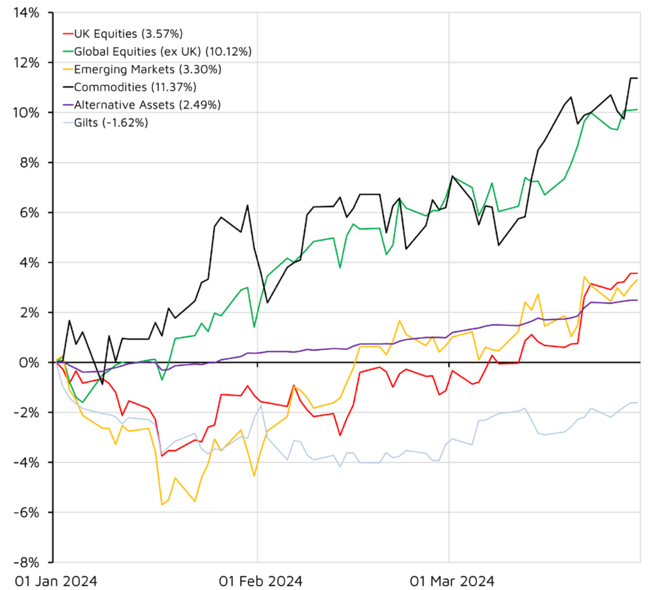
HARTLEY ROSS

SPRING OUTLOOK

REVIEW OF THE PAST QUARTER:

Inflation has continued to fall since the start of the year. However, the decline has been patchy and this, combined with relatively strong economic growth in the US and strong wage growth on both sides of the Atlantic, has caused markets to reassess their expectations for interest rate cuts. Central banks are still widely expected to cut rates, but the timing of the first rate cut and the expected magnitude of the rate cuts have been revised down.

This caused bonds to give back some of gains from the final quarter of 2023, particularly as central banks have pushed back against expectations of early rate-cuts. High interest rates mean holdings in cash continue to produce the strongest returns seen in this asset class for some time. UK and emerging-market equities struggled initially as weak economic growth in both regions and concerns about China's moribund property market and weak consumer confidence weighed on sentiment. However, Improving inflation in the UK and signs of economic growth in China have helped markets rise through March. In contrast, US, European and Japanese equities have continued to rise strongly. The US economy remains robust, helped by strong consumer spending, and high growth technology companies have mostly met ambitious forecasts for earnings growth. In Japan, modest wage growth has helped sustain the rally in equities as higher wages are likely to help sustain economic growth. European equities have also performed well despite weak economic growth.



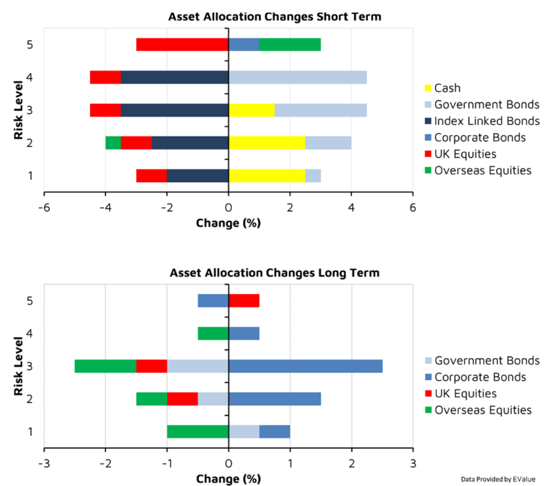
ASSET CLASS RETURNS

Cash	Government Bonds	Index Linked Bonds	Corporate Bonds	UK Equities	Overseas Equities	Emerging Markets	Alternative Assets
+1.08%	-1.62%	-1.81%	+0.02%	+3.57%	+10.12%	+3.30%	+2.49%

THE ACTUARIAL VIEW:

The decline of inflation increases the chances of rate cuts, as signs of cooling jobs markets, slowing wage inflation and weak economic growth erode arguments in favour of keeping interest rates high. However, relatively robust economic growth in the US mean investors now see the first rate cut coming a bit later than some were predicting only recently.

The high chance of rate cuts and the declining chance of a severe recession have changed the outlook. Falling interest rates means the positive environment for cash is likely to deteriorate; however, this may be more modest than had been expected. Falling rates should help bond values, but potential for gains may be more limited if inflation moves back to target with little negative impact on growth. The outlook for Japanese, US and European equities remains positive. The Japanese economy continues to recover and modest inflation is beginning to bed in. Many US stocks have met ambitious targets for earnings growth. European economic growth is likely to remain weak, but lower energy prices will offer some support. The UK is still something of an outlier as the poor economic outlook and slightly more resilient inflation means the outlook is still more negative than its peers.



WHAT TO LOOK FOR:

- **UK:** The Monetary Policy Committee (MPC) announcements and minutes are set to be released on 9 May. The inflation update for March is to be released on 17 April. Preliminary GDP growth for Q1 is available on 10 May. Employment data is set to be published on 16 April.
- **US:** The interest rate decision from the Federal Open Market Committee (FOMC) is on 1 May. Minutes are published three weeks after each decision. The initial estimate for GDP growth for Q1 is to be released on 25 April. Change in Nonfarm Payrolls is expected to be available on 5 April. Inflation data from March is to be released on 1 April.
- **Eurozone:** March inflation data is to be released on 3 April. The initial estimate for first quarter GDP growth is set to published on 30 April. A European Central Bank monetary policy meeting has been arranged for 11 April. The unemployment rate is set to be published on 10 April.
- **Other Data:** Caixin China PMIs are set to be published on 3 April. Chinese inflation data is set to be released on 11 May. The Chinese interest rate decision is due on 20 May.

ASSET CLASS SCENARIOS:

UK EQUITY

Most Likely: Inflation falls as the Bank of England holds rates. The outlook remains gloomy with little economic growth. Consumer sentiment remains low and manufacturing output contracts, but small and mid-sized companies perform better than large companies. Consumer-facing businesses suffer more than less-exposed peers. Global markets are volatile as investors see if a 'soft landing' will materialise.
Worst Case: Wars in Ukraine and Gaza cause energy bills to rise – fuelling a reignition of inflation. Aggressive interest rate rises and rapid reduction in central bank balance sheets, particularly the US, pushes markets into a deep recession and stocks and bonds plummet. This culminates in the collapse of an unexpected area of the market and a run on the wider market. The UK should be more defensive than other regions due to lower relative valuations.
Best Case: Inflation returns to target without a significant rise in unemployment and drop in GDP. UK equities rebound strongly as the economy returns to sustained growth. An end to war in Ukraine and Gaza cools energy, food and commodity prices, further reducing inflation. Flows into UK equities turn positive as sentiment improves and smaller companies stand to benefit the most from sustained positive performance.

GLOBAL EQUITY

Most likely: Inflation falls as markets see June as the likely date of the first Federal Reserve cut. Energy prices remain high due to geo-political tensions, and supply restraint by OPEC. The US rally broadens as the next AI winners become clearer. In Europe, economic gloom fades combined with optimism of significant rate cuts. Wage growth and steady inflation in Japan could lead to a strong rerating in various cyclical sectors.
Worst case: The war in Gaza escalates and political inaction in the US hampers the Ukrainian war effort raising the prospect of Russian incursions further into Europe. Supply shortages push up energy and food prices as central banks hike rates to avoid stagflation. Energy and defensive sectors are the best place to hide.
Best case: An end to war in Ukraine and a ceasefire in Gaza allows commodities to flow more freely as increased supply from North America and Brazil brings down the oil price. The Chinese economy rebounds as it tackles problems in its real estate market. Moderate inflation allows central banks to cut interest rates, buoying global markets and helping generate a global bull market.

EMERGING MARKET EQUITY

Most Likely: China announces measures to boost domestic demand but consumers remain cautious as growth remains weak as the property market struggles. Any rate cut by the Federal Reserve will be favourable for emerging markets. Attitudes to China remain polarised as some investors are attracted by very low valuations, but others steer clear due to concerns about the property market and potential for political interference.
Worst Case: Attempts to restore Chinese investor and consumer confidence are unsuccessful. China's property market deteriorates, further diminishing investor sentiment. Inflation in developed markets remains sticky, reducing global demand for Chinese exports and posing a negative effect on emerging market currencies. Heightened geopolitical tensions may escalate in a Chinese invasion of Taiwan, however the probability of this is relatively low.
Best Case: China announces further measures to tackle deflation, capital outflows, highly indebted property sector and reduce high youth unemployment. US-China tensions ease and a cut in US rates is favourable for emerging markets. Indian growth accelerates, fuelled by foreign direct investment. Taiwan and South Korea attract inflows on the back of AI-related tech optimism.

Data Sourced from FE Analytics and MSCI

CASH

Most likely: Money market instruments continue to provide high yields, with the Bank of England waiting until at least June before delivering the first interest rate cut as it waits for a clearer picture of where growth and inflation are heading.
Worst case: If economic indicators show a meaningful growth slowdown, the Bank of England may begin to move aggressively on interest rate cuts, reducing the interest paid by money market funds and increasing the attractiveness of government bonds. Cash instruments will therefore be a less compelling option for investors.
Best case: Money market instruments continue to provide high yields as the Bank of England leaves rates unchanged in the face of a resilient economy. Returns adjusted for inflation improve as inflation falls.

FIXED INCOME

Most likely: Central banks continue to watch inflation closely and the Federal Reserve is likely to hold rates for now. The growth outlook is weaker for the UK and Eurozone and earlier rate cuts are more likely. Providing no major shocks, investors see negligible risk of a hard recession. High-quality corporate bonds perform best as government bond valuations remain sentiment-driven.
Worst Case: US inflation remains elevated, leaving additional Fed hikes a possibility. 'Higher for longer' interest rates make it harder for companies to refinance their borrowing, weakening balance sheets. A 'stagflation' period for markets becomes apparent as bond prices and yields struggle. Premium paid by corporate borrowers rise in the face of sagging global demand. Defaults increase, and investors are likely to suffer capital losses in riskier markets.
Best case: Central banks cut rates in the second quarter as inflation falls towards target. Markets shrug off the chance of serious recessions. Government bond yields fall as positive growth continues, and returns are positive. Investment grade corporate bonds and more speculative 'high yield' bonds benefit from sentiment and are not required to offer much additional premium to remain popular as defaults stay low.

ALTERNATIVE ASSETS

Most likely: The outlook for traditional asset classes is improved as growth remains solid in the US and central banks are expected to signal imminent rate cuts. Listed real assets such as REITs and gold miners – whose stock performance has struggled since 2022 due to the rapid rise in interest rates – now have a broadly positive outlook. In terms of alpha strategies that use manager skill to outperform, styles which can benefit from rising asset prices while not being significantly hit should there be a correction, such as global macro and equity long short, may be poised to benefit.
Worst case: More benign conditions where equity markets rally, led by large US technology stocks, would likely lead to relative underperformance of listed real assets and most alpha strategies.
Best case: Solid fundamentals allow most real asset sectors to perform well, while increased market dispersion provides profitable trading opportunities for managers of alpha strategies.

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