Economic & Market Commentary

Q2 2024

Quarter to 30 June 2024

UK election – time for change or more of the same?

At last, the waiting and obsessive pre-election media coverage is over and the result everyone had predicted is a known thing and not just an expectation.

But what does this mean for investors?

History has shown that the UK stock market tends to perform better under Conservative governments, with Margaret Thatcher's second term providing the biggest boost to the FTSE All Share index in post-war Britain, as seen in the charts below.

FTSE all share nominal return

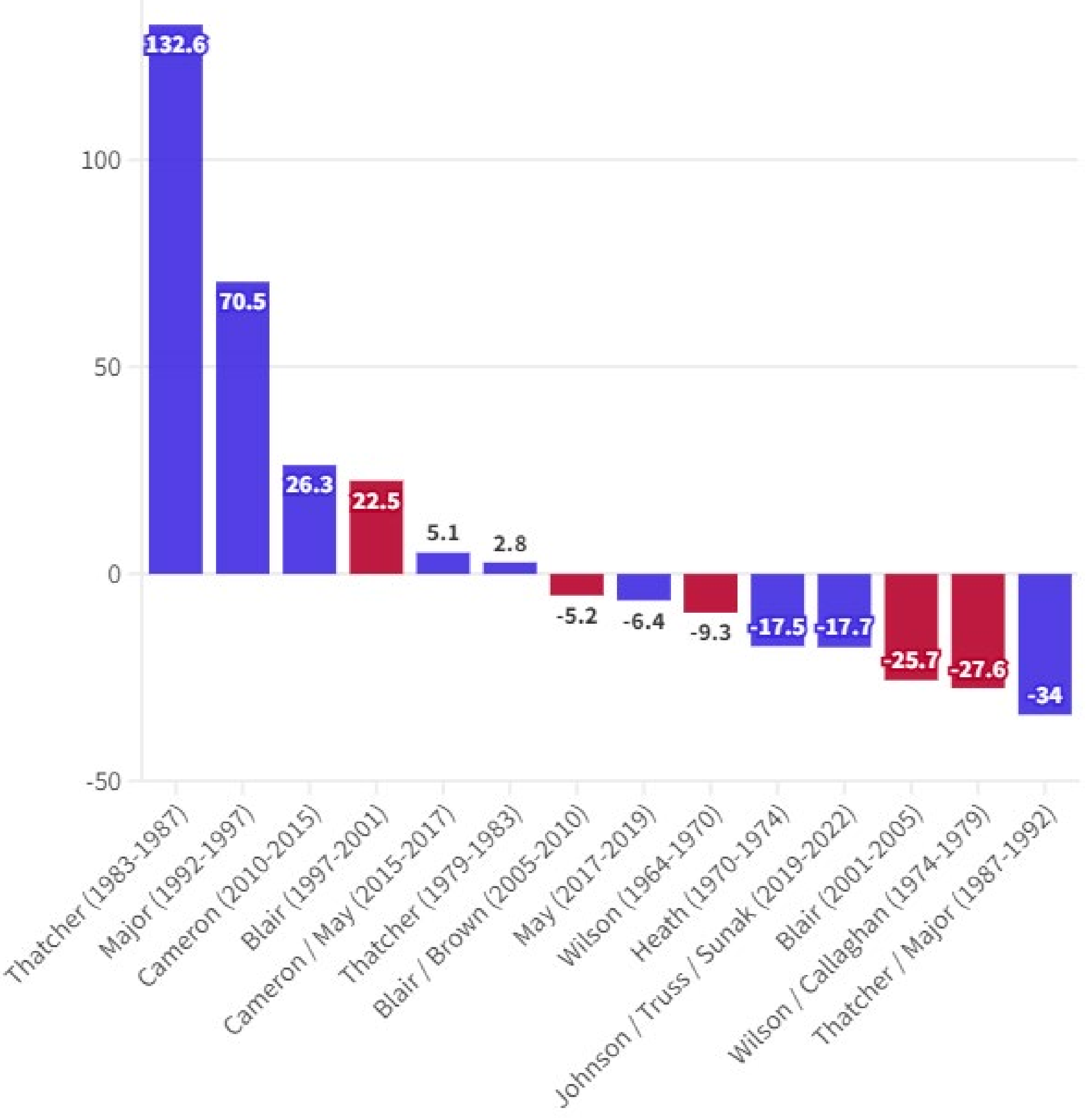
150
100
50
0
-50

152.8
84.4
83.5
57.8
41.9
33.7
21.9
20.1
14.2
11.3
10
2.3
0.8
-15.6

Thatcher (1983-1987)
Wilson / Callaghan (1974-1979)
Major (1992-1997)
Thatcher (1079-1983)
Cameron (2010-2015)
Blair (1997-2001)
Heath (1970-1974)
Wilson (1964-1970)
Johnson / Truss / Sunak (2019-2024)
Blair / Brown (2005-2010)
Cameron / May (2015-2017)
Thatcher / Major (1987-1992)
May (2017-2019)
Blair (2001-2005)

Source: AJ Bell

The outperformance is even more stark when inflation is considered, with most of the larger gains from Labour governments in the 70s wiped out by the impact of extremely high inflation rates, as shown below.



Source: AJ Bell

However, while these charts could imply a Labour government might be less positive for the investment markets than another Tory one, we believe the data reflects global themes and general global conditions much more than it reflects domestic political conditions.

As an example, the 1974 Labour government was unfortunate in that the first oil price crisis, hardly their fault, fell within its term of office.

It is also the case that, under Labour governments in post-war Britain, the Pound has depreciated 0.2% on average each year against the US Dollar, whereas under the Conservatives it has depreciated 1.1% per year. (Source: Investment Week).

This could imply that the Labour Party is better at keeping the Pound strong. Again, though, this is probably largely down to outside factors, rather the result of the policies of the party in power.

Regardless of the history, the real question is how does any of it help to guide us in what to expect from investment portfolios while a Labour government is in power over the next 5 or more years?

The answer is that it doesn't. There is just too little similarity between the past, the present and any probable future to make history gazing a worthwhile endeavour, when trying to gauge the impact of domestic politics on portfolio results.

An unexpected result at the election could have impacted the Pound and perhaps the domestic market in the short term. However, the outcome was entirely in line with expectations, so the reaction was negligible.

The key drivers impacting the UK market in the next year or two will mostly be global inflation (and, hence, interest rates) and geopolitical developments.

Domestic decision making will have some impact, but probably only at the margin.

What is likely to change is the amount of tax investors must pay, but, at this stage, we will just have to wait and see on that one, as Labour's plans in that direction were notable by their absence in their manifesto.

It seems likely, then, that portfolios will continue to be blown forwards or backwards by global and not domestic winds, just as we have generally seen for many years. Overall, those appear positive as inflation abates and a reversal of the trend of interest rates rising looms closer, but a smooth and easy journey seems unlikely, even if the direction of travel is supportive.

With the wars in Ukraine and Gaza showing little prospect of ending soon, and at some risk of escalation, we must expect geopolitics to continue to dominate sentiment.

Add to that the uncertainty created by the US election in November, where the disarray in the Democratic Party may well hand the keys to the White House over to Donald Trump, and it's hard to be that confident in much political stability in the shorter term.

A Trump win might go down well with the US markets, and maybe others, as he is very pro-business, but it would also introduce yet more potential chaos and even less predictability.

Time will tell, and we recognise the challenges ahead, but also the opportunities for investors as these get resolved.

In the meantime, we do not believe there is any need to make any snap decisions regarding investment strategies until we have a better idea of the outcome of these elections around the world and what this means looking forwards.

In any case, our view, as always, is to look towards the longer term and we feel that the markets will continue their upwards trajectory, even if by having to climb the proverbial "wall of worry".

Market performance

How each of the major indices have performed to the end of the current quarter

Investment Association Sectors and Other Indices – Total Return to 31 March 2024 (in GBP)					
	3m	**1yr**	**3yr**	**5yr**	**10yr**
Equities					
IA UK All Companies	2.9	11.5	6.9	21.6	63.3
IA UK Smaller Companies	7.2	13.6	-17.2	19.1	83.7
IA Europe Excluding UK	-0.6	11.5	14.1	42.5	114.6
IA North America	1.9	20.9	29.4	77.5	261.0
IA Latin America	-13.1	-7.5	1.1	-8.0	17.4
IA Japan	-2.1	11.0	10.0	31.6	125.9
IA Asia Pacific Excluding Japan	3.4	9.5	-5.0	20.9	101.7
IA China/Greater China	0.3	-6.5	-39.7	-16.8	57.3
IA Global Emerging Markets	2.5	11.3	-7.6	12.1	67.0
MSCI Frontier Markets	0.2	13.4	-1.1	11.3	44.6
Equity specialist					
IA Healthcare	0.1	6.3	3.2	36.6	166.5
IA Technology and Technology Innovations	5.1	29.8	23.8	112.1	395.7
IA Commodity/Natural Resources	-2.4	6.2	26.0	52.4	84.7
MSCI ACWI/Energy	-3.0	17.6	73.4	48.2	59.2
Bonds					
IA Standard Money Market	1.3	5.5	8.9	9.7	11.1
IA Sterling Corporate Bond	0.2	10.2	-8.5	-0.5	25.5
IA Sterling High Yield	1.4	10.7	3.7	14.7	35.1
IA UK Gilts	-0.8	4.2	-23.0	-20.4	6.0
IA UK Index Linked Gilts	-2.2	-1.6	-34.2	-31.1	8.4
IA Global EM Bonds Blended	-1.2	6.3	0.3	0.8	34.8
IA Global Mixed Bond	-0.2	4.6	-4.5	-1.5	24.8
IA Global High Yield Bond	0.9	10.0	6.7	14.4	60.8
Alternatives/Specialist					
IA Infrastructure	0.1	0.2	4.5	11.5	78.3
IA UK Direct Property	0.8	-0.1	1.1	-1.0	28.4
IA Property Other	-1.0	7.3	-10.1	-2.1	42.0
IT Private Equity	4.0	10.5	31.1	55.3	142.2
IA Targeted Absolute Return	0.9	7.8	8.5	15.7	26.5
Gold Bullion Sterling/Troy Ounce in GBP	2.0	21.8	41.7	66.2	137.7

Source: FE Analytics – Total Return; bid to bid

Equity markets overview

Global equity markets largely delivered positive returns over the quarter, driven by investor optimism surrounding potential interest rate cuts coming sooner rather than later.

Data showed improvements in manufacturing and services activity across the West, helping equities advance in the hope that the impact of the high interest rates would be less than feared and the risks of a full recession reduced.

The best performing sectors were smaller companies in the UK, together with technology shares. This is a tale of two opposites as Big Tech is a sector that continues to surge forwards to eye-watering valuations, whereas the valuations of smaller domestic UK shares have suffered extremely during the period of higher interest rates, so their strong run was a case of an undervalued sector beginning to bounce back.

The notable detractors were Latin America and commodities shares. The two have always been linked, given South America's dependence on exporting resources, so it's no surprise to see them travel in tandem. We continue to feel that this presents an opportunity to buy at depressed values and enjoy the recovery, as and when it comes along.

Bond and property markets overview

Bonds continued to tread water during the quarter as the data painted a mixed picture in terms of the state of the global economy and the prospects for interest rates.

The consensus is that the global economy has proven to be quite resilient to the higher interest rates and that has favoured the riskier areas of fixed income such as high yield bonds, as the fund managers can identify and take advantage of the opportunities of companies improving their credit ratings.

Property markets have also seen little movement over the quarter and remain depressed by the impact of high borrowing costs, causing many Real Estate Investment Trusts to trade at huge discounts to their underlying value, reflecting the lack of investor support for these assets whilst rates remain inflated.

The discounts could be reasonable if current valuations were proved to be inaccurate, but we have seen plenty of activity within the funds themselves that shows they are not, with properties sold for prices very close to those used in the accounts. Given this, and the fact that interest rates are very likely to start falling soon, our view is that these discounts are overdone and therefore present a highly attractive investment opportunity.

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Our views on sectors and regions

What we think about investment opportunities in each sector or region, be it negative (✗), neutral (–) positive (✓), or very positive (✓✓) over 12 months and 5 years.

Region or sector	12-month view	5-year view	Notes
Buy to let residential property	✗	–	Legislative and regulatory headwinds and higher borrowing costs seem likely to continue to dampen demand, while government policy to build 1.5 million homes over the next 5 years, equivalent to about 14 cities the size of Southampton or 7 the size of Bristol, could also weigh down on both rents and values, depending on how net immigration pans out.
UK and Global Real Estate Investment Trusts (REITs)	✓✓	✓✓	Very weak values and high income yields combined with an expected end to the main headwinds of high borrowing costs and the risk of recession, should support a recovery in sentiment and values. Sector variation is expected though, with demand for office space unlikely to recover quickly (unless driven by change of use to low-cost housing) but demand for industrial property and warehousing potentially robust.
UK Gilts (Government bonds)	–	✗	The turning interest rate cycle is supportive but a potential reversal in government policy, from requiring pension funds to hold Gilts to cover liabilities, to forcing them to sell a proportion of the Gilts holdings to buy UK equities, might have a big impact on the supply/demand dynamics in the sector.
UK Index Linked Gilts	✓	✓	The same factors facing traditional Gilt markets apply but values have fallen badly so there seems more potential for some upside as that corrects.
UK Investment Grade Corporate Bonds	✓	✓	Unlike Government Bonds, these are priced to reflect the risk of default as well as the prospect for changing interest rates. An improving economic backdrop should reduce default risk, offering some additional upside compared with Gilts, but the reverse is also true.
Global Bonds	✓	✓	This sector includes both government and corporate bonds issued almost anywhere in the world, so an enormous pond for a fund manager to fish in. While interest rate policy and economic prospects tend to travel in the same direction across the globe, there are large local differences in the pace and extent of changing fortunes, allowing plenty of opportunity for investors to benefit from the research and analysis capabilities of specialist fund managers.
UK High Yield Bonds	✓	✓	Very high income and the potential for greater capital gains in an improving economic background supported by falling interest rates should drive valuations higher, but UK government policy is a currently unknown ingredient while we await clarity on what it will be.
Global High Yield Bonds	✓	✓	These are exposed to much of the same factors as their UK equivalents, looked at above. However, the much bigger marketplace creates more opportunities and assists diversification, both of which are supportive.
UK Large Cap	✓	✓	The relative undervaluation seen ever since the 2016 Brexit decision is, at last, showing signs of correcting, perhaps supported by some takeover offers at large premiums to the share price. However, high corporation tax rates and overbearing regulation remain a concern and we may see our domestic market continue to shrink as companies relocate to escape these headwinds. Whether the new Government will help address this trend remains to be seen.
UK Mid and Small Cap	✓✓	✓✓	Savaged by the impact of rising interest rates, we believe the shares in smaller and medium sized companies are exceptionally well placed for recovery as rates fall back, while the longer term prospect for growth is often inherently more compelling than with larger companies, where the main growth spurt may be behind them.
Europe (excluding UK)	–	–	The political background may have some impact on economic prospects, in either direction, but the region holds a large number of the world's most successful companies and is starting to get a lot more attention from global investors, seeking diversification.

Region or sector	12-month view	5-year view	Notes
North America	▬	▬	This is a divided market. The Magnificent 7 “big tech” shares make up about 30% of the S&P 500 after a spectacular rise driven by euphoria over the potential for AI. Many believe the big gains are in the past, for now at least, and the risk of a tumble significant. However, most of the other 70% of the market doesn’t look overvalued at all. A rotation from one to the other might take place, much as we saw when the dot com bubble burst in March 2000, with tech shares heading south while the sectors shunned during the buying frenzy rallied. But that’s just one possible scenario and there are many others, which leads us to neutrality overall, but advise caution with big tech due to the very demanding share prices.
Japan	✓	✓	It took a bit over 34 years for the Nikkei 225 index to revisit the high point it hit in December 1989, finally achieving that in February. True, the Japanese equity and property markets were both suffering from irrational exuberance in the run up to the crash in 89, but for much of the time since then it’s been a case of irrational despondency. Global investors shunned Japan while domestic investors chose to hoard cash, despite pitiful, or even negative, interest rates. There were a few false dawns along the way, but Japanese shares generally failed to live up to their potential until the recent change in sentiment, and this time if feels as though the doldrums drifted off. Overseas investors, unless hedging the Yen, gave up a good deal of recent gains due to the currency falling, but that theme may start to reverse now the Bank of Japan has joined the rest of the world in raising interest rates. With numerous world class companies on reasonable valuations, a supportive government and growing political risks in many other markets, Japan looks well set to continue its recent return to favour.
China	▬	▬	This is a cheap market with good reason, due to both economic and political risks. In all probability the economic gloom will lift in time, but concern over the direction of travel for the Chinese Communist Party seems well founded and unlikely to abate unless Xi Jinping reverses away from his increasingly authoritarian stance and his tacit support for Putin. Add to the mix the possible extra frictions if Trump regains the White House and it’s easy to see why overseas investors might choose to stay away. On the other hand, cheap shares combined with enticing longer term potential could reward the brave handsomely.
Asia and the Far East	✓	✓✓	This is a vast region, covering a very wide diversity of economies. The common theme for many is rapid development and industrialisation supported by exports. Companies operating in this environment have abundant opportunities to grow and prosper, while lacklustre performance from the equity markets in recent years has left many looking undervalued. The availability of decent dividends is another ingredient likely to attract the smart money and enable values to rerate.
Emerging Markets	✓	✓	Asia and China, referred to above, and Latin America, referred to below, make up the lion’s share of this broad region. That diversity gives a skilled fund manager, supported by well-considered analysis, every opportunity to achieve strong returns, while the flexibility allows risks to be diluted. For those comfortable with a bumpy ride, emerging markets funds look well placed to provide good rewards.
Latin America	▬	✓✓	Resource rich but often politically poor, Latin America can sometimes be seen as a problem child amongst the world’s regions. Stock market valuations tend to reflect that, but it feels as though that has been overdone in recent times and a recovery looks likely. If patience is needed then investors can enjoy some exceptionally high dividend payments while they await better times.

Region or sector	12-month view	5-year view	Notes
Africa	▬	▬	Africa may reward investors handsomely one day, but the risks are high, and seem to be rising, so we feel exposure via emerging markets funds, or simply through companies quoted in the developed markets but operating in Africa, is currently adequate.
Frontier Markets	✓	✓✓	These are the smaller emerging markets and offer investors access to unusually high growth prospects in exchange for inevitably increased risks, albeit with those mitigated by diversification. Many are well placed to benefit from China's lurch back to authoritarianism, as "western" economies seek to reduce their dependency on Chinese imports, and others from China's global expansionary ambitions and its "belt and road" initiative, pumping money into underdeveloped regions in its search to enhance its trading relationships and political influence.
Commodities and Natural Resources	✓	✓✓	This is such a huge sector it is hard to generalise, but overall demand for most commodities seems set to increase while the expansion of supply is likely to lag that, so the prospects for many companies operating in the sector look bright. Investors must expect a lot of volatility, as that is the pattern, but some very high dividend yields, reflecting low valuations, can cushion that and enable patience to be exercised.
Gold	▬	▬	As we've covered in previous commentaries, gold can be a useful diversifier for portfolios that don't require income, although it's direction of travel is infamously difficult to predict.
Healthcare and Biotechnology	▬	✓	An aging global population should drive ever-increasing demand, while scientific breakthroughs can offer exceptional opportunities. With core healthcare well represented in mainstream regional funds, we prefer funds focussed on the more specialist and cutting-edge biotechnology sector, but the higher risks must be factored in when assessing allocation levels.
Technology	▬	✓	We've set out our views on this exciting but somewhat scary sector many times and referred to it in our commentary above on the US markets. Our current take is that big tech carries big risks due to the very high valuations and that the few funds looking elsewhere for exposure to global technology remain a better option. Over the longer term, the big tech companies could well see their share prices rise substantially, but we feel the ship has sailed for the moment and this is not the right time to buy in.
Infrastructure	✓	✓	This sector has experienced similar headwinds to commercial real estate, with high borrowing costs weighing down on valuations. As with Real Estate Investment Trusts, we see this as a very attractive buying opportunity. The relatively low correlation with other sectors can also be helpful in risk management, while the high dividends are particularly appealing for those investing for income.
Clean Energy	✓	✓✓	Reduced government & private sector investment, higher interest rates and a reversal of momentum back to fossil fuels following the challenge to energy security created by the Russian invasion of Ukraine, have all combined to depress values in this sector. However, while some of these problems may persist for a while, a more benign interest rate climate should help over the next few months, while the longer-term attractions of this sector remain compelling, for obvious reasons.

Important notes

The importance of investment time horizon

There is a direct relationship between risk and potential reward, and between risk and time horizon. One of our core objectives is to help our clients find a sensible balance with their capital to reflect these relationships and, of course, their own objectives and preferences. In this document we tend to look at shorter term history and future expectations, since that is the purpose of a quarterly market review. However, while short term movements in asset values are often critical to speculators, they are not nearly so relevant to the sensible investor. They are, of course, interesting to follow but it is the medium to long term outlook which really matters, and that is where Atkins Bland retains its main focus when assessing suitable investment strategies for our clients. This is because sensible people investing in stock markets, bonds or property do so with capital available for the medium to long term and will have positioned themselves, so they have enough cash to meet shorter term spending needs. Sensible investors are, therefore, able to ride through the ups and downs of capital values. For those investing for capital growth, shifts in the medium-term outlook, economic cycle or relative valuations between different investment areas can provide good opportunities to enhance capital values and our advice seeks to take advantage of this. For those investing for income, changing valuations and conditions seldom have much impact on the income being generated from investments already held (other than from deposit accounts) but they can alter the percentage income yield available from new investments. This means that moving from one area to another can prove a worthwhile strategy as conditions shift. Again, our reviews and ongoing advice processes are designed to take advantage of opportunities created by these changes. Advice we give does, therefore, take into account current conditions and some shorter-term developments but is always overlaid with the prime objective of a focus on medium to long term outlook, since this is what actually drives medium to long term results. During any year there will be good and bad days for the stock markets, and often there will be bad and good weeks or even months. The fact that this will be the case is easy to predict, but the timing of short-term changes in share prices is notoriously almost impossible to predict, so attempting to do so is largely the domain of gamblers rather than investors. For anyone prepared and able to put up with the short-term volatility of capital values, we firmly believe that equities and other asset backed investments are an ideal home for longer term investors seeking income, growth or a mixture of both, and our recommended strategies will continue to reflect this belief.

Risk warning and disclaimers

Any opinions expressed on the merits or disadvantages of any options are intended as a general comment only and not as specific advice to the reader. This document is intended as a supplement to full independent advice and not as a replacement for it and should be read in conjunction with any personalised recommendations provided by Atkins Bland Ltd and with any product brochures supplied. The value of investments will fall as well as rise, as can any income produced or generated. An investor may, therefore, get back less than invested.
Inflation can reduce the real value of capital and the income it generates. Past investment performance is not a reliable guide to the future. Any reference to taxation, regulation or legislation is based on our current understanding and details should be checked before any reliance is placed upon its accuracy. The impact of taxation and tax planning depends on individual circumstances and may be subject to change, which can be retrospective. Errors and omission excepted.

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