January 2024

XPS Investment News

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Quarter in brief

- The Federal Reserve shifted its tone from hawkish to dovish over the quarter but the Bank of England and European Central Bank refused to declare victory over inflation
- Global equity markets recorded their best year since 2019 following a blistering two-month rally in the fourth quarter
- Signalling of rate cuts in 2024 by major central banks resulted in a very strong quarter for fixed income markets
- World leaders reached an historic agreement to transition away from fossil fuels at COP28 which came to a close in December

Daniel Carpenter
Partner

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Daniel's January update

The beginning of the end in the fight against inflation? Or still too soon to tell?

All eyes remain firmly locked on major central banks heading into 2024 as messaging over when interest rates may start to come down began to diverge over the fourth quarter. Dovish comments from Federal Reserve (Fed) Chairman, Jerome Powell, sparked a 'Santa Claus rally' for equities and bonds towards the end of the quarter.

After a languid October, the final two months of the fourth quarter were much more positive for investors. The quarter began with the US Federal Reserve warning that interest rates would remain "higher for longer" than many had hoped in the battle to quell inflation. However, by the final meeting of the year in December, Chairman Powell had declared that the benchmark rate was "likely at or near its peak for this tightening cycle". This marked a sharp pivot in messaging from the Fed over the space of just a few months and interest rate swap markets are now pricing in six rate cuts by the Fed in 2024 compared with just three at the beginning of the quarter.

However, the Bank of England (BoE) and European Central Bank (ECB) stuck to their official lines in messaging to the market that there remains a long way to go to get inflation back to their respective targets. Despite the UK Consumer Prices Index falling from 6.7% to 3.9% between September and November, and some mixed messages in November from the Chief Economist around potential rate falls during 2024, BoE Governor Andrew Bailey has left the door open to further rate rises if necessary and expects interest rates to be kept high for "an extended period of time".

Inflation in the UK remains stubbornly higher than in the EU where the Harmonised Index of Consumer Prices across the region had fallen to 2.4% by November, almost 2% lower than at the start of the quarter. However ECB President Christine Lagarde warned that "we should absolutely not lower our guard" against inflation after the ECB maintained its benchmark deposit rate at a record-high of 4% in December.

Despite mixed messaging from the major central banks over the quarter, global equity markets performed strongly over November and December and revelled in a 'Santa Claus rally' in the final trading days of the year. UK equities were also positive over the quarter but have faced stronger inflationary headwinds than most major developed economies over 2023. Revised figures in December also showed that the UK economy was on the brink of recession after GDP contracted in the third quarter of 2023.

Emerging market equities, heavily reliant on the performance of China, were positive but also lagged. China has seen significant outflows of foreign investment over 2023 due to the combination of a limping real estate sector and falling consumer and business confidence. Despite a thawing of relations with the US following the meeting of Presidents Biden and Jinping in November, geopolitical risks remain a key deterrent from the Chinese market as the Chinese government ramps up its pursuit of the reunification of Taiwan.

UK corporate bonds enjoyed a strong quarter thanks to the combination of falling interest rates and tightening credit spreads. Global high yield bonds, highly sensitive to expectations of future borrowing costs in the US, benefitted from growing expectations of significant interest cuts in 2024. Whilst US and European high yield default rates picked up over 2023 compared to 2021 and 2022, they are currently at levels that don't look out of place compared to long term averages.

With a more dovish tone from central banks and in particular the US Federal Reserve, UK government bonds had a strong quarter of returns further boosted by lower than anticipated UK inflation figures.

The 28th Climate Change Conference of the Parties (COP28) summit drew to a close in the United Arab Emirates in December. Despite some controversy, and significant 11th hour redrafting, the final agreement brought new cross-country agreements around fossil fuels and sector pledges to address climate change. You can read more about the key outcomes and implications for investors **here**.

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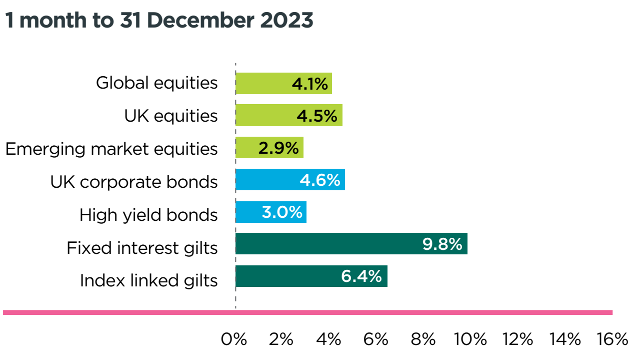
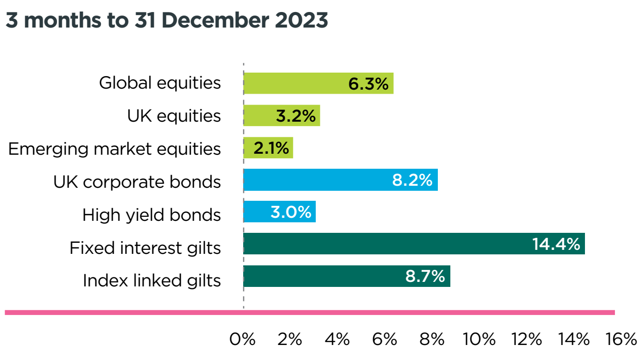
Market returns

Equities and bonds performed well in Q4 driven by a rally in December



Source: Refinitiv



Source: Refinitiv

XPS Investment asset class views

Asset class	Favourable	Neutral	Unfavourable	Movement
Developed equities	●			↑
Emerging market equities		●		
Investment grade corporate bonds		●		
High yield bonds			●	↓
Senior secured direct lending		●		↓
Balanced property (UK)		●		
Long lease property		●		↓
Diversified private markets		●		↓
Secure income		●		↓
Private equity		●		
Equity option strategies	●			
Cash	●			

Find out more

To discuss any of the issues covered in this edition, please get in touch with Alasdair Gill or Fraser Weir:

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