HYMANS ROBERTSON
INVESTMENT SERVICES

Hymans Robertson Investment Services (HRIS)

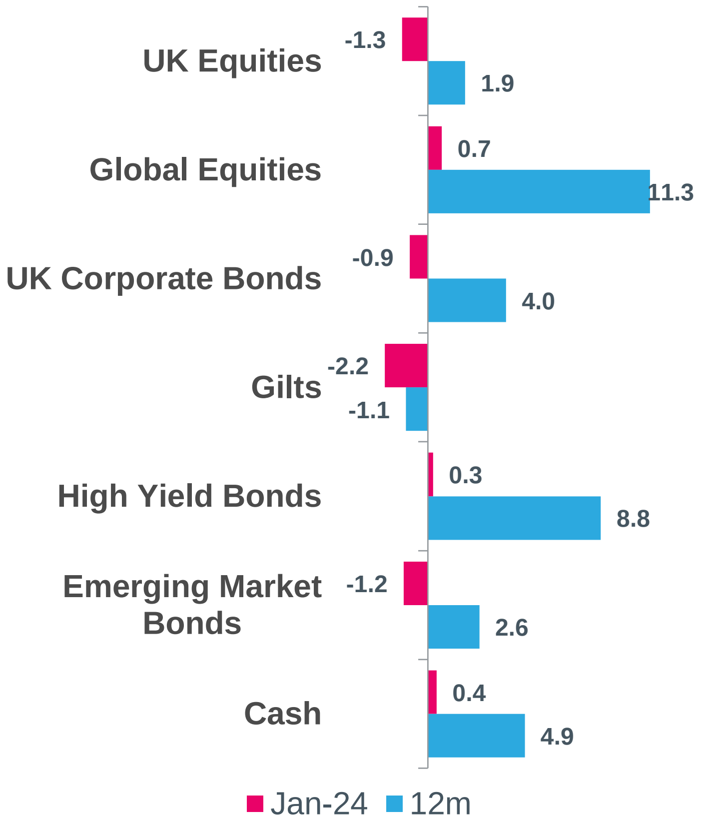
Market Digest

January 2024

Monthly Highlights

- Asset class performance was mixed as central bankers tried to moderate investors' hopes of imminent rate cuts. Economic strength in the US continued to surprise though.
- Inflation rose by 0.1% to 4.0% in the UK in December. The US and eurozone also saw small increases to CPI.
- Given these market conditions, portfolios were typically flat over the month.
- Almost all asset classes generated a strong return over the 12-month period.

Asset class returns (%)



Source: Morningstar. Figures to 31 January 2024. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

Market summary

- Our model portfolios are typically invested in a combination of the asset classes shown in the left-hand chart.
- After a blistering rally at the end of 2023, markets had a mixed month in January as some asset classes gave back part of the large gains generated in November and December last year.
- Economic data in the US continued to show a strong economy which, although boosting some asset prices, also dampened hopes that central banks will start cutting interest rates imminently. The US Federal Reserve chairman reinforced this by appearing to pour cold water on the idea of cuts at their next meeting in March.
- Global equities generated a small positive return in January but the dispersion between regions was wide. Japanese equities returned over 4%. Conversely, the Asia-Pacific & Emerging Market regions performed poorly, as attempts from the Chinese government to boost the economy disappointed.
- In the UK, inflation rose 0.1% to 4.0% in December. This led to negative returns in January on bonds, such as gilts, as yields rose (bond prices fall as yields rise).
- At a portfolio level, equities outperformed bonds, meaning higher risk portfolios outperformed lower risk ones over the month.
- Over the 12-month period, equity returns have been strong, as cooling inflation and interest rate cuts on the horizon boosted sentiment. At the same time, solid economic growth in the US, meant corporate earnings remained resilient. Bond performance has been more mixed over the period, with corporate bonds returning 4%, while gilts returned -1.1%. This means that higher risk portfolios have outperformed lower risk portfolios over the year.

Outlook and topical market themes

- The Bank of England and other central banks are expected to start cutting interest rates this year. In the US this could be as early as Spring. The UK will likely be behind, but not by much.
- Shipping costs more-than-doubled in January after attacks on container ships in the Red Sea, but the risk of this driving goods prices significantly higher remains low.

When will central banks cut interest rates?

Despite last month's blip, most Western economies have made good progress with reducing inflation. In the UK, CPI has fallen from an 11.1% peak in October 2022 to 4.0% in December 2023. It is pretty clear that the next move from central banks, like the Bank of England (BoE), is likely to be an interest rate cut. What investors are now contemplating is how cautious policymakers will be in waiting to make their first cut, and how fast they will cut once they've started.

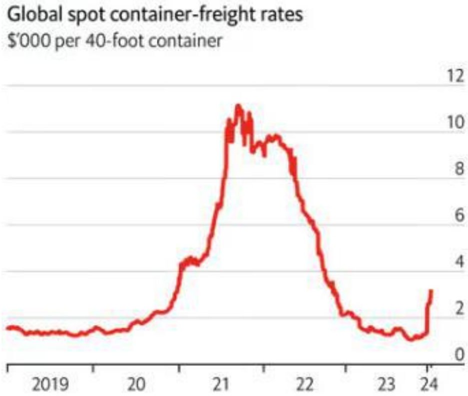
Most central bankers have, so far, pushed back against an exuberant market that may have got carried away with the number of rate cuts for this year. Policymakers at the US Federal Reserve (Fed) told investors that they expect to cut three times this year, but investors went ahead and priced in five to six cuts instead, which would take interest rates down to around 4%. The reason for the caution from central bankers is that they fear that inflation may rise once more if interest rates are cut prematurely. Unemployment remains low, meaning wage growth is still running at elevated levels, risking a further wave of price increases. Even so, if inflation and wages data keeps heading in the right direction, then we could see the Fed act in late Spring. The BoE will likely be a bit behind, but recent statements from BoE officals indicate cuts in Summer are a realistic propositon.

Does conflict in the Red Sea risk stoking inflation again?

Tensions in the Middle East ratcheted higher again in January, as the conflict in Gaza expanded to the Red Sea, where Houthi rebels have been attacking container ships. The Red Sea, leading to the Suez Canal, is one of the busiest trade routes in the world, with around 30% of shipping container traffic passing through. A prolonged disruption to the route could raise shipping costs (see chart below), increasing the risk of another bout of goods' inflation like we experienced during the Covid pandemic. The region is also an important fossil fuel exporter, meaning sustained disruption to this trade route could send oil prices higher, which may feed through to petrol and energy prices.

As things stand however, we don't believe the disruption will have a significant impact on inflation. ECB president, Christine Lagarde, said that shipping costs made up only 1.5% of the cost of goods. Oil prices did initially rise in January, but have since fallen back, as weaker demand from a slowing China and higher supply from the US outweighs the prospect of disruptions.

Chart of the month – Shipping costs have spiked but are well below the Covid peak



Source: The Economist, LSEG Workspace

Container-freight rates have increased sharply since the Houthi attacks in the Red Sea began. However, when shown in the context of how high shipping rates were during the pandemic, rates are still low.

There is also less pressure in other parts of supply chains, compared to the Covid period, meaning any impact on goods prices should not be significant.

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