Ravenscroft

COMMENTARY

1st October to 31st December 2023

For professionals and intermediaries

Pivot *verb* /ˈpɪvət/: [intransitive] (business) to change direction; to change the way in which something is done.

Even with the benefit of hindsight, it's difficult to pinpoint precisely what caused the consensus view on central bank policy rates to pivot from "higher for longer" to "cuts are coming". We do know, however, the shift that, to quote the Dinah Washington classic, *brought the sun and the flowers where there used to be rain*, began on Monday October 23rd. We also know that this resulted in bond markets' strongest month for 15 years, the biggest month-on-month equity gains since the announcement of the first Covid vaccine and the Dollar's weakest calendar quarter for a year.

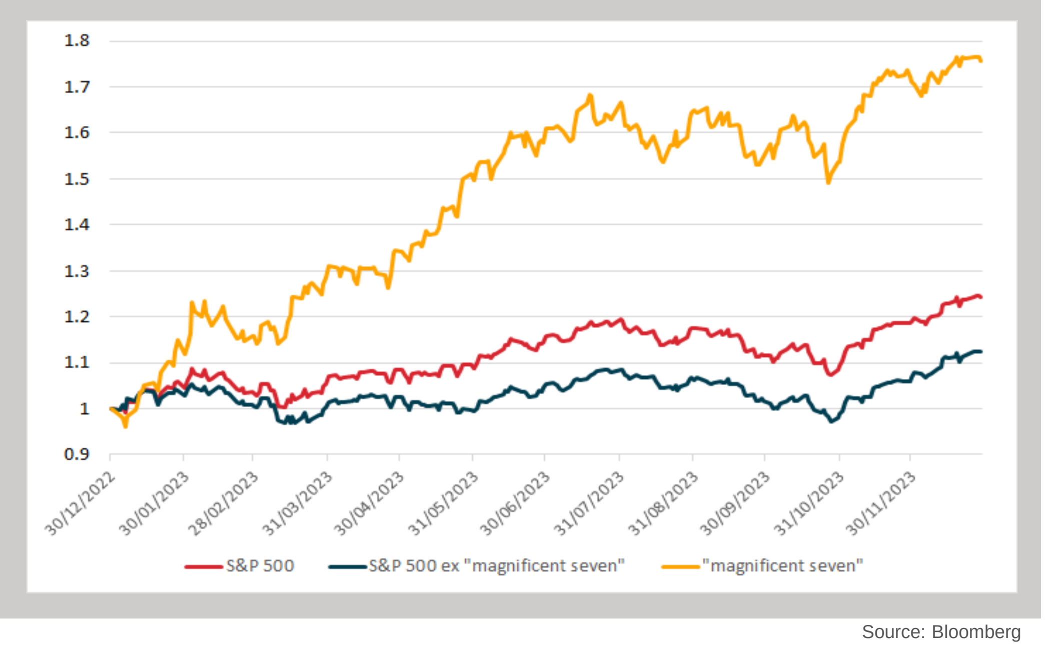
EQUITIES

Equity Market Indices

Index	Q4-2023	YTD
MSCI World ($)	+ 11.07%	+ 21.77%
MSCI World (€)	+ 6.19%	+ 17.88%
MSCI World (£)	+ 6.23%	+ 15.42%
MSCI World (local ccy)	+ 9.50%	+ 21.11%
S&P 500 ($)	+ 11.24%	+ 24.23%
FTSE UK All Share (£)	+ 2.54%	+ 3.85%
MSCI Europe Ex-UK (€)	+ 7.47%	+ 14.89%
Japan Topix (¥)	+ 1.85%	+ 25.09%
MSCI Asia Ex-Japan ($)	+ 6.12%	+ 3.60%
MSCI Emerging Markets ($)	+ 7.45%	+ 7.04%
MSCI Emerging Markets (€)	+ 2.73%	+ 3.63%
MSCI Emerging Markets (£)	+ 2.76%	+ 1.47%

While perhaps not quite brave enough to commit the thought to print, we have been speculating for some time in our internal discussions that, although the prevailing pessimistic views on the level of interest rates and likelihood of recession seemed hard-wired into the collective psyche, markets were only one favourable data point or central bank comment away from a change in outlook. Equity benchmarks may have ended October in negative territory, but the shift in momentum described above was already underway. By the end of November, there were signs that investors' attention had begun to shift from a small number of US mega-cap growth companies – the "magnificent seven" - that were responsible for most of global indices' (and all of the S&P 500's (Fig. 1)) prior gains to a broader opportunity set. This continued until the year-end, at which point the MSCI World Index (local currency) had closed within 0.60% of its January 2022 all-time high.

Fig 1. S&P 500 vs "magnificent seven" & excluding "magnificent seven"



Source: Bloomberg

The impetus for the initial stages of the markets' rally was a series of data releases that pointed to a progressively more benign US economic backdrop, the trend in which continued as the quarter unfolded. The most significant of these were signs of an easing in the previously tight labour market conditions and a drop in inflation rates – the prior levels in which had been seen as key obstacles to the Federal Reserve ("Fed") ending its hawkish monetary stance. Sure enough, although its policy rate remained unchanged, there followed what was interpreted as being a softening in the narrative from multiple Fed officials, adding further to the bullish mood. By the quarter-end, a stable unemployment rate, slower pace of job creations and year-on-year headline / core inflation rates of 3.1% and 4.0%, in combination with improving Purchasing Manager Index (PMI) prints and robust Q3 GDP (Gross Domestic Product) growth of 4.9% had some commentators suggesting that a "no landing / goldilocks" economic scenario was upon us. Others, by contrast, continue to maintain that the lag effect means the full impact of last year's rapid rate rises has yet to take effect and a recession in the US is still the most likely outcome. You pays your money and you takes your choice……

With activity levels that are far less robust than those across the Atlantic (Q3 GDP was -0.1% and PMIs materially below 50) and year-on-year headline inflation falling from 4.3% to 2.9% (3.4% core), there are fewer reasons for policy rates in Europe to remain unchanged and the consensus view is that the ECB (European Central Bank) is the most likely first mover in the downward leg of this cycle. In this regard, the UK has the capacity to surprise: within the backdrop of prevailing pessimism that we have described previously, data has consistently exceeded forecasts, with inflation falling to 3.9% headline / 4.2% core and the latest composite PMI at 50.7 (Q3 GDP was -0.1%). In spite of this, the UK remains a notable laggard among major developed equity markets, and its valuation metrics an outlier, even after adjusting for the differences in underlying sector composition.

On the subject of valuations, a year-end multiple of 16.6 times twelve-month forward earnings puts the MSCI AC World Index unchanged versus the Q3 close and slap bang in line with the average at which it has traded over the past 25 years. Away from the US, which arguably merits its premium rating based on superior forecast earnings growth, most developed and emerging markets are valued at a discount to their historic averages and supported by the prospect of declining interest rates. Accordingly, we retain a positive outlook on the prospects for equities, albeit within a market environment that is likely to be characterised by bouts of volatility.

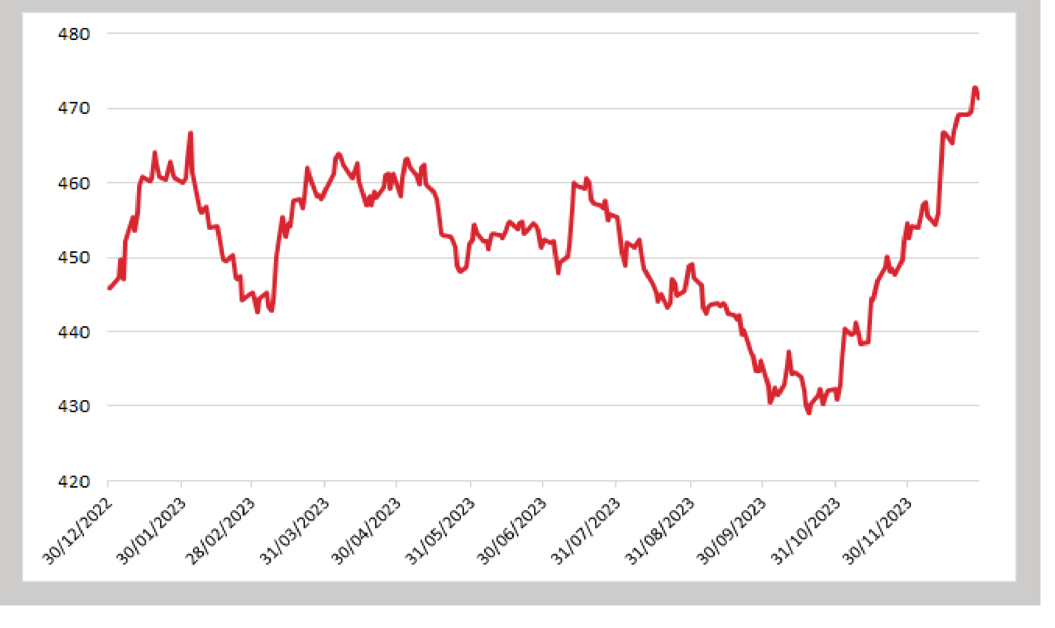
BONDS

Bond Market Indices

Index	Q4-2023	YTD
Bloomberg US Gov't >1yr ($)	+ 5.66%	+ 4.05%
Bloomberg German Gov't >1yr (€)	+ 6.43%	+ 5.57%
Bloomberg UK Gov't >1yr (£)	+ 8.57%	+ 3.56%
Bloomberg Global Aggregate ($)	+ 8.10%	+ 5.72%
Bloomberg US Aggregate ($)	+ 6.82%	+ 5.53%
Bloomberg Euro Aggregate (€)	+ 6.57%	+ 7.19%
Bloomberg Sterling Aggregate (£)	+ 8.24%	+ 4.96%
ICE BofA US Corporate ($)	+ 7.91%	+ 8.39%
ICE BofA Euro Corporate (€)	+ 5.54%	+ 8.01%
ICE BofA Sterling Corporate (£)	+ 8.47%	+ 9.83%
ICE BofA US High Yield ($)	+ 7.06%	+ 13.44%
ICE BofA Euro High Yield (€)	+ 5.55%	+ 12.00%
JPM EM Gov't Bond ($)	+ 9.26%	+ 10.45%

If Carlsberg did bonds......Measured by the Bloomberg Barclays Global Aggregate Index, the fixed income market recorded the best quarterly return since 2008, as the consensus view on the near-term outlook for central bank policy rates was flipped on its head (Fig. 2). The speed and extent the transition from "glass half empty" to "glass half full" was such that futures markets went from implying an even chance of one further hike, after which core sovereign rates would flat line for at least two calendar quarters, to pricing as many as seven 25basis points (bps) cuts by the end of 2024. The consequent strong rebound lifted broad (investment grade) market benchmarks back to levels last seen in early/mid 2022.

Fig.2 - Bloomberg Barclays Global Aggregate Index (local currency)

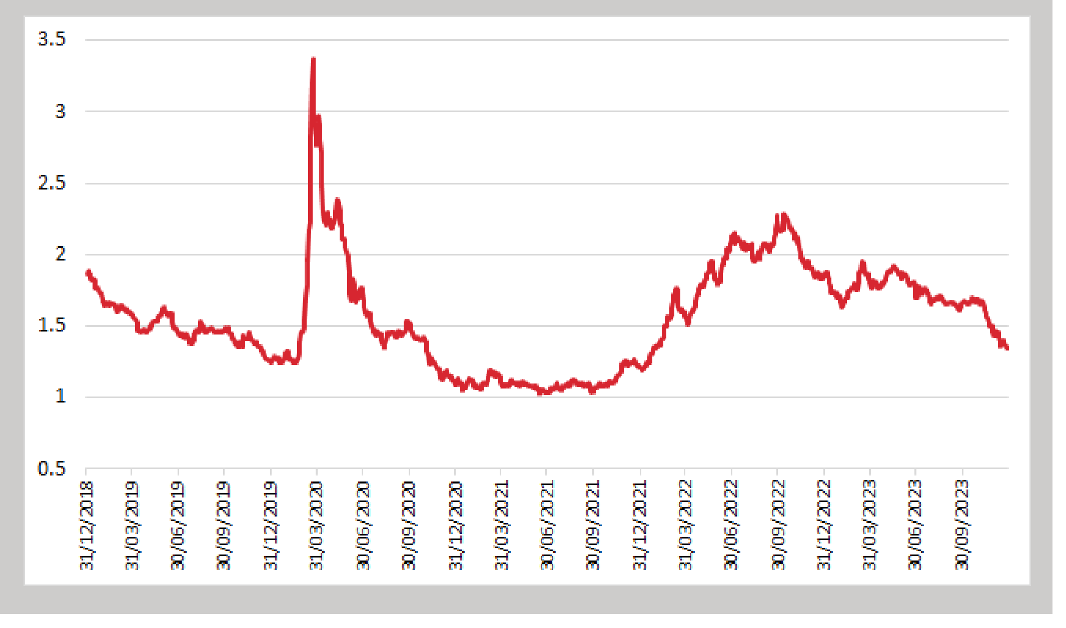


Source: Bloomberg

After a brief weaker opening, core sovereign bond yields rallied steadily from late October onwards, with yields falling across their respective maturity curves. In the US, the benchmark ten-year Treasury ended the quarter at 3.80%, down 69bps over the quarter and some 111bps below the intra-period high. German and UK yields fell even further: the ten-year Bund closed 90bps lower and the equivalent Gilt was down 103bps.

Thanks to a curious quirk of bond maths (it's a function of the indices' differing maturity profiles and resulting average duration), European and UK corporate benchmarks lagged their government counterparts, despite credit spreads having tightened across the ratings spectrum. As a result of the most recent movements, investment grade and high yield spreads have declined to the bottom end of their historic ranges (**Fig. 3**). Although these represent levels that would ordinarily be considered the wrong side of fair value and grounds for a degree of caution, there are important mitigating factors. Crucial among these is the quantum of the returns on offer, both in absolute and real terms, which we expect to become increasingly attractive to investors as cash yields and inflation rates subside. Equally significant are the fundamentals of borrowers within the corporate space (particularly in high yield), which, measured by metrics such as balance sheet leverage and interest cover, are unusually healthy by historic comparisons.

Fig.3 – US BBB Yield spread vs Treasuries



Source: Bloomberg

Although marginally less so following last quarter's strong gains, bond markets continue to offer a combination of income yield, potential capital appreciation and limited downside that, in our view, represents as compelling a proposition as has existed for a number of years. We remain confident that the blend of strategic, generalist and specialist managers through whom we are invested are well placed to make the most of this unusually attractive opportunity set.

CURRENCIES

A 4.56% decline in the Dollar over the quarter, as measured by the DXY Spot Index, was the US currency's weakest since Q4 of last year (2022) and a predictable reaction to the shift to risk-on conditions. Every one of the other 16 major currencies listed by Bloomberg appreciated in USD terms by at least 2.5%.

Having said that, one of the notable aspects of the quarter's FX movements was the strength in those that are also traditionally viewed as safe havens: the Swiss Franc (+8.78%) and Japanese Yen (+5.91%) were two of the three best performers versus the USD – the other being the Swedish Krone (+8.32%).

In the Yen's case, the closing mark of JPY/USD 141.04 represented a remarkable turnaround from the 20+ year low of ¥/$ 151.64 at which it traded earlier in the quarter (**Fig. 4**). The decline below ¥/$ 150 represented an important test of the Bank of Japan's (BoJ) resolve, it being the level that the central bank had previously signalled as being a "line in the sand" that it was prepared to defend by intervening in the open market. Rather than direct action on this occasion, hawkish comments from BoJ officials prompted speculation that it was preparing a further relaxation to the yield curve control policy through which it restricted government bond yields and this was enough to ensure a rebound in the currency.

Fig.4 – JPY vs USD

Source: Bloomberg

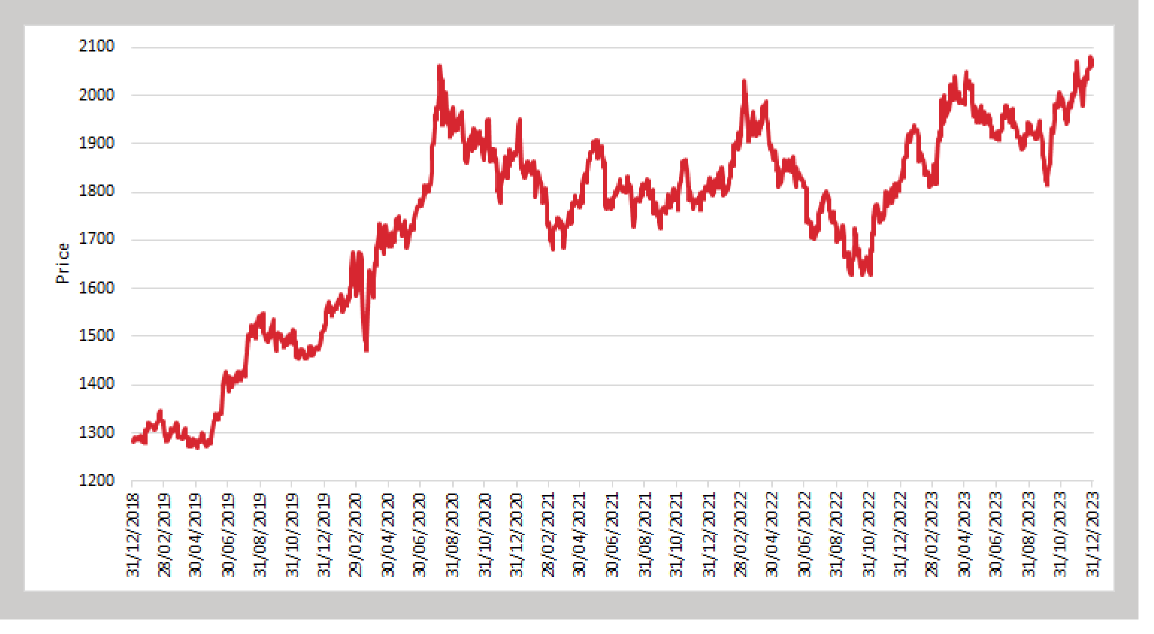
COMMODITIES

Broad commodity indicators were dragged lower by softer energy prices, leading to a reversal of all or most of the preceding quarter's gains: the Refinitiv CRB Commodity Index ended the period down 7.28% in USD terms. As is often the case, the range of individual commodity price movements that contributed to this headline index figure was a sizeable one. Coffee (+28.84%), Cocoa (+22.76%) and Wheat (+15.97%) led the list of gainers, while the largest detractors included Heating Oil (-24.06%), Sugar (-21.08%) and Lean Hogs (-15.24%).

Weakness in oil prices was a notable feature of the quarter: the trajectory of the front month future for a barrel of West Texas Intermediate copied that of sovereign bond yields and declined steadily from late October onwards to end the period down 19.33% at USD71.65 bbl. This sell-off took place despite forecasts of healthy global demand growth and the announcement of a further reduction in OPEC's (Organisation of the Petroleum Exporting Countries) quotas that will see its members' output reduced by 2.2million barrels in the present quarter and is largely explained by increased production from outside the cartel, specifically Russia and the US.

Gains in precious metals were another feature of the period. While the strength in the gold price (+6.73% to USD2,062.98 per troy ounce, via an all-time intra-quarter high of USD2,072.20, **Fig 5**) made sense when viewed through the lens of its negative correlation with the Dollar, it also jarred with another established inverse relationship with real yields. Given our view that the latter is likely to be the dominant driver of future price action, we took advantage of the metal's move to the top of its historic trading range to exit our remaining positions.

Fig.5 – Gold Spot USD per troy ounce



Source: Bloomberg

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January 2024, Figures source Bloomberg

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