HYMANS ROBERTSON
INVESTMENT SERVICES

Hymans Robertson Investment Services (HRIS)

Market digest

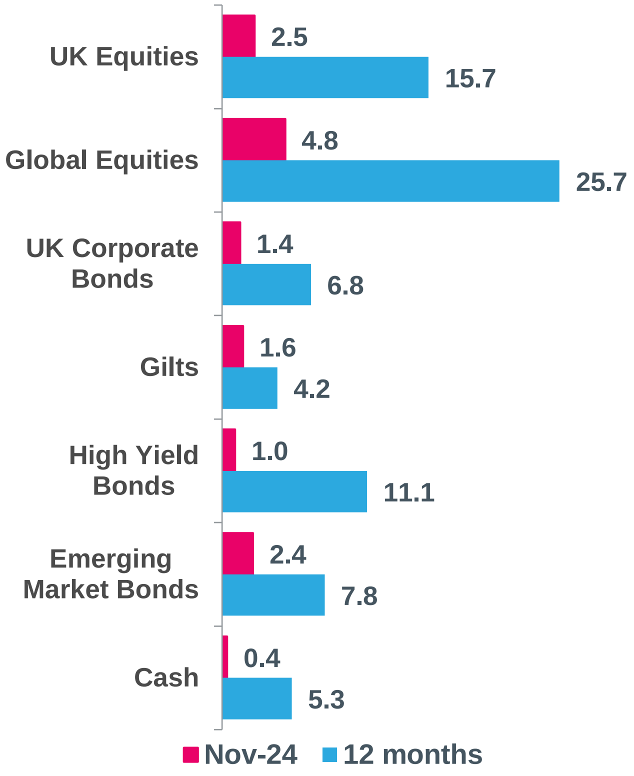
November 2024

Monthly highlights

- Trump's election victory drove strong performance in the US equity market.
- Bond yields fell over the month, despite an initial increase following the election result.
- On page 3 of this document, we provide market commentary to cover the 12 months to 30 September 2024.

Market summary

Asset class returns (%)



Source: Morningstar. Figures to 30 November 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.

- Our model portfolios typically invest in a combination of the asset classes shown in the left-hand chart.
- Donald Trump's election victory drove strong performance of over 7% in the US equity market. Trump's policies, including tax cuts and deregulation, are seen as supportive for American stocks.
- Despite cautious rhetoric from the Federal Reserve (Fed) and Bank of England (BoE), both central banks cut interest rates by 0.25% in November.
- Equity regions outside the US underperformed especially Emerging Markets as China are expected to be on the target of Trump's tariffs.
- The UK was one of the few ex-US regions to also perform well as a large exposure to the outperforming financial sector helped drive performance.
- Bond yields, especially in the US, initially rose immediately after Trump's victory but fell back later in the month which pushed up bond prices (bond prices rise as yields fall).
- Emerging market bonds were the top performing bond sector as US-dollar denominated bonds were buoyed by lower yields and the stronger dollar.
- At a portfolio level, equities tended to outperform bonds resulting in higher risk portfolios producing greater returns than lower risk portfolios over the month.

Outlook and topical market themes

- As 2024 draws to a close, we look ahead to 2025 and the key themes that are likely to drive asset markets over the year.
- Past tariffs show that, although the price impact on specific goods can be large, the overall impact at the economic level is not significant.

Market opportunities and risk for 2025

We recently wrote our outlook for 2025. To summarise, Trump still creates a level of uncertainty for investors in 2025 especially around the extent of tariffs. Trump's "America First" narrative puts US companies at a relative advantage to others, but a lot of this is already likely to be priced into what is an expensive and concentrated market.

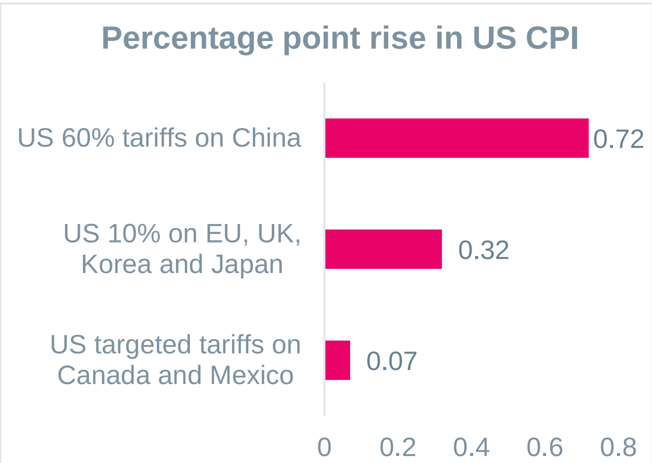
We expect central banks such as the Bank of England to continue to cut interest rates next year. In the UK, this is likely to be at a cautious pace until the full picture around the Budget's impact on inflation is apparent and/or the Bank of England see a sufficiently looser labour market.

Lessons from past tariffs

The potential for additional tariffs is one of Trump's key policies. There has been much discussion as to the impact that tariffs could have on economies and asset prices. Evidence from Trump's first term shows that the impact on trade can be significant. For example, research from Oxford Economics shows that a 25% tariff on imported Scotch whisky in 2019 reduced import volumes by 33% - compared to what's thought to have been the case had the tariff not existed (it's also worth noting whisky imports recovered quickly after the tariffs were lifted in 2021). The whisky example highlights why German car manufacturers like Volkswagen and Mercedes-Benz were down 6-8% on 6 November (i.e. immediately post-election). Beyond the dispersion between the winners and losers there's also a potential inflationary impact. Tariffs have the effect of increasing the prices of imported goods. Further analysis from Oxford Economics shows that, although the impact of tariffs on prices of specific goods can be large, in aggregate over the economy, it's unlikely to be material enough for the Fed to consider it in its interest rate decision making (see below chart). This is because imports make up a relatively small portion of goods consumed in the US, compared to other more open economies. However, the Fed will be looking at the aggregate of Trump's policies enacted, in particular the tax cuts and tighter immigration measures, where the impact on inflation could be greater.

Chart of the month

Possible US inflation impacts of tariff rises



Source: Oxford Economics.

The chart shows several tariff scenarios, modelled by Oxford Economics and an estimate of the impact on inflation in the US.

A 'worst case' scenario of broad 60% tariffs on China would have the biggest impact of a 0.7% increase in inflation.

However, within other scenarios, where tariff rates are lower or more targeted, the inflationary impact is minimal. These are more in line with a base-case expectation.

Any actual impact might be even smaller in practice as tariffs could shift spending towards domestic producers.

Jack Richards
Investment Manager
jack.richards@hymans.co.uk

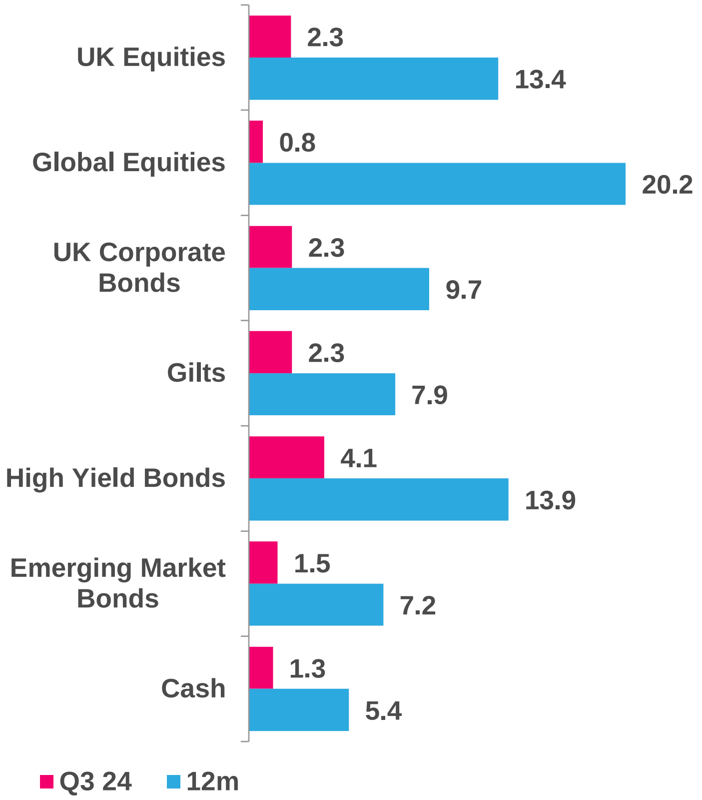
Annual market summary: covering the 12 months to 30 September 2024

Throughout this 12-month period, the US economic growth story gave mixed signals. Recession doubts dwindled for most of the period before a below expectations job report, amongst other data points, brought it back into question. The UK started the period with a technical recession, having shrunk again in Q4 2023. However, the UK is expected to have grown since then with estimated GDP figures of 0.6% in Q1 24 and 0.7% in Q2 24, putting deeper recession fears to bed.

Central banks began to cut rates over the 12 months. The Bank of England held the rate at 5.25% until August 2024 when they cut it to 5%. The Fed followed in September 2024 with a 0.5% cut. The rate cuts were well received by investors with equity and bond prices both increasing. Further rate cuts have been priced into markets for the next 12 months into 2025. The pace of future rate cuts has now become a key talking point for investors with the macroeconomic backdrops far from straightforward. In the UK, headline CPI briefly fell back to the BoE's target of 2.0%. Services inflation caused some caution and was a factor in the BoE deciding to cut just the once over the period. Over the 12 months, UK inflation fell from 6.7% to 2.2%, while interest rates fell from 5.25% to 5.0%.

Geopolitical risk in the Middle East grew, as conflict in Israel and Palestine broke out into Lebanon. The region's importance to global trade and energy markets meant the price of oil increased towards the end of the period. The threat of a reversal in the disinflationary process experienced over the last 12 months was brought further into question.

Asset class returns (%)



Source: Morningstar. Figures to 30 September 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.

Bond performance was mixed over the period as expectations on inflation and interest rates were ever changing. Q3 24 saw key central bank rate cuts boost bond markets, ending the 12-month period strongly. Equity markets performed even better, with large US technology driving markets for most of the 12 months. China's announcement of fresh stimulus boosted sentiment for emerging markets, leaving the global equity market with strong returns over the 12-month period. The US market was the best performing region, benefitting from a heavy tech exposure and several companies that gained from exposure to stocks that gain from the growth of Artificial Intelligence, such as chipmaker Nvidia. Emerging Markets and the UK both lagged the global market, with growth prospects looking weak in the first 9 months of the period. They recovered to some extent in Q3 24 as fresh stimulus in China, and the controlling of inflation in the UK, contributed positively to their respective economic outlooks.