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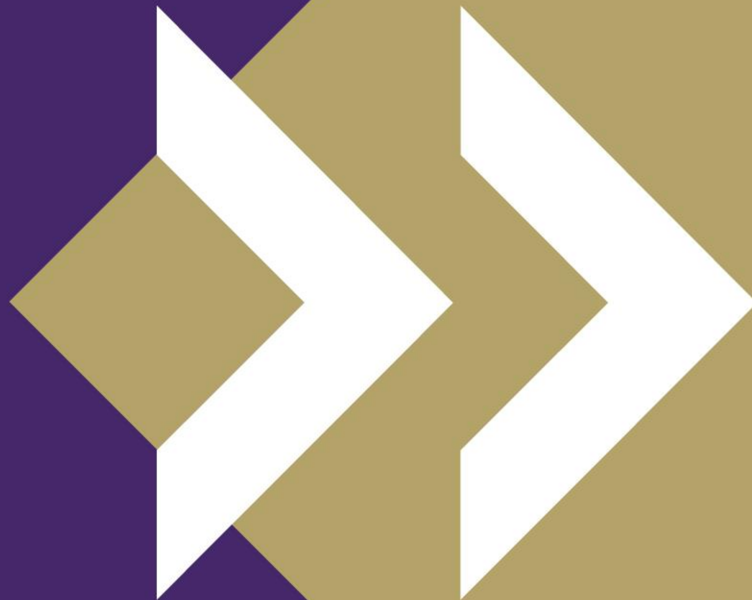
Market Update

Q4 2024



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Macro Backdrop

Much like his billowing hairstyle, the cloud hanging over Q4 was equally impossible to ignore and endlessly discussed: Donald Trump's imminent return as the now-47th President of the United States. Market reactions have been mixed.

His presidency is widely forecast to be inflationary, reinforcing expectations that interest rates will stay elevated for longer. His proposals including high tariffs, lower taxes, steep immigration cuts and the potential for mass deportations have unsettled bond investors.

Equity markets in the US, however, have surged, with the main market finishing the year more than 23% higher than it began in January. During Mr. Trump's previous term, US equities soared by nearly 65%, led by financials and industrials. Policies such as tax cuts, incentives for onshoring, and deregulation are expected to bolster the US economy, particularly smaller companies.

Broadly, Trump's return has been welcomed by investors in risk assets like equities but has created headwinds for non-risk assets such as bonds.

Expectations of trade tensions following Mr. Trump's election initially shook global equity markets, with markets in Europe and China contracting notably. However, these markets have since recovered and are contending with their own particular challenges.

Looking to the U.K., the economic picture remains lacklustre. Q3 growth was reported at just 0.1%, reflecting a sluggish economy. This was further underscored by a 3.3% drop in retail sales during November and a significant decline in manufacturing activity, with output contracting sharply as businesses reported weaker demand and production levels. Rachel Reeves' budget has been widely deemed inflationary, with measures such as National Insurance hikes further straining business and passing costs on to consumers. The government is prioritising efforts to tackle widespread economic inactivity through job incentivisation schemes alongside record-breaking levels of inbound immigration. Despite this, inflation surprised many, rising to 2.6% in November, complicating the Bank of England's attempts to normalise monetary policy following a 25-basis-point rate cut during the quarter bringing rates to 4.75%. Rate cuts in the UK, alongside dollar strength caused by expectations of higher rates for longer in the US, contributed to GBP falling against USD.

Staying close to home, Europe remains mired in familiar, yet no less pressing, challenges. Political instability continues to plague the region, with the French government dissolving following a vote of no confidence, as right-wing parties across Europe continue to make ground against incumbent governments widely viewed as listless. French government bond yields surpassed those of Greece, highlighting the country's precarious position financially, politically and geopolitically. Eurozone growth remains weak, inflation has climbed to 2.2%, and labour markets remain tight. Germany, the economic engine of Europe, continues to grapple with flat growth driven by slumping industrial output, labour disputes, and persistently high energy costs. Fiscal stimulus is under consideration as a potential remedy, whilst the European Central Bank cut rates to 3.65% in mid-December.

Asian markets were subdued in Q4 compared to the previous quarter, which had been marked by economic data surprises, stimulus measures, rate cuts and the threat of forthcoming tariffs from the US once Mr. Trump is inaugurated. Following significant stimulus measures at the end of Q3, China unveiled a RMB10 trillion local government debt resolution package in November. However, the absence of expected bank recapitalisation and consumer stimulus disappointed markets. Despite subdued macro data, there were bright spots, including stronger-than-expected retail sales and a smaller decline in property market activity. Further stimulus announcements are anticipated across the coming months.

In Japan, November elections resulted in the incumbent Prime Minister, Shigeru Ishiba, losing his party's majority. This mirrors global trends of incumbent parties facing electoral backlash. Whilst Japanese markets have been relatively unaffected, the outcome amplifies political uncertainty in the country.

Bond Markets

Whilst Q3 was generally a positive period for fixed income investors, with bond yields falling sharply and delivering solid returns, the fourth quarter presented a much tougher environment.

The opening week saw yields on UK and US 10-year government bonds rise from below 3.8% to over 4%, peaking close to over 4.5% in the quarter. This sharp turnaround for the bond market can be traced to two key factors: concerns around increased borrowing and persistent, resurgent, inflation.

In both the UK and US, rising borrowing appears set to define fiscal policy. Chancellor Rachel Reeves' budget includes plans for up to £50 billion in additional gilt issuance, a market already under strain from the Bank of England's quantitative tightening. This anticipated increase in supply has driven investors to demand higher yields. In the US, the

budget deficit, already exceeding 6% of GDP, is expected to grow further under Donald Trump's proposed tax cuts (which are themselves inflationary), prompting similar moves in yields on US government debt.

In Europe, yields remain relatively low compared to the UK and US, likely reflecting subdued growth expectations and therefore limited inflationary pressures, rather than a higher level of investor confidence.

On a more encouraging note, expectations of a soft landing for the global economy have compressed credit spreads—the premium investor's demand for corporate debt over "risk-free" government bonds—to very low levels. In plain English, this move reflects confidence in the business environment, supported by the healthy balance sheets of many companies.

With yields currently elevated, there is potential for bond markets to benefit if interest rates are reduced in the coming months.

Equity Markets

The defining story of the quarter was the strong performance of US equities, with the market delivering good returns. Investors are optimistic about the potential impact of Donald Trump's presidency on equity markets. His proposed policies—sweeping tax cuts for individuals and corporations, incentives for onshoring industry, deregulation, and tariffs on foreign goods—are viewed as particularly supportive of the US corporate environment. Smaller companies, in particular, have drawn significant interest. Trading at a steep discount to their larger peers, they are seen as offering outsized potential for strong returns in the years ahead. This optimism propelled US equity markets to all-time highs in Q4, a stark contrast to the more challenging environment for the growth-oriented market in Q3. However, although U.S. equity markets ended the quarter higher, they surrendered a significant portion of their Q4 gains in mid-December, largely due to a broad-based sell-off as investors took year-end profits.

In the UK, the market showed resilience despite some volatility around the Budget and the US election, finishing the quarter up, and with the main market returning around 6% for the year. Strong earnings from oil majors, energy companies, and banks underpinned this progress. Persistently low valuations for UK companies continue to attract interest for mergers and acquisitions as well as share buybacks, which have provided additional support to share prices. These factors, coupled with robust corporate balance sheets and high levels of international revenue exposure, present a positive case for equity investors seeking value opportunities.

Europe had a more challenging quarter, with markets ending lower. French companies were a particular drag as the country struggled with ongoing political instability, coupled with economic concerns such as persistently high levels of indebtedness. Luxury goods firms, such as Kering, experienced declines amid concerns over consumer health, particularly in China. Though only a small part of the index, European automakers faced another difficult period, with Volkswagen notably shutting down two factories in Germany for the first time and dealing with strikes at nine others. However, the region still boasts some exceptional companies that are exciting prospects for managers, including LVMH, Ferrari, ASML, and Novo Nordisk. These examples highlight why exposure to European equities remains valuable despite broader challenges.

In China, markets were largely flat during Q4 after a dramatic Q3 rally of around 30%, driven by stimulus measures. This event is largely responsible for Chinese markets impressively adding more than 14% this year. Short-term concerns over Donald Trump's election and potential trade tensions did little to unsettle markets significantly. Investors are now focused on the potential for additional stimulus announcements in the months ahead.

Lastly, Japan experienced a relatively quiet but positive quarter. Following Q3's volatility, driven by interest rate hikes and weak economic data, Q4 was far more subdued. The most notable development was a sharp decline in the yen, which weakened as global risk appetite increased—likely a result of market optimism following Trump's election.

Outlook

Looking ahead into 2025, investors are likely to remain closely and nervously attuned to developments in corporate earnings, interest rate decisions, and political events, all of which have repeatedly demonstrated their ability to drive sharp and immediate market reactions throughout 2024.

In such uncertain times, a well-structured investment approach is essential. Diversifying across asset classes, regions, and investment styles enables Square Mile to navigate market turbulence without taking excessive risks or becoming overly cautious. Our focus is on delivering smoother, more consistent growth for our investors by prioritising high-quality investments and strategic diversification. Through a selection of best-in-class multi-asset funds, meticulously chosen by our award-winning research team, we aim to provide resilience and long-term performance in an unpredictable landscape.

All information sourced from: CNN, Macrotrends, Trading Economics, Office for National Statistics, Investment Week, Action Forex, Reuters, Bank of England, The Guardian, Funds Europe, European Central Bank, CNBC, Bloomberg, Institute for Strategic Studies, Morningstar, Congressional Budget Office, ING Think, Financial Times, Forbes, BBC News, Council on Foreign Relations.

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