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Quarterly Market Commentary

For clients of Atomos FInancial Planning Ltd

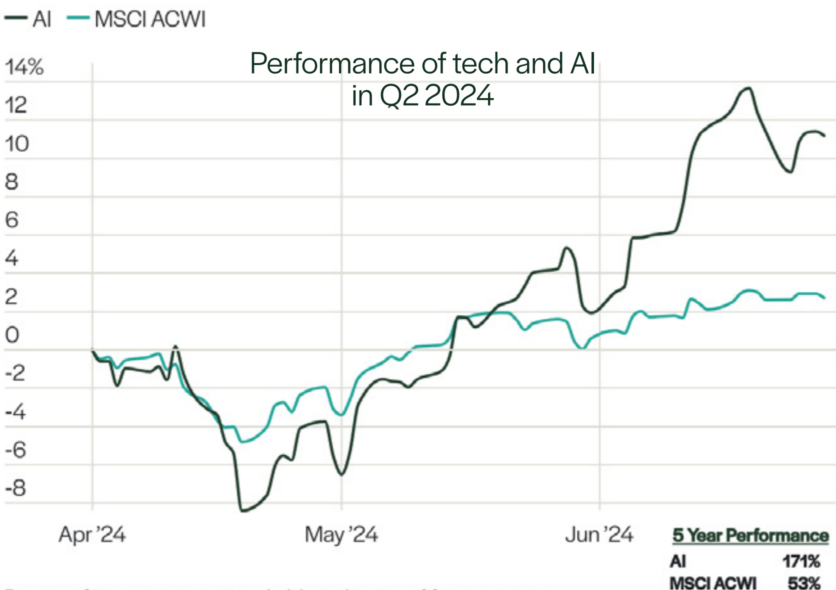
April to June 2024

What moved markets over the quarter?

Between April and June, global stocks continued the upwards trend we saw over the previous quarter, although a few factors threatened to knock performance off course.

In April, we saw escalation of the Middle East conflict. This, combined with the rising possibility that the US central bank may keep interest rates higher for longer, caused a wobble in markets. However, stocks regained their momentum over the rest of the quarter.

A major driver of market performance in Q2 was strong company earnings growth and growing excitement about artificial intelligence (AI), which encouraged investors to take a little more risk in equities.



Past performance is not a reliable indicator of future returns.

Source: MSCI, Bloomberg. MSCI ACWI Information Technology is used as a proxy for AI. Data is from 01/04/2024 to 30/06/2024. The MSCI ACWI is an index of large- and mid-sized stocks from across the world.

Some of the 'Magnificent Seven' stocks continued to perform well, as Nvidia became only the third company to breach a $3 trillion market capitalisation, overtaking Microsoft as the world's most valuable company. UK equities also performed well over the quarter, especially small- and mid-sized companies. Financials and industrials were among the top contributors at the sector level.

Inflation and interest rates

In May, UK headline inflation finally dropped to the Bank of England's 2% target for the first time in three years. This had seemed quite unlikely at the start of the second quarter. As a result, expectations shifted towards an August interest rate cut.In the US, data released in May showed that inflation remained 'sticky', meaning prices are falling at a slower rate than desired. The US Federal Open Market Committee, which is responsible for setting policy rates, left interest rates on hold its May meeting.
The latest economic data from the US is pointing to lower wage growth and higher unemployment, which could push core inflation downwards.

In fact, as of May, inflation in the US had already started to slow.

Within the eurozone and Canada, the Bank of Canada and the European Central Bank were the first to cut headline policy interest rates to 4.75% and 3.75% respectively at the beginning of June, with both central banks flagging greater confidence that inflation is falling back to target.

In Japan, inflation data continues to suggest that the economy is on track to achieve sustainable inflation of 2%, however the persistently weak yen negatively impacted investor sentiment over the quarter.

Election effects

During the second quarter, European markets were volatile due to uncertainty over the impact of the French election – the spread on 10-year French bonds over German bonds widened to levels not seen since 2017. The 'spread' refers to the difference in yield between two debt instruments, which often widens in a negative economic environment. This means the price of French bonds fell significantly compared to similar German bonds as investor demand for them dropped.

However, certainty on how far the party has gained will only be clear after the round of constituency run-offs on 7 July.

The UK prime minister Rishi Sunak called a general election for 4 July, but this announcement had little impact on bond and equity markets.

In India, Narendra Modi's governing BJP party lost its outright majority in a shock to markets.
The sudden uncertainty led to a sell-off in Indian equities immediately after the result.

Our view on the major asset classes

Equities

Positive returns for developed market equities continued into 2024 with similar market leadership as at the end of 2023. The valuations of US stocks reflect expectations for earnings outperformance and exceptional growth over the next five years.
Over the next three to five years, we still expect to see moderately better value from Japanese markets.

Despite a wobble in April, overall, global equities had a positive quarter following, while UK equities also delivered a strong absolute return as a broad range of sectors performed well.

Japanese equities suffered over the quarter as the weak yen hit investor confidence.

Bonds

We expect high-quality credit will provide moderate returns above equivalent government bonds over the medium term (three to five years). We have a cautious outlook on speculative-grade (higher-risk) credit given some near-term risks, plus current pricing only pointing to an average level of credit defaults.
We think some UK government bonds look attractively priced given significant interest rate rises in 2023 and a weaker economic growth outlook.

Government bonds from most major developed markets fell in April on reduced expectations of lower interest rates, but rebounded in May as inflation slowed and investors hoped for rate cuts sooner rather than later.

UK government bonds showed positive performance as inflation finally fell back to the Bank of England's target. In the US, a poor show from Joe Biden in the presidential debate against Donald Trump led to a spike in US government bond yields (remember that bond prices and yields move in opposite directions) which detracted from portfolio performance.

Investment-grade bonds (the highest-quality corporate bonds) performed better than government debt in Q2, while the high-yield portion of the portfolio (meaning lower-quality corporate bonds) fared very well over the quarter, outperforming both government and investment-grade bonds.

Real assets

Listed real assets have been acutely sensitive to changes in interest rates over the past two years.
As bond yields gradually increased from the start of the year, both real estate investment trusts and listed infrastructure posted negative returns year-to-date and lagged wider equity markets. Ongoing headwinds to the office sector continue to weigh on the US commercial real estate market in particular.
Looking forward, we expect listed real assets to be well positioned to benefit as interest rates fall.

Real estate investment trusts (REITs) and listed infrastructure initially struggled in Q2 as persistent high interest rates continue to hurt property valuations, but this trend later reversed as falling interest rate expectations uplifted asset valuations based on future earnings.

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