Wealth Management US

Quarterly report

Q2 2024 market review

Forward-looking
for generations

Cover image
Bauer brothers, Hortus Botanicus, detail from "Lilium," 1776/1804

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Markets have fluctuated between anticipating one or two Federal Reserve rate cuts this year. However, due to persistent price pressures and a robust job market, the Fed is unlikely to rush to cut rates.

Sanjay Rijhsinghani, Chief Investment Officer

Summary: Q2 2024

Markets slowed the pace of expected rate cuts as inflation data provided mixed signals. Equity markets continued their climb towards all-time highs in the second quarter, driven by US technology companies and the ongoing exuberance surrounding artificial intelligence (AI). On the political front, the UK and France saw both leaders call snap elections, with the Labour Party securing a landslide victory and France facing gridlock as none of the three parties secured a majority. Although the European Central Bank (ECB) lowering interest rates in its June meeting was expected, it is noteworthy that interest rate cutting regimes are picking up pace with central banks in Sweden, Switzerland and Canada all cutting rates.

At a glance

- Labour secures landslide victory in the UK
- Equity markets push towards all-time highs
- Rate cutting cycle broadens out
- Inflation concerns gradually fade
- France election shows deadlock

Macro summary

Glacial pace

Markets have fluctuated between anticipating one or two Federal Reserve (Fed) rate cuts this year. However, due to price pressures and a robust job market, the Fed is unlikely to rush to cut rates. The glacial pace of expected cuts means timing remains uncertain. Meanwhile, the Bank of England (BoE) indicated in June it is more comfortable cutting rates and will likely start in August.

Regional differences will widen the gap between central banks. The Fed has significant influence, so it is likely central banks elsewhere will be more cautious and favour ambiguity over clear guidance.

The ECB had been signalling for months that it was due to cut interest rates amid declining inflation and a sluggish economy. In June, it followed through by cutting rates by 0.25% to 3.75%.

Although the ECB became the first major developed market central bank to lower rates, the number of future rate cuts remains uncertain. The ECB will rely on data and analyse the inflation outlook before proceeding with future cuts. Europe's economic recovery has been uneven, with southern European nations outperforming industrialised northern countries.

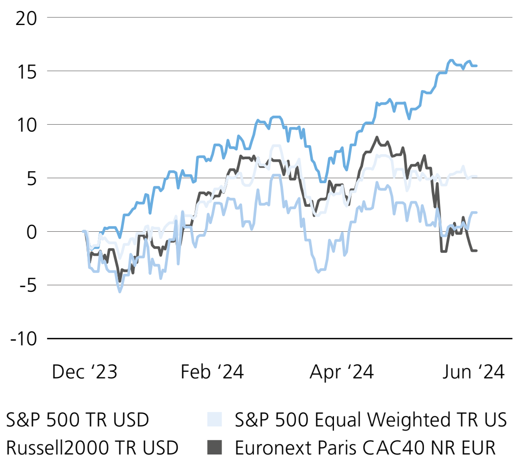
New records

Following an unexpected rise in April, the US Consumer Price Index (CPI) showed signs of moderation,[1] suggesting inflation is heading in the right direction. Bond yields followed suit, with 10-year Treasuries reaching 4.7% early in the quarter before falling to 4.4% by quarter-end.[2] Despite positive CPI developments, the Fed indicated markets should only expect one cut this year.

After a slight pullback in May, US equity markets continued to hit record highs, lifted by Nvidia, Apple and Microsoft, with Nvidia briefly overtaking Microsoft in June to become the world's most valuable company with a market capitalisation of USD 3.3 trillion.[3]

The narrowness of the markets was even more pronounced this quarter, as Nvidia rose 37% while the S&P 500 gained 4.3%. Nvidia is responsible for some 35% of the S&P 500's gains since the start of this year. Keeping with technology and AI-related themes, Apple and Microsoft also rose 23% and 6% respectively in the quarter, further boosting the S&P 500's returns. In comparison, the equal weighted S&P 500 Index fell 2.6% in the quarter, clearly indicating a handful of companies continue to drive the indices. We expect something to give in coming quarters as history tells us hot sectors should not be chased at any price, but we do believe there is a place for these companies, albeit in a well-diversified, high-quality portfolio comprising of different asset classes. The Small Cap Index, as measured by the Russell 2000, fell 3.3% over the quarter, further highlighting narrowness of markets.[4]

Equity Market Performance YTD (USD terms)



Source: Bloomberg

[1] Bureau for Labor Statistics
[2, 3, 4] Bloomberg

It's the season for snap elections

Rishi Sunak's decision to bring forward the UK general election to 4th July stunned market participants. Labour won the election by a landslide, but markets showed limited reaction to the news as polls predicted the Labour victory for months. Given fiscal headroom remains limited, policy changes are likely to be marginal. In the US, the first presidential debate brought forth fresh concerns over President Joe Biden's health. In early June, the European Parliamentary elections showed surging support for right-leaning parties, with President Emmanuel Macron calling a snap national election in France. The French CAC 40 fell over 6% following Macron's announcement and spreads on French and German bonds reached levels not seen since 2017.[5] In the first round of the French parliamentary election on 30th June, Marine Le Pen's National Rally party secured approximately 34% of the vote, but following the second round of elections on 7th July, France now faces a hung parliament after the left-wing block New Popular Front and President Emmanuel Macron's party received more votes than the National Rally, with all three parties having at least 100 seats below an absolute majority.

Cobble together a coalition

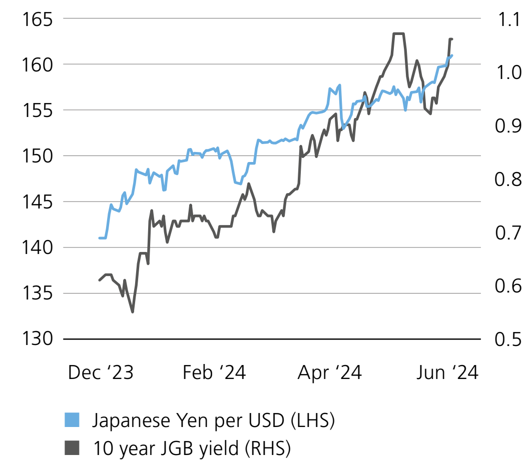
In India, Prime Minister Narendra Modi lost his outright majority for the first time in a decade, and will now focus on forming a coalition government, which means passing important reforms will likely be more challenging. In Mexico, Claudia Sheinbaum's landslide victory sent the peso and Mexican equities falling, as markets feared more extreme policies.[6]

[5] Bloomberg
[6] www.reuters.com/markets/currencies/mexico-peso-drops-nearly-3-sheinbaum-landslide-raises-reform-worry-2024-06-03/

Asia rally fizzles out

The Hang Seng Index's April rally quickly fizzled out, but it still finished the three-month period up 9%.[7] China unveiled wide-ranging measures to stimulate its ailing property market, but this is not expected to be sufficient to boost the economy materially.[8] The Shanghai Composite fell 1.3% over the quarter,[9] while Japan's equity market paused for breath. The Bank of Japan (BoJ)'s reluctance to take material action resulted in the yen falling 5.9% against the dollar in the quarter to reach the weakest level since 1986.[10] This puts further onus on the BoJ to raise rates sooner.

Yen/Dollar vs 10 year JGB Yield



Source: Bloomberg

Conclusion

As elections conclude and global governments take office and form post-election policies, this should help settle the tone and provide clarity around the evolving political landscape in the second half of the year. That said, the US election is not until November, so uncertainty will remain. In the post-pandemic world, markets are increasingly influenced by fiscal policies. Consequently, as money managers, we are increasingly attuned to political risks while constructing portfolios. We continue to monitor these developments closely, but our focus remains on quality companies able to withstand political turbulence and deliver solid returns over the medium to long-term.

> "As elections conclude and global governments take office and form post-election policies, this should help settle the tone and provide clarity around the evolving political landscape in the second half of the year.
>
> Sanjay Rijhsinghani, Chief Investment Officer

[7, 9, 10] Bloomberg
[8] edition.cnn.com/2024/06/17/business/china-property-price-record-slump-intl-hnk/index.html

Fixed income

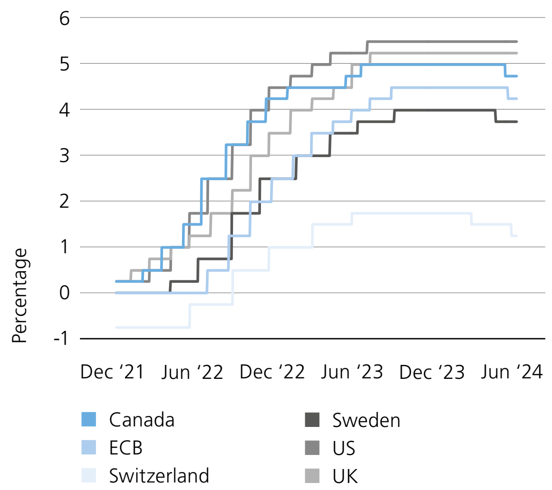
If the main theme last year was predicting where rates would peak, then the first half of 2024 saw investors re-assess when, and to what degree, rates will come down. The Fed wield an enormous amount of influence on central banks globally, so leadership on the rate cutting regime rests firmly with the US. As inflation concerns mounted in April, investors dialled back expectations of rate cuts from three 0.25% reductions to one or two cuts. On average, ten-year government bond yields nudged 0.2% higher over the quarter, as rate markets show signs of moving in tandem. Furthermore, the dollar index is up 4.5% so far this year, a trend that could continue should interest rate differentials between central banks widen materially.

ECB proceeds with cuts

Notwithstanding these concerns, the European Central Bank (ECB) pushed ahead and eased policy by 0.25% to 3.75% as widely expected. It had signalled in March that it intended to cut rates in June, subject to inflation falling in line with their expectation. While this rate cut had been so clearly telegraphed, the future path is more challenging. The economy is showing improved momentum after a challenging year but to maintain this trend, some further policy loosening is likely required.

However, the snap election in France has not only put pressure on French sovereign debt but has also raised the risk premium for other Eurozone bonds relative to German debt, applying further pressure on the euro. This development makes it more challenging for the ECB to commit to any further loosening. Over the quarter, Sweden and Canada cut rates once by a similar magnitude, while Switzerland became the first developed market central bank to lower its rates for the second time this year.

Central Bank Policy Rates



Source: Bloomberg

In the UK, the Bank of England (BoE) has started edging closer towards its cutting cycle as headline inflation fell to the target 2% for the first time in nearly three years. This would be a welcome development for the incoming Labour government, who will want to demonstrate that they can be trusted with the economy. However, with elevated core price pressure, particularly in services, the BoE will want to proceed slowly to ensure a sustainable path to 2% over the medium term. Favourable base effects are likely to fade, resulting in inflation projected to drift higher over the second half of the year.

> "The Federal Reserve wield an enormous amount of influence on central banks globally, so leadership on the rate cutting regime rests firmly with the US.
>
> Jeremy Sterngold, Deputy CIO and Head of Fixed Income

Fed may ease in September

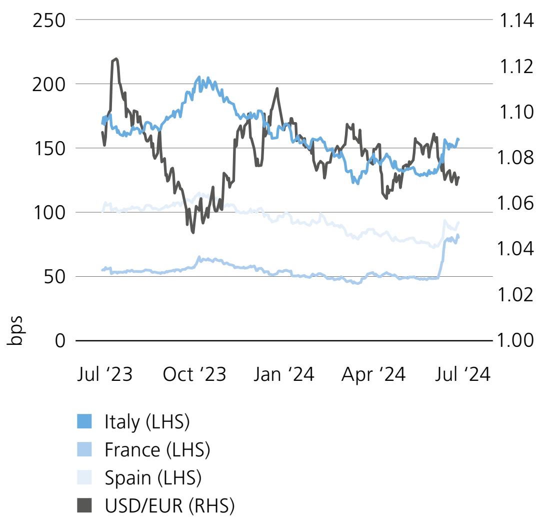
Recent data releases in the US have offered some optimism that the Fed will be able to cut rates later this year. Core PCE, the Fed's preferred inflation gauge, fell from 2.8% to 2.6% year-on-year during the quarter.[11] Various indicators of the labour market show signs it is coming into better balance with wage pressures abating. The quits rate, a measure that shows voluntary job departures, has declined to pre-pandemic norms, further reinforcing the view that companies are more cautious with wage negotiations. If these trends persist, the Fed may well decide to start easing policy in September.

Yen weakens

While rate cuts are considered elsewhere, Japan is headed in the opposite direction. After raising rates in March to 0.1%, moving away from a negative interest rate policy, it saw yen weakness persist. The Bank of Japan (BoJ) is under pressure to raise rates at swifter pace but has so far toed the line. After spending decades trying to produce inflation, the BoJ doesn't want to squash it down too forcefully. However, the yen has depreciated by over 12% versus the dollar this year, resulting in government approval ratings falling sharply.[12]

The corporate bond market remains supported, with overall yield driving investor flows in this space. Companies are actively extending maturities to improve their liquidity profiles and offering investors favourable terms to tender their bonds. However, the market was not immune to the effect of the French snap election. As sovereign spreads widened, it had a notable knock-on effect to businesses in Italy and France.

10 year spreads vs German 10 year vs USD/EUR



Source: Bloomberg

[11] Bureau of Economic Analysis
[12] Bloomberg

Equities

International Equities

In terms of equity performance, the second quarter was an amplified continuation of the first quarter of the year. Whilst it was not "only" about one company, it is equally true that one company dominated returns once again. The equity market rally broadened early in the quarter, but it was ultimately the artificial intelligence (AI) theme that drove US stock markets, with a very small cabal of stocks driving US equity returns.

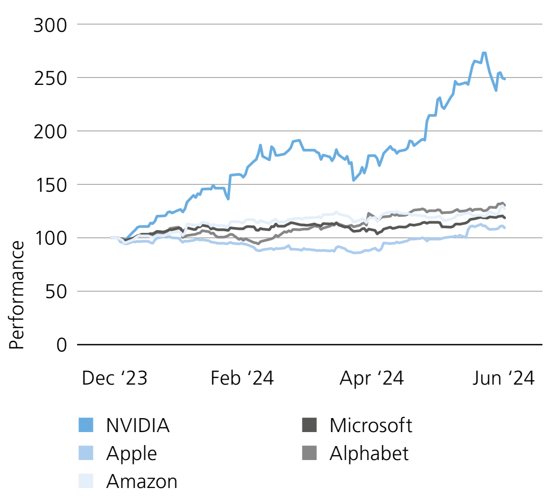
Nvidia, the designer of the chips at the heart of the frenzy of current AI investment, rose 37% during the second quarter, even after an 83% return in the first quarter. It added almost USD 800 billion to its market capitalisation in the second quarter, on top of the USD 1 trillion added in the first quarter. That's 11 HSBC's added in six months.[13]

Nvidia grabbed the headlines, but it wasn't all about the chip designer. Apple rose 22% and added USD 600 billion of market capitalisation, while Alphabet (Google) rose 21% and added USD 400 billion. Microsoft's 6% and Amazon's 7% gains, and a combined USD 300 billion of market cap over the quarter, would normally be excellent but paled by comparison.[14]

The market cap weighted S&P 500 rose 4% in the second quarter, but returns were concentrated, as evidenced by the equal-weighted index actually falling 3%. While the S&P IT Index rose 14%, only four other sectors posted gains over the quarter. One of those is the communication services sector, which includes Alphabet (and Meta/Facebook 4%). Energy fell 3%, financials 2%, healthcare 1%, industrials 3%, materials 5%, and real estate 3%. Apart from the AI cohort, the sectors performing well were the more defensive ones, such as utilities which increased by 4% and consumer staples which edged up 1%.[15] The more cyclical consumer discretionary sector was essentially flat.

[13, 14, 15, 16, 17] Bloomberg

Nvidia soars in 2024



Source: Bloomberg

Defensive sectors performing better mirrored trends seen around the world. China's two main indices (Shanghai and Shenzhen) both fell 2%, MSCI Europe was flat with Germany falling 1% and France down sharply 9% after President Emmanuel Macron called a snap election,[16] with polls indicating the far right and extreme left were set to squeeze the centrists for parliamentary seats.

In fact, almost the sole exception was Hong Kong's Hang Seng, which rose 7%, aided by Chinese tech behemoth Tencent rising 23%, though its price was only back to where it was fifteen months ago. Japan's Topix Index eked out a 1% return in local currency terms.[17]

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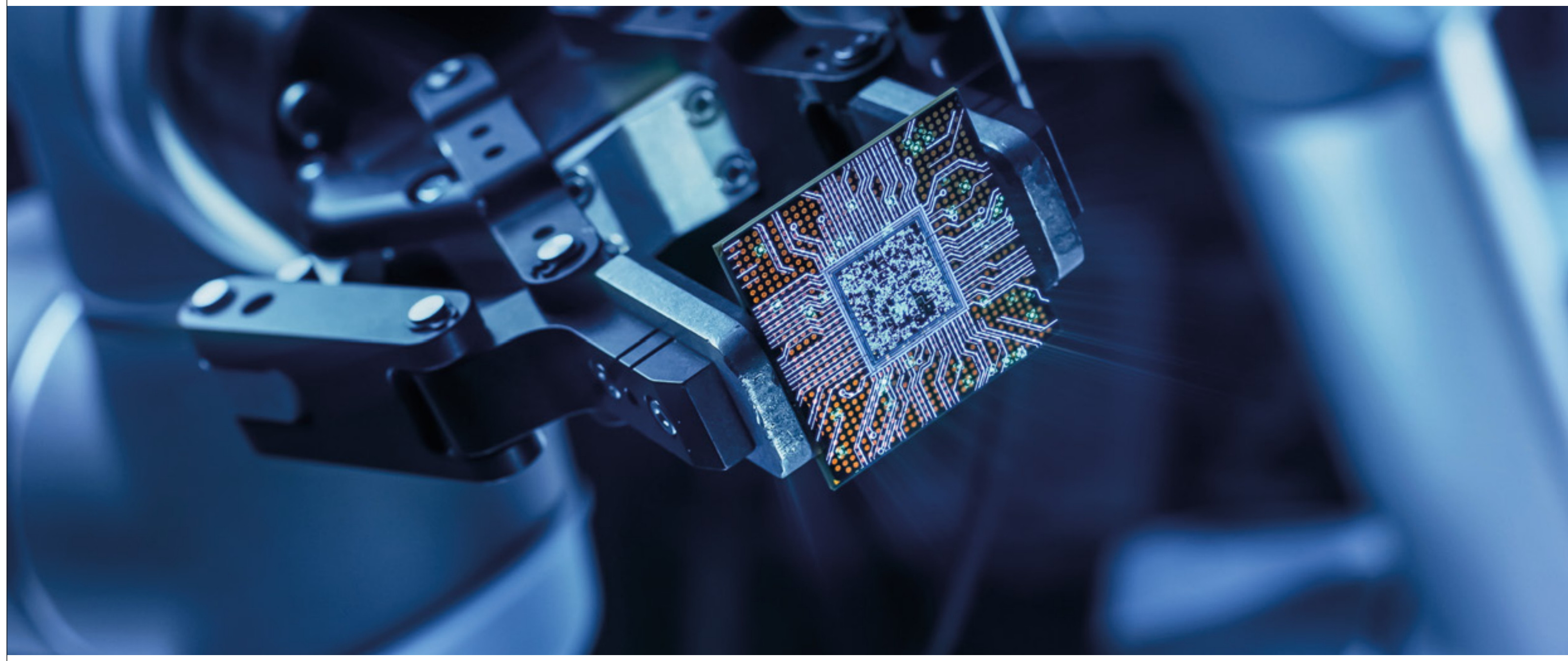
>
> Russell Harrop, Head of Equities



UK Equities

The FT All-Share Index rose 2.6% in the quarter, lifting year-to-date gains to 5.2%, or 7.4% including dividends. Corporate activity has been a notable highlight so far this year.

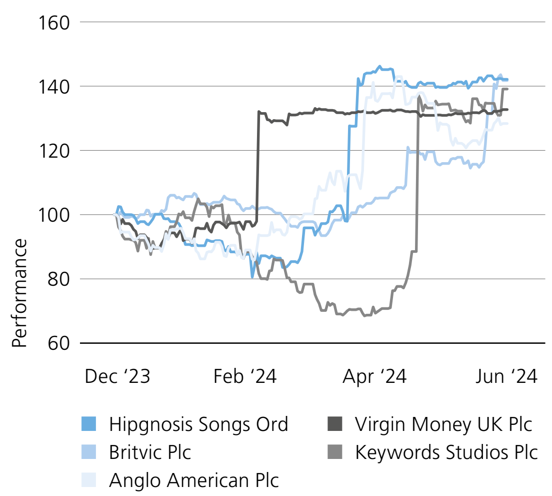
According to Peel Hunt data, there were 32 transactions above £100 million in value announced in the first half of 2024. This includes 17 approaches for larger FTSE 350 stocks, a noticeable increase on just two similarly sized bids last year.

Uptick in corporate activity

Wood Group, an engineering and support services business with a high degree of reliance on the oil and gas industry, received a series of offers from Middle Eastern rival Sidara, while Danish lager giant Carlsberg bid for the soft drinks business Britvic. Other companies receiving bids included Keyword Studios, which helps larger businesses develop computer games; logistics company Wincanton; music royalty business Hipgnosis; and International Distribution Services, the owner of Royal Mail. We also saw further consolidation within the UK banks, as Nationwide Building Society made an offer for Virgin Money, and the non-listed Coventry Building Society sought to take over the beleaguered Co-op Bank. Taking advantage of overseas interest in UK assets, the consumer goods company Haleon (the name behind Sensodyne toothpaste, Panadol headache tablets, and the Voltarol pain relief gel) also managed to sell Nicotinell, and other nicotine replacement therapy brands outside of the US to the Indian generic drugs company Dr Reddy's for £500 million. Offers for Direct Line, electrical retailer Currys, and chemicals group Elementis were rebuffed by their respective group boards, while BHP's bid for rival mining group Anglo American was withdrawn after its offer failed to secure much support.

Anglo helped ward off BHP's bid by unveiling their own turnaround plan involving the divestment of the diamond business De Beers, a metallurgical coal business, and several other subsidiaries.

UK bid activity YTD



Source: Bloomberg

Other highlights included new share buyback programmes from Legal & General and Prudential; a large rights issue from National Grid; and a well-received capital markets day (CMD) event by drugs giant Astra Zeneca. We see the merits of National Grid's unexpected fund raising as it will enable National Grid to accelerate new electricity transmission and distribution investment. This investment is welcome, not only because electricity demand is increasing quite materially. It will also help the UK's aspirations to lower carbon emissions and create value for shareholders as growth in the group's asset base will result in higher profits and dividends via the return mechanism allowed by regulatory bodies such as Ofgem.

"In the third quarter, we will also be watching to see if the shift in UK politics changes the investment landscape for UK-listed stocks. The last 14 years have resulted in five prime ministers and seven chancellors.

James Follows, Head of UK Equities

Ambitious targets

Pharmaceutical giant Astra Zeneca owns a world-class portfolio of oncology-related drugs. It also has a broad array of cardiovascular and respiratory products, and a division that specialises in rare diseases. Its recent CMD was the first such showcase event for ten years. At the 2014 event, the company aimed to reach $45 billion in sales by 2023, a target they met. At the most recent CMD, Astra issued a new target of $80 billion in sales by 2030 with sustained growth thereafter. The key to achieving this growth will be new drug development and additional applications for several of their best-selling products. We believe the group's aspirations are laudable but will be watching to see if late-stage trial results on potential new drugs support their goals.

In the third quarter, we will also be watching to see if the shift in UK politics changes the investment landscape for UK-listed stocks. The last 14 years have resulted in five prime ministers and seven chancellors. It is too early to say whether the next 14 years results in greater stability, and any material change in the way that the UK is regarded by international investors. However, we are hopeful the new government adopts pro-growth policies in areas such as housing, with new initiatives backed up by reform in areas such as planning approval and local government land usage. We look forward to commenting on this in future communications.

Key market data

Key market data (as at 30 June 2024)

Asset class	Level	1m %	3m %	6m %	1y %	3y %	5y %	YTD %
Equity indices (total return) *								
FTSE All-Share (GBP)	4452	-1.44	2.62	5.20	8.68	10.89	9.74	5.20
S&P 500 (USD)	5460	3.47	4.13	14.48	22.70	27.06	85.62	14.48
Euro Stoxx 50 (EUR)	4894	-1.80	-3.73	8.24	11.25	20.41	40.89	8.24
Nikkei 225 (JPY)	39583	2.85	-0.55	18.28	19.27	37.48	86.05	18.28
MSCI World (USD)	2770	2.35	3.45	13.72	21.89	29.37	84.75	13.72
MSCI AC Asia Pacific ex Japan (USD)	680	3.78	6.47	11.50	15.16	-3.01	32.49	11.50
MSCI Emerging Markets (USD)	67433	4.32	6.37	11.20	15.96	-3.61	33.85	11.20
10 year bond yields **								
UK	4.15	-0.17	0.44	0.61	-0.26	3.43	3.32	0.61
US	4.37	-0.12	0.38	0.49	0.56	2.92	2.37	0.49
Germany	2.47	-0.18	0.35	0.47	0.06	2.68	2.79	0.47
Japan	1.06	0.00	0.45	0.45	0.67	1.00	1.22	0.45
Commodities (USD)								
Gold	2327.70	0.95	4.08	12.86	21.13	30.58	64.19	12.86
Oil	86.41	5.87	-1.16	12.16	13.32	13.44	36.51	12.16
Currency								
GBP-USD	1.26	-0.71	0.62	-0.84	-0.57	-8.49	-0.68	-0.84
GBP-EUR	1.18	0.57	0.88	2.20	1.22	1.25	5.54	2.20
EUR-USD	1.07	-1.28	-0.25	-2.98	-1.76	-9.63	-5.89	-2.98
USD-JPY	160.86	2.36	6.07	14.10	11.29	44.93	49.30	14.10

Source: Bloomberg, ICE, London Stock Exchange, MSCI, Standard & Poor's, Stoxx Tokyo Stock Exchange

* Performance is given on total return indices, but the levels are for the main indices.
** Displayed as absolute changes in yields, rather than percentages.

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Apart from the AI cohort, the sectors performing well were the more defensive ones, such as utilities which increased by 4% and consumer staples which edged up 1%.

Russell Harrop, Head of Equities

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Quarterly report contributors

Sanjay Rijhsinghani, Chief Investment Officer
Jeremy Sterngold, Deputy Chief Investment Officer
Russell Harrop, Head of Equities
James Follows, Head of UK Equities

Media relations

Esther Clark
Phone +44 (0)203 207 8007, esther.clark@lgt.com

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LGT Wealth Management US Limited
14 Cornhill, London EC3V 3NR
Phone +44(0)20 3207 8000, info-us@lgt.com

www.lgtwm-us.com

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