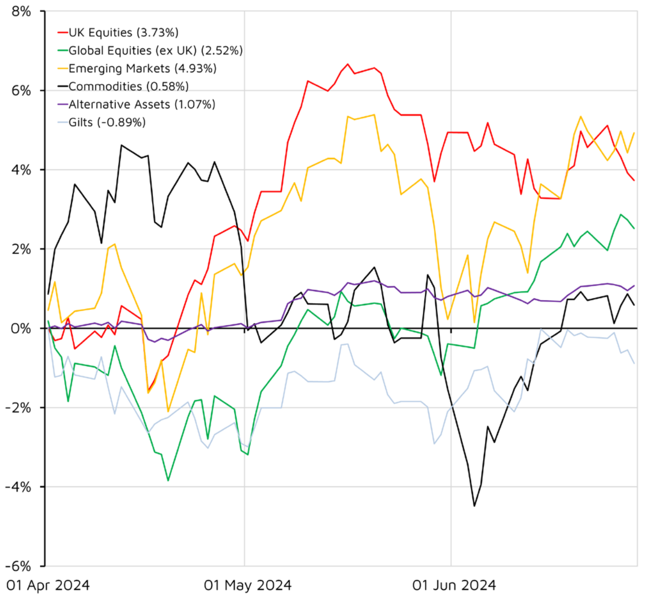
![Hartley Ross]

# SUMMER OUTLOOK

## REVIEW OF THE PAST QUARTER:

Global equity markets have continued their strong run, powered by growth in the US. Most of the companies in the S&P 500 exceeded their earnings targets in the second quarter as economic growth and consumer demand remain robust. Investor interest in artificial intelligence (AI) that helped giant US tech stocks to record further big gains as Nvidia, Alphabet, Meta and Microsoft were joined by Apple and some of the smaller semiconductor stocks in the AI rally. UK stocks have produced substantial gains as a combination of slowing growth and rising commodity prices lifted share prices. Emerging markets benefited from demand for Indian equities as investors seek exposure to strong economic growth there. Economic news from China has been mixed but an increase in consumer demand and in manufacturing helped boost Chinese stocks. European equities initially performed well, but the uncertainty caused by a strong showing by far-right parties in the elections to the European parliament caused markets to fall after a snap general election was called in France. Japanese stocks declined and this was compounded by the decline of the yen against UK sterling.

Fixed-income markets experienced more volatility. Sticky inflation meant any expectations of early interest rates cuts were dashed and forecasts had to be revised as several central banks warned that rates may have to be kept high. However, the European Central Bank and the Bank of Canada both cut rates in June and slowing economic activity in the UK and US helped UK government and corporate bonds to rally towards the end of the quarter.




Performance Data Calculated on a Total Return Basis

## ASSET CLASS RETURNS

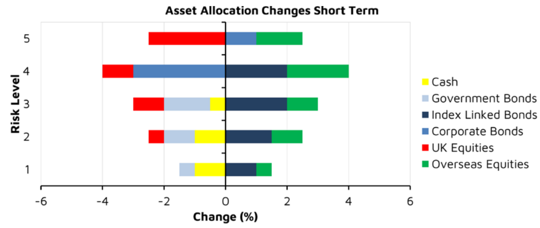
| Cash | Government Bonds | Index Linked Bonds | Corporate Bonds | UK Equities | Overseas Equities | Emerging Mar-kets | Alternative Assets |
|---|---|---|---|---|---|---|---|
| +1.19% | -0.89% | -2.09% | -0.09% | +3.73% | +2.52% | +4.93% | +1.07% |

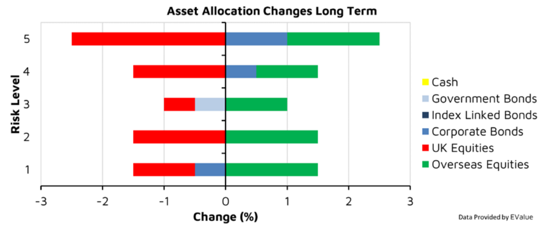
## THE ACTUARIAL VIEW:

Inflation continues to slow in the UK and Europe, and has resumed its downward trend in the US, but progress has not been as swift as hoped and there is a greater chance that interest rates remain high for longer than expected.

Higher long-term interest rates improves the outlook for gilts due to higher yields and the potential for capital gains if rates fall. Corporate bonds benefit from the same forces as gilts but tightening spreads have slightly trimmed the positive outlook. Any delay to rate cuts helps the outlook for cash. Even so, economic growth remains weak, so this movement does not reflect an obvious long-term trend.

The outlook for equities has improved. The US has performed wll and a strong economy and hopes for AI companies keep the outlook healthy. In Europe, rising hopes of recovery and attractive valuations supported a strong first quarter but didn't leave much more in the tank. The UK economy is showing signs of improvement but the long-term picture is less positive than other developed markets. Emerging markets have received mixed economic updates but sentiment remains positive.




Data Provided by EValue

## WHAT TO LOOK FOR IN THE NEXT QUARTER:

- **UK:** General election on 4 July. The Bank of England's Monetary Policy Committee decision and minutes are set to be released on 1 August. Inflation update for June to be released on 17 July. Preliminary GDP growth for Q1 is available on 15 August. Employment data for June set to be published on 13 August.
- **US:** The interest rate decision from the US Federal Reserve on 31 July. Minutes will be published three weeks after each decision. Initial estimate for GDP growth for Q2 to be released on 25 July. Change in Nonfarm Payrolls and unemployment rate for June expected to be available on 5 July. Inflation data from June to be released on 11 July.
- **Eurozone:** June inflation data to be released on 2 July. Initial estimate for second quarter GDP growth is set to published on 30 July. A European Central Bank monetary policy interest rate decision due on 18 July. Unemployment rate set to be published on 10 April.
- **Other Data:** Chinese GDP growth for Q2 and monthly industrial production data due on 15 July. Chinese inflation data for June set to be released on 10 July. Japanese inflation rate for June published on 19 July. Bank of Japan interest rate decision due on 31 July.

# ASSET CLASS SCENARIOS:

## UK EQUITY

**Most Likely:** Inflation continues to grind down, although it could bounce back in the second half of the year. The economy shows tentative signs of improvement but significant headwinds remain. With rate cuts likely, interest-rate sensitive parts of the market like housebuilders and technology should benefit. Overall, global markets remain volatile and growth suppressed as geopolitical tensions remain elevated.

**Worst case:** War in Ukraine and Gaza cause energy bills to rise – fuelling a re-ignition of inflation. The aggressive interest rate rises pushes markets into a deep recession and sends stocks and bonds plummeting. 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 from relatively low valuations as the economy returns to sustained growth. An end to war in Ukraine and Gaza helps further reduce 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 slows as markets look to rate cuts in 2024. Energy prices remain volatile as high interest rates begin to feed through into the real US economy and investors assess the impacts of AI. In Europe, the gloom begins to fade, with rising optimism of a recovery and the prospect of significant rate cuts if inflation remains grounded.

**Worst case:** The war in Gaza spreads, potentially drawing in global superpowers. Meanwhile, the limited manpower of Ukraine hampers its war effort, allowing Russia to make meaningful territorial gains. Global supply shortages return and energy and food prices hit new highs to push inflation back up. Central banks are forced to hike interest rates further as they fight another stagflationary period.

**Best case:** War in Ukraine ends creating optimism that commodity supplies will begin to flow more freely and a ceasefire in Gaza calms tensions, at least in the short term. The Chinese economy rebounds, while issues in its real estate market are offset by greater support and stimulus, providing a boost to the global economy and markets. Inflation slows allowing central banks more room to cut interest rates.

## EMERGING MARKET EQUITY

**Most Likely:** China's gradual recovery becomes more evenly spread. The People's Bank of China announces measures to boost domestic demand but more forceful stimulus is needed to revive growth. China's troubled property sector starts to stabilise but could still drag heavily on overall growth. A rate cut by the Federal Reserve is widely expected and will be favourable for emerging markets.

**Worst Case:** China's economic recovery remains patchy and attempts to calm investors' nerves and restore consumer confidence are unsuccessful. China's property sectors deteriorate, hurting investor sentiment. High inflation in developed markets reduces demand for Chinese exports and provides a headwind for EM currencies.

**Best Case:** China's economic recovery broadens is combined with further support for its highly indebted property sector. US-China tensions ease which should boost investor sentiment. Indian growth continues to accelerate, fuelled by foreign direct investment. Taiwan and South Korea, both tech-heavy markets continue to attract foreign inflows on the back of AI related tech optimism.

## CASH

**Most Likely:** Money market instruments continue to provide high yields, with the Bank of England waiting until at least September 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 the economy is slowing down, 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:** The Bank of England follows the European Central Bank's lead by cutting interest rates. Weaker growth supports the case for earlier cuts in the UK and Europe, while the US Federal Reserve holds rates. High quality credit performs well, with potential for significant recovery in government bonds if the Bank Of England cuts rates.

**Worst Case:** Inflation rises unexpectedly, and rate cuts in Europe and the US will be delayed. 'Higher for longer' interest rates impact companies struggling to refinance, as higher mortgage rates create a drag on consumer spending. A 'stagflation' period for markets becomes apparent as bond prices decline. Defaults increase sharply, and investors suffer capital losses in riskier and emerging markets.

**Best case:** The UK follows the European Central Bank with staggered 'cut and hold' rate adjustments, as inflation moves towards target. Government bond yields fall as weak growth continues. Corporate bond defaults remain at long-term average levels, and risk adjusted returns are considered attractive. Company profit margins remain stable, and a 'soft landing' is a reality.

## ALTERNATIVES ASSETS

**Most Likely:** The outlook for traditional asset classes improves as US economic data remains solid and central banks are expected to signal imminent rate cuts. Listed real assets such as real estate investment trusts and gold miners – whose stock performance has been negatively impacted since 2022 by the rapid rise in interest rates – now have a broadly positive outlook. In terms of alpha strategies that use manager skill to outperform, styles that can benefit from rising asset prices while not being significantly hit should there be a correction may be poised to benefit. These strategies include global macro and equity long short.

**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.

Data Sourced from FE Analytics, and MSCI Barra