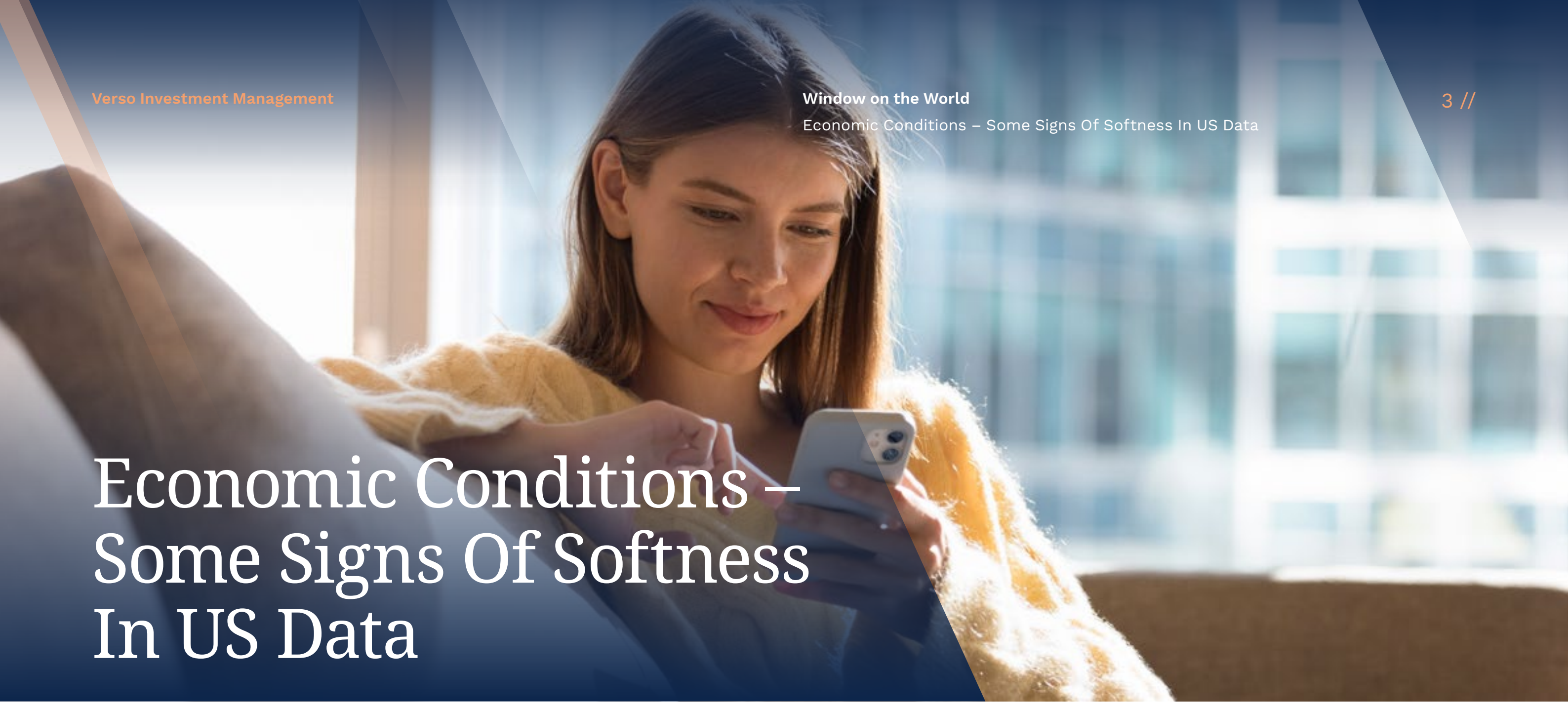


Economic Conditions – Some Signs Of Softness In US Data

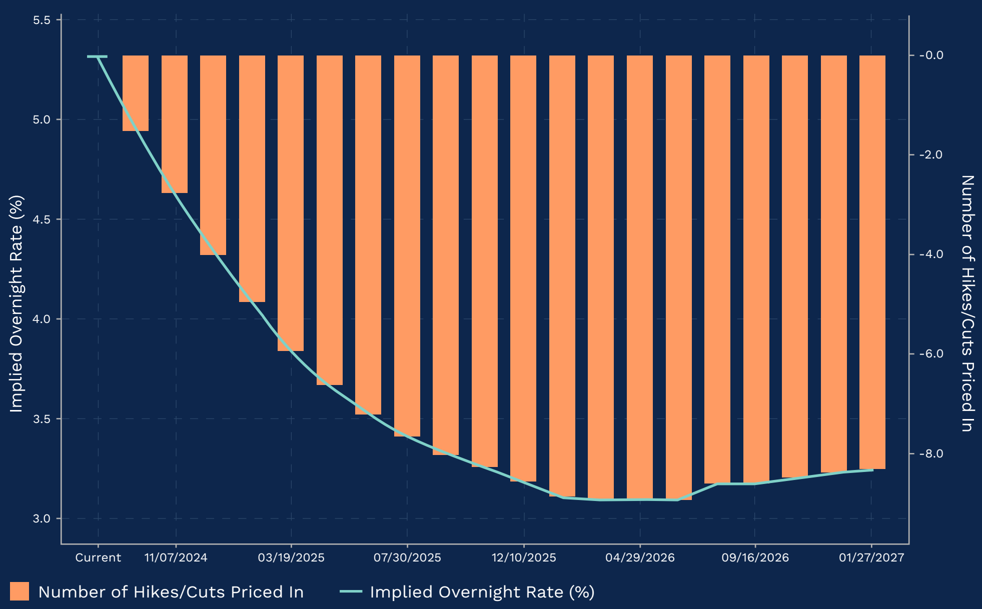
The US economy continued to exceed expectations in the second quarter of 2024, with Gross Domestic Product (GDP) data signalling the economy expanded by 2.8%, way above expectations of 2.0%. Consumer spending remains a key driver of US growth, which was also boosted by inventory build and business investment.

Forward looking indicators and also employment data do signal a likely softening in US economic data. A closely watched manufacturing survey fell to 46.8 in July, and an employment component was also much lower than expected. Labour market data has also begun to soften at the margin, with unemployment continuing to tick up, reaching 4.3%, its highest level since October 2021.

Some of this increase is a function of the growth in the labour market, as opposed to corporate redundancies. Nevertheless, the prospect of falling wage growth and evidence that pandemic savings have been drained may start to weigh on the consumer going forward. This has led investors to increase expectations for the Federal Reserve to begin cutting rates meaningfully from September. Both the European Central Bank and the Bank of England have started the process of cutting interest rates.

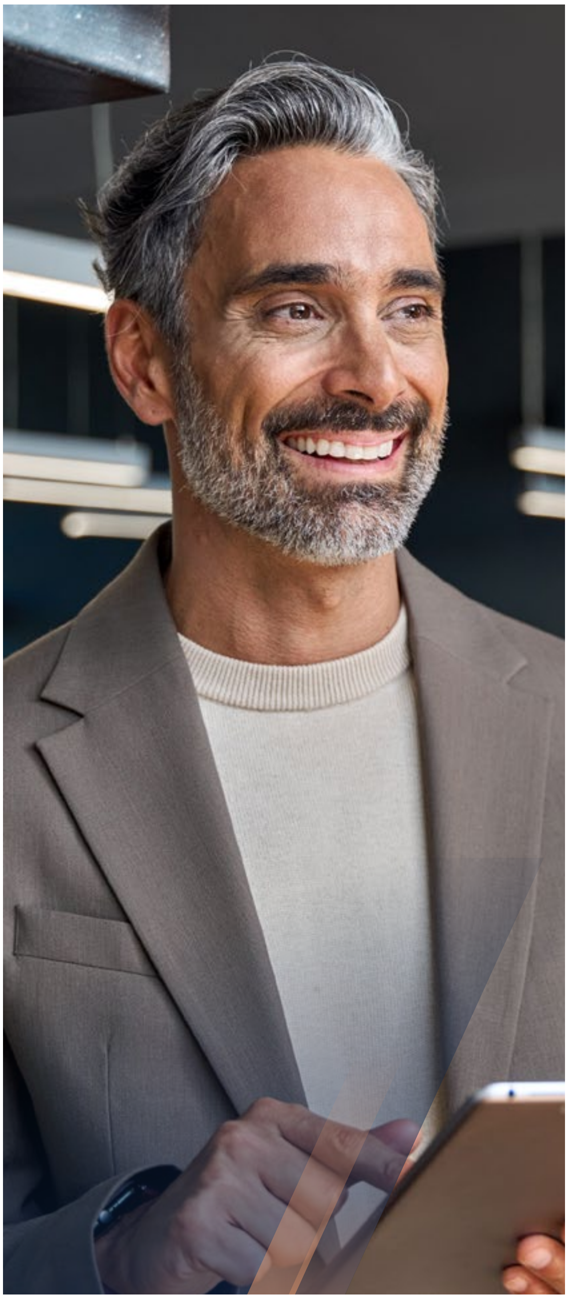
Market is now pricing in 4 cuts from the Federal Reserve by end of 2024, and forecasts that rates will be close to 3% by the end of 2025.

IMPLIED OVERNIGHT RATE & NUMBER OF HIKES/CUTS



Source: Bloomberg

Capital Market Performance and Positioning



UK equities rose over the month, boosted by strong economic data, including GDP data which exceeded expectations and robust service sector Purchasing Managers Index, both pointing towards improving economic momentum. European stocks lagged, falling by around a percent in Sterling terms, on tempered economic momentum, whilst political uncertainty continued to weigh on French assets.

US stocks had a mixed month, with weaker than expected earnings from large technology companies weighing on the tech heavy Nasdaq Composite, which declined by around a percent. Laggards played catch up over the month, particularly US small cap equity stocks, which had their largest one month outperformance against Tech in over 20 years.

Japanese stocks were lower in local currency terms but were positive in sterling terms due to sharp currency movements. Yen appreciation remained a key feature of the month, following the Bank of Japan's decision to hike rates, and appreciated by more than 6% against the US Dollar, its strongest monthly move in eight years. Emerging market equities were also lower, despite efforts by the authorities in China to stimulate lending and economic growth via the provision of additional liquidity support to the financial system.

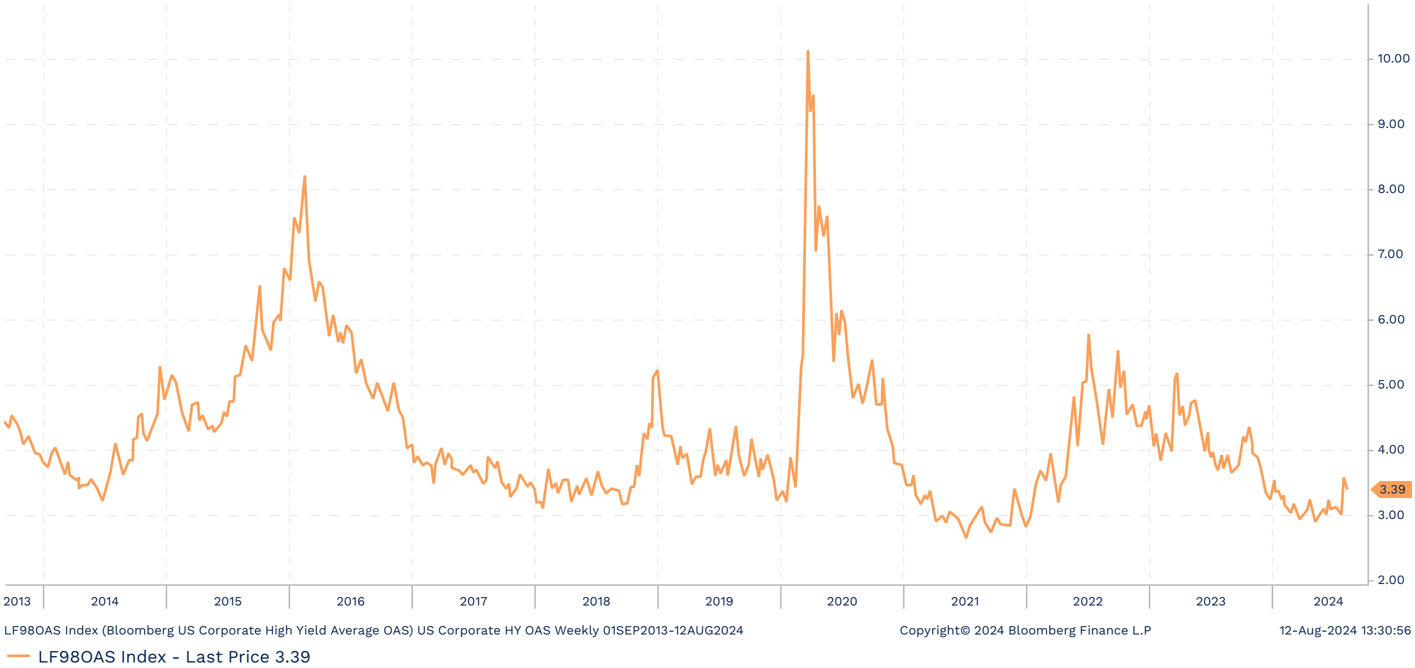
Fixed income markets pushed ahead during the quarter, with bond yields moving lower in anticipation of further monetary policy easing from major central banks. In the UK, the decision by the Bank of England to cut interest rates put downward pressure on short-duration Gilts, leading the curve to steepen. Similar moves were observed in the US and European bonds markets, although with the latter, yields on French Government Bonds remained higher than their German equivalents.

In credit markets, investment grade credit outperformed high yield. In both markets' spreads, whilst widening somewhat, remain tight, and arguably expensive, and our preference therefore remains on short-duration in this sub-asset class.

	Total Return (%)			
	1 Month	3 Months	12 Months	YTD
UK Equities	2.5	3.5	12.8	10.6
US Equities	-0.3	7.2	22.3	16.0
European Equities	-1.0	-1.0	10.7	7.7
Japanese Equities	4.6	3.9	16.4	11.1
Emerging Market Equities	-1.2	2.3	6.8	7.4
UK Gilts	1.9	4.1	5.8	-1.1
UK Corporate Bonds	1.9	3.8	10.4	1.9
UK High Yield Bonds	1.4	3.2	14.8	6.0
US Corporate Bonds	2.3	4.9	6.8	2.3
US High Yield Bonds	2.0	4.1	11.0	4.6

Source: Bloomberg

SPREADS ON HIGH YIELD BONDS, AT 3.4%, REMAIN TIGHT RELATIVE TO THEIR HISTORICAL AVERAGES



Source: Bloomberg

We retain a constructive stance on UK, European and emerging market equities, which appeal on fundamental and valuation grounds. In the UK, economic activity continues to improve, which coupled with political stability is likely to continue to attract investor interest. In Europe, manufacturing activity has stalled, but we expect this will improve, also driving a better economic performance from this region. In the US, we expect market activity to broaden out, allowing those areas which have lagged to perform better, and in Japan we are running reduced exposure following a strong run and uncertainty surrounding the impact of higher rates. Within fixed income, we retain a preference for short-dated investment grade credit and UK Government Bonds, both conventional and short-dated index-linked instruments.

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versoim.com / info@versoim.com / 020 7380 3300

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