Balkerne Asset Management

Market Review as at 31 December 2024

Overview

The final quarter of 2024 ended with a spate of profit-taking and negative returns for UK investors, primarily in small and medium sized companies and the bond market, as a result of the first Labour budget for many years, which included significant tax/cost increases for UK companies. Not the best or most encouraging catalyst for the outlook for UK equities or economic growth.

As you will recall we wrote to you on 20 November 2024 with our opinion and actions:

We write to inform you that following detailed analysis and reflection on the finer points of the first Labour budget for many years, we can only conclude that the significant tax/cost increases for UK companies are not a positive catalyst for the outlook for UK equities or economic growth. We are therefore taking an informed decision to reduce our allocation to UK equities in favour of a higher weighting towards International equities.

Initially the increased allocation to International equities will be held in collective investments (such as OEICs or Investment Trusts), but we are pleased to announce that we are in the advanced stages of development to be able to hold direct US and European equities, to complement our international collective investments.

We are pleased to report that we have started to make these changes and have made further progress on the development to hold direct US and European equities. We will announce the introduction of these services shortly.

Market Review

Central banks in developed economies started cutting interest rates in 2024, but resilient economic growth and stubborn inflation became more evident towards the end of the year. This led to markets scaling back expectations of how quickly rate cuts would be delivered, particularly in the US.

In addition to inflation worries, investors became concerned that incoming US president Donald Trump's intended policies will lead to a widening budget deficit and increasing global trade tensions. Although the Federal Reserve (the Fed) cut interest rates by 0.25% (to a 4.25-4.5% range) at its December meeting, Chair Jerome Powell said that to make further rate cuts the bank will need to see evidence of lower inflation.

2024 saw US economic performance decouple from the other major regions. Despite concerns over the summer, US economic exceptionalism remained largely intact. GDP growth averaged +2.6% quarter on quarter annualised over the first three quarters of 2024 and the Federal Reserve Bank of Atlanta GDP forecast is projecting a similarly strong end to the year.

The S&P-500 was the top performing equity market with returns of +25.0%, and while the "Magnificent Seven" artificial intelligence (AI) stocks still delivered outsized returns, economic momentum did feed through into a broadening of earnings expectations which is set to continue in 2025.

Conversely, European economic momentum weakened significantly over the year. The manufacturing sector was particularly hard hit due to a combination of high energy costs, damaging regulation, and a lack of export demand, coupled with government subsidised competition from China. This divergence was compounded by political turmoil in both France and Germany where fiscal pressures and the rise of populist parties fractured the political consensus. Economic weakness and limited exposure to AI hindered European equities and the region underperformed.

UK equities marginally outperformed their continental counterparts as the economy recovered from the 2023 lows. This cyclical rebound was boosted by initial optimism following the election, however the autumn budget, which delivered larger tax rises than anticipated, poured cold water on some of the positivity. The increase in the national insurance tax on employment proved particularly corrosive to business sentiment with surveys in the final months of the year pointing to falling hiring and rising price intentions and leaving the Bank of England in a difficult position.

In Asia, Chinese activity remained weak as the country grappled with falling property prices and weak consumer confidence. Investors were initially unimpressed with the policy response. However, September's more cohesive policy announcements appeared to convince markets that 2025 would finally see the significant stimulus required to restart the economy and Chinese equities rallied in the second half of the year. Continued optimism about the end of deflation, coupled with a weak yen and ongoing corporate reforms, helped Japanese equities deliver the second best performance of major equity market.

Bond investors hoping for a strong run in December, a so-called 'Santa rally', were disappointed. The positive performance seen in November was reversed, and then some. This weakness in bond markets was the result of lower levels of market activity, mixed economic data, reduced expectations for further interest cuts and growing concern around the possible implications of Trump's re-election.

Yields on ten-year US government bonds pushed up past 4.5% to reach their highest levels since April. UK government bond yields were dragged along for the ride, despite weak economic data and investor concerns about the nation's public finances and the potential for stagflation. German government bond yields also rose, but by far less, as investors increasingly look to the ECB to rescue the Eurozone's ailing manufacturing sector

Sources – J P Morgan, The Financial Times, Ionic Information, Bloomberg, Liberum

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