Cantab
ASSET MANAGEMENT

Investment Comment

3 July 2024

The second quarter of 2024 was marked by falls in inflation rates, with Emerging Market economies generally making more headway than their Developed Market counterparts in returning inflation to the 2% target. Political developments are also notable, with far-right candidates gaining ground in European countries and a general election in the UK on 4 July. In the US, the Presidential race is intensifying, highlighted by the recent debate between the two candidates.

In the US, Non-Farm Payrolls for May were strong, with 272,000 jobs added compared to the expected 185,000, suggesting a robust job market. However, a closer look reveals that most of the gains came from the Healthcare and Government sectors, which are not typically the primary growth drivers in a booming economy. Despite this, the Federal Reserve (Fed) held interest rates steady at 5.25–5.50% at its June meeting. The Committee acknowledged that its inflation and employment goals have moved toward better balance over the past year but, due to economic uncertainty, it does not expect to reduce rates until it is confident that inflation is sustainably moving toward 2%.

Core CPI year-on-year (y/y) continued its downward trend, hitting 3.4% in May compared to the expected 3.5% and down from 3.6% previously. The Fed's preferred inflation gauge, PCE, matched expectations at 0.0% month-on-month (m/m) and 2.6% y/y. Although the trend is heading in the right direction, average earnings are still not conducive to 2% inflation, with recent data showing average earnings growth of 4.1% – higher than the expected 3.9% and up from the previous figure of 4.0%. Additionally, final GDP for Q1 2024 came in at 1.4%, above the anticipated 1.3%. Given the uneven progress on inflation and ongoing economic growth, it seems realistic to expect the Fed to maintain higher rates for a longer period.

The ECB cut rates in its June meeting from 4.00% to 3.75%, marking the first interest rate cut in five years. However, market reaction was muted due to the overall hawkish tone. ECB President Christine Lagarde noted that while the inflation outlook had improved significantly, inflation is likely to remain above the 2% target well into next year, with strong domestic price pressures and elevated wage growth. She stated that the ECB would keep rates "sufficiently restrictive for as long as necessary". Despite this stance, markets are anticipating another rate cut in September. GDP for the quarter was 0.3%, with year-on-year growth at 0.4%, driven by household consumption and increased exports.

The elections in the Euro region are seeing a common trend: a rise in far-right movements. Six EU countries – Italy, Finland, Slovakia, Hungary, Croatia, and the Czech Republic – already have far-right governments, and now the Netherlands can be added to the list. France has elections in July, with polls suggesting that the far-right Rassemblement National party may achieve a majority on its own.

The Bank of England (BoE) kept rates unchanged at 5.25% in June, signalling a potential reduction as soon as the next meeting in August. The Monetary Policy Committee noted that the labour market continues to loosen, with the unemployment rate rising to 4.4% compared to the expected 4.3%, though it remains relatively tight by historical standards. While CPI has hit the BoE's 2.0% y/y target, Core CPI remains strong at 3.5%, albeit trending towards the target. With GDP figures surprising to the upside by 0.1% each, at 0.7% m/m and 0.3% y/y, the BoE is cautious and prefers to wait for more data before starting a rate-

cutting cycle. On the political front, polls suggest that Labour is on track to win the upcoming General Election by a majority, potentially returning to power for the first time in 14 years. Labour's manifesto includes plans to increase taxes for non-doms, expand the windfall tax on energy companies, and impose VAT on private school fees.

Japan narrowly avoided a technical recession for H2 2023, after Q4's GDP figure was revised from -0.1% to 0.0%. However, it is not out of the woods yet, as Q1's GDP showed a q/q decline of -0.5%. Inflation continues to strengthen, with Core CPI at 2.5% y/y (up from 2.2%) and CPI at 2.8% y/y (up from 2.5%). Unemployment remained flat in May at 2.6%. This year's Shunto wage talks resulted in an average pay rise of 5.2%. Despite the Bank of Japan (BoJ) raising rates to 0.0–0.1% earlier this year, the yen continues to struggle against other currencies. The BoJ has refrained from market intervention but is closely monitoring the currency.

Elsewhere, China's woes continue. In May, the government announced a RMB 300bn (c. £32bn) fund to support government purchases of unsold housing, which was expected to help the sluggish real estate market. However, with RMB 30 trillion of unsold housing inventory, this injection was just a drop in the ocean of China's housing stock. Inflation remains low, with CPI at 0.3% y/y. Exports are strong at 7.6% y/y growth (6.0% expected), up from 1.5% the previous month, while imports fell to 1.8% y/y (4.2% expected), down from 8.4%. Additionally, potential tariffs on Chinese goods heading to the US could worsen the situation, depending on the Presidential election outcome in November.

We remain cautiously optimistic about global inflation progress and the outlook for rate cuts. However, we are mindful of geopolitical uncertainty and the potential volatility it may cause, and we remain vigilant regarding the risks.

Sterling-denominated returns of major indices	10Yr (p.a.)	5Yr (p.a.)	1Yr	Q2 2024
	%	%	%	%
Fixed Interest				
Overseas Bonds (unhedged)	2.6	-2.2	1.4	-1.1
Index-Linked Gilts	1.1	-6.4	-0.7	-2.3
Corporate Bonds	2.3	-0.8	9.7	-0.1
Equities				
UK	5.6	5.2	13.2	3.4
World (ex-UK)	13.0	12.2	21.2	2.5
Emerging Markets	5.9	3.2	13.2	4.9
Property	1.8	-0.3	12.2	-0.3
Commodities	1.7	7.4	5.6	2.8
Infrastructure	4.9	-0.3	4.5	6.0
ARC Sterling Balanced Asset	3.7	3.0	9.2	1.3
ARC Sterling Steady Growth	5.0	4.0	10.9	1.6
ARC Sterling Equity Risk	6.0	5.0	12.4	1.9
MSCI PIMFA Income	5.8	4.3	12.9	1.3
MSCI PIMFA Balanced	6.6	5.2	14.0	1.7

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Cash	1.2	1.9	5.2	1.3

Source: MSCI UK IMI, World Ex-UK, Emerging Markets; ICE BofA Global Broad Market+, Bloomberg UK Government Inflation-Linked Bond, ICE BofA Sterling Non-Gilts; UK IMI Liquid Real Estate; Bloomberg Commodity Index (GBP Hedged); IT Infrastructure; Asset Risk Consultants (preliminary data); MSCI PIMFA; Cash Equivalent (Bank of England Base Rate). Total Return, Sterling adjusted. Figures over 1 year are annualised.

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