GOT NOWHERE TO RUN TO BABY, NOWHERE TO HIDE

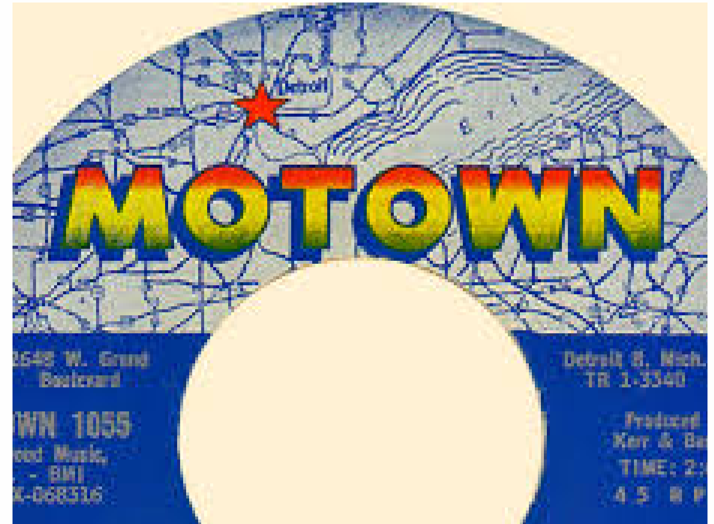
Market Review:

Now you might wonder why this weekly missive is named after a classic Motown number from Martha Reeves & The Vandellas, but if you look at the moves in the financial markets last week you will get the gist. Pretty much everything was down, across all geographical equity regions and across asset classes, although gold did nudge a tiny bit higher. With representatives of the Federal Reserve showing no urgency to reduce interest rates, the S&P 500 ended its five-week winning streak. Treasuries and investment-grade bonds also declined, despite a favourable inflation report on Friday that briefly lifted bond prices.

Equity Indices		1 wk %
Nikkei 225 in JP		-0.41
S&P 500 TR in US		-0.51
FTSE 100 TR in GB		-0.51
MSCI Europe ex UK TR		-0.68
MSCI India TR		-2.17
MSCI Emerging Markets TR		-2.60
MSCI AC Asia ex Japan TR		-2.62
MSCI China TR		-3.00
Bonds/Currency/Commod	24.05.2024	31.05.2024
Bond: UK 10 Year Yield	4.259	4.331
Bond: US 10 Year Yield	4.467	4.502
Currency: GBP/USD	1.2740	1.2739
OIL: WTI $	77.80	77.18
Gold $	2335.00	2347.50

The week was filled with significant events, including lacklustre Treasury auctions that sent bond yields whipsawing, a glitch in live pricing for the S&P 500 index, finally an ok US inflation number and a guilty verdict for former President Donald Trump. These developments contributed to market volatility and for the first time in a while the 'naysayers' or disbelieving bears, looked less contrarian. Still, let us not lose sight of the fact, May was another good month for equity investors with many regions setting all-time highs during the month.

It looked like it was shaping up to be a poor finish to the week after we got news that Euro area Inflation had accelerated more than expected in May, rising 2.6% versus expectations for 2.5%. A measure stripping out volatile components like food and energy also surpassed expectations by quickening to 2.9%. German Bund yields rose to their highest level in over 6 months. Worrying stuff, but the ECB have been clear that they were



expecting the journey down to their 2% target would be choppy. They are nevertheless still likely to reduce the deposit rate from its current record high of 4% next week, moving before either the Federal Reserve or the Bank of England (see graph 1).

After the disappointment in Europe, all eyes turned to the big event of the week, the release of April's inflation data in the US where we finally got some good news, although you have to go out to 3 decimal places to find it! The Federal Reserve's preferred measure of underlying US inflation, core PCE rose by 0.249% from March, versus 0.25% expected. Inflation-adjusted consumer spending fell by 0.1% due to reduced spending on goods and softer services and wage growth also slowed. It took a while for the good news to sink in, but in the final hour we got a surge higher from the Dow Jones and the S&P 500 but the Nasdaq was left in negative territory (see graph 2).

The lag in the Nasdaq, was unusual to say the least, countering everything we have seen so far this year as big tech and high growth stocks sold off, whilst cyclical and value stocks powered the S&P 500 higher. Investors betting tech giants will continue to drive gains could be in for a rough ride when other sectors start to catch up, according to strategists at Bank of America who said the outperformance of value over growth as market breadth improves could be the next pain trade. That's a brave statement and I think I wouldn't be in a rush to ditch my technology stocks in favour of old industry after one strange day of trading.

Still, it was the first inflation report in a while that suggested things might finally be moving in the right direction. Household's cut back on restaurant meals and recreation and spending on goods decreased by 0.4%. It is just possible, with household debt at a record high and lower consumer confidence, that high interest rates are finally starting to have the

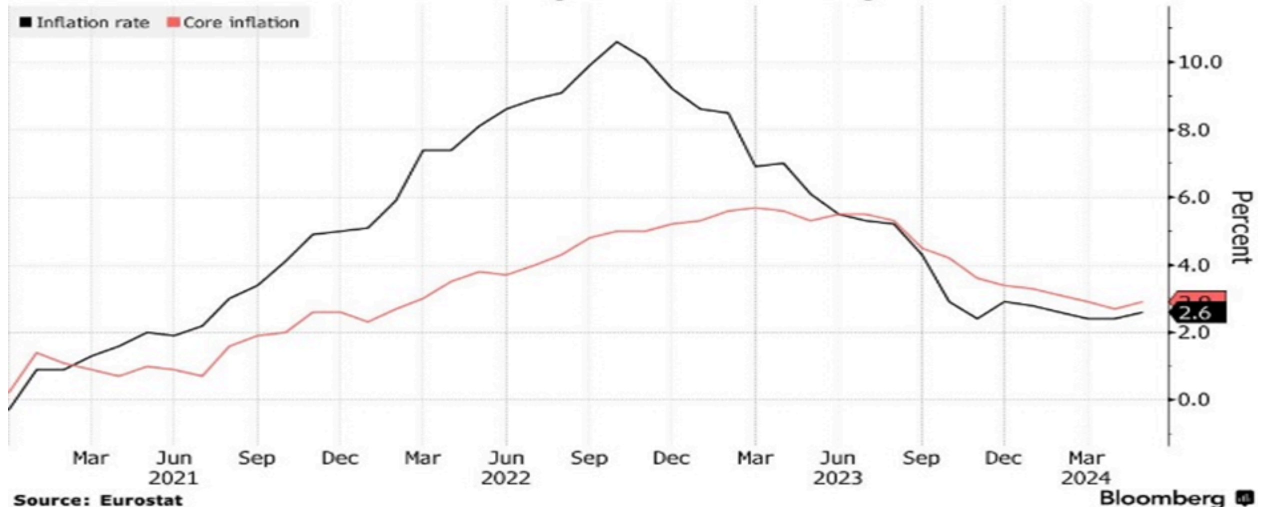
desired effect of curbing spending and while demand for workers remains strong, wage growth is slowing. Overall incomes rose by 0.3% in April, with wages and salaries increasing by 0.2%, the smallest gain in five months.

Don't expect this to change the 'higher for longer' narrative any time soon but J Powell will probably be sleeping a little easier this weekend. One man who you would think would not be sleeping as soundly is Donald Trump now that he is officially facing a potential jail sentence after he became the first former President to be convicted of a felony. But these are very strange times indeed and if the political betting markets are to be believed, the presidential election campaign has shifted sharply in his favour during the trial. This is how RealClear Politics' average of the probabilities of Joe Biden or Trump winning the election have moved since the beginning of last year, although I suspect it isn't so clear cut (see graph 3).

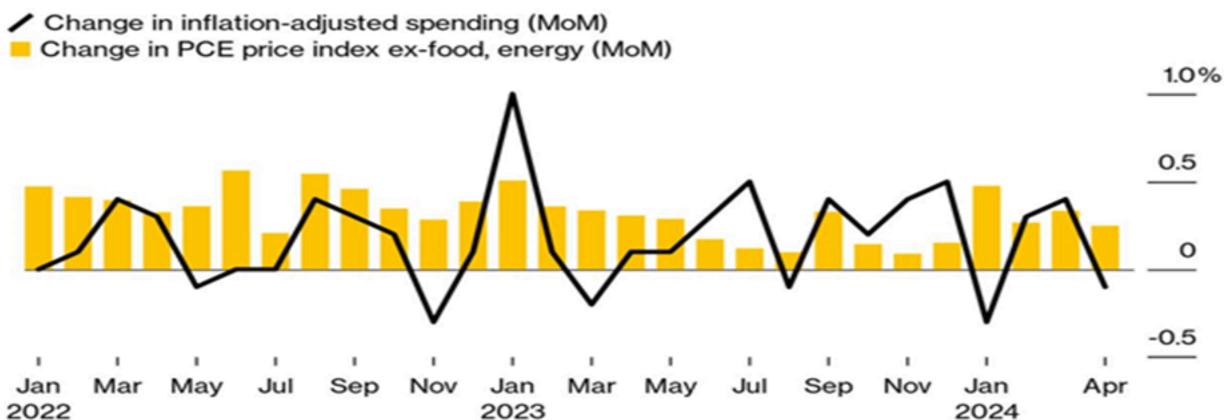
Less than 18 months ago, Trump's chances seemed slim after the Democrats' successful midterms. Since then, he has faced four indictments and a six-week trial in New York, but these have not hindered his progress; they may have even helped. Despite Biden's resurgence post-State of the Union, Trump's support has increased, with bettors now giving him over a 50% chance of victory. The betting markets and Wall Street figures like Bill Ackman are increasingly backing Trump, reflecting widespread belief in his potential win. Biden is getting blamed for the higher prices, but with costs of gasoline and food price inflation falling it could yet still move his way and the www.fivethirtyeight.com polls I follow only have Trump by a whisker +1.2%

Just in the last few weeks, we have seen the various market experts, fund manager groups and investment banks begin the speculation on who is going to win and what that means for

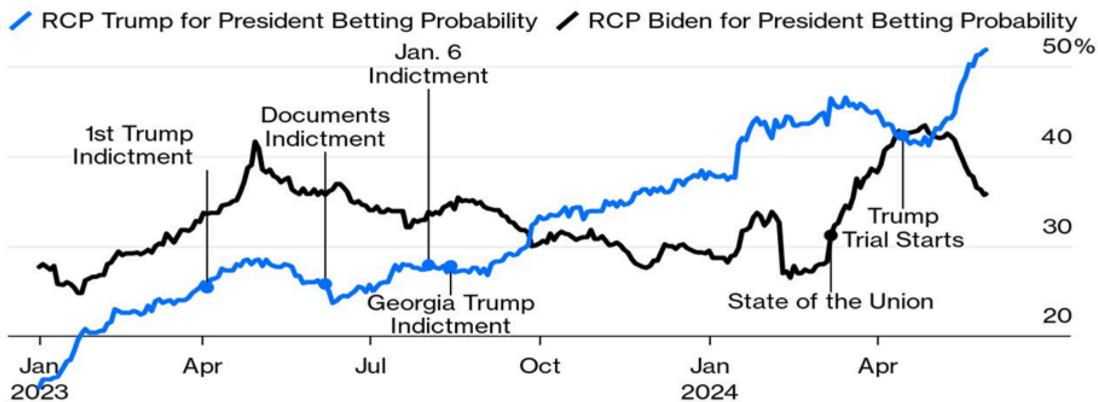
Graph 1 - Source - Bloomberg 01/06/2023



Graph 2 - Source - Bloomberg 01/06/2023



Graph 3 - Source - Bloomberg 01/06/2023



markets. As we near the election expect this to only increase. So far, it would seem that they do think Trump is going to win and that broadly speaking this could be good news for equity markets, less so for bonds but that much rests on whether the Republicans can also win Congress, as well as the Senate which looks like a done deal. Here the Democrats hold the slimmest of leads in the polls. Either way, the size of the national deficit is going to impose strict fiscal constraints on both parties, so don't expect any wild tax cuts or national spending programmes but expect foreign policy changes and an increase in tariffs from both parties.

UK

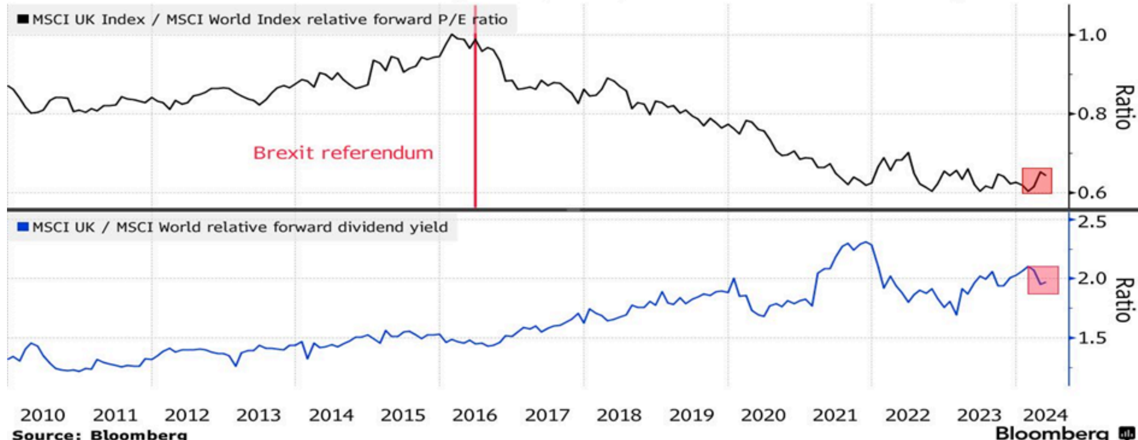
It is now only just over a month before we go to the polls in the UK and so far equities and gilts have mostly traded sideways since the announcement of the July 4 election. It still looks like a Labour shoe-in and strategists have been speculating that a new government could bring stability and remove a longstanding political overhang on the markets. Regardless, markets are fairly relaxed about the election because the outcome seems near certain and the economic and fiscal policies of the ruling Conservatives and Labour are expected to be similar.

With a bit more stability in politics on offer and signs of a return of global investors, I still think the UK has a very good chance of being one of the best regions for returns this year and I think the following chart says it all. A cheap market backed by high dividends and buy back policies

Nowhere to Hide?

I will finish this week's missive on the same note as I started, as last week's symmetrical move lower in both bonds and equities, does highlight the challenge ahead for multi asset investors. Once upon a time, back in the good old days, us multi asset managers could rely on decent

Graph 4 - Source - Bloomberg 01/06/2023



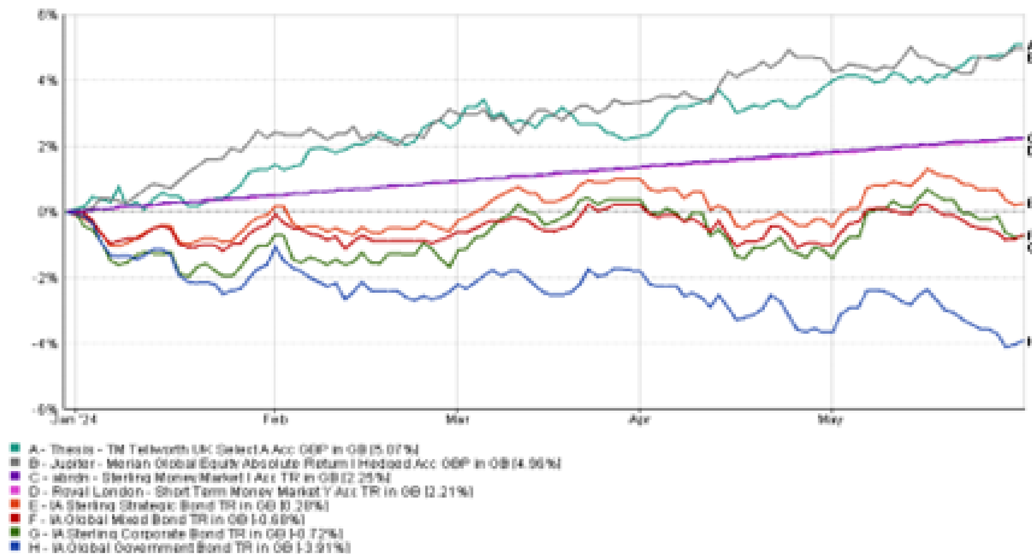
inverse correlation between equities and bonds – when one fell the other rose, but I think we have entered a period where I expect we will see the two primary asset classes move together. The 50-day correlation between the iShares 20+ Year Treasury Bond ETF and SPDR S&P 500 ETF has stayed positive for 10 months now in the longest stretch on record. The reason is simple, neither likes inflation and both would welcome rate cuts.

Unfortunately, recent data suggests the inflation genie isn't quite ready to hop back in the bottle and there is much mischief that can happen before it does. Investors are once more grappling with the reality that interest rates are likely to remain high for the foreseeable future. If that is the case, then Bonds will not offer the inverse correlation of yore and fund managers have to seek stability and returns elsewhere. The good news is that cash as an asset class is finally delivering meaningful returns which are now in excess of inflation. Some absolute return fund managers are also really getting their act together and delivering positive returns with little or no correlation to either equities or bonds.

The chart shows the year to date performance of various bond sectors versus cash and the absolute return funds we currently favour. So whilst the traditional 60 Equity /40 Bond portfolio might be under the threat of persistent inflation, there are still places to hide and we have our own fixed income exposure just about as low as it has been, in favour of cash and absolute return.

Next week is all about the ECB and lets hope they are the first central bank to cut rates and pave the way for others to follow.

Graph 5 - Source - FE Fundinfo - 01/06/2023



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