Wealth
Management US

Quarterly report

Q3 2024 market review

Forward-looking
for generations

Cover image
Bauer brothers, Hortus Botanicus, detail from "Lilium," 1776/1804
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>
> Sanjay Rijhsinghani, Chief Investment Officer

Summary: Q3 2024

The summer months are always vulnerable to volatility, and this year was no different. Equity markets experienced a dip over concerns the US economy may be stalling and worries that the Federal Reserve (Fed) was too late to cut interest rates, exacerbated by a hawkish Bank of Japan (BoJ). The Fed decided to cut rates by 0.50%, becoming the latest central bank to lower rates, thereby bolstering investor confidence that a soft landing (a slowing down of economic growth without a recession) can be achieved. Overall, it was a positive quarter for equity and bond markets, with returns in equities more broad-based rather than concentrated on just a few large technology stocks.

At a glance

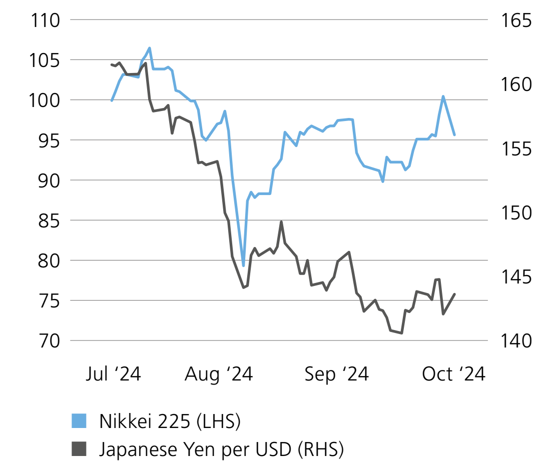
- Bank of Japan hike rattles markets
- The Fed goes bold with its first cut
- Growth fears overtake inflation
- Equity market rally broadens out
- Kamala Harris steps in for Joe Biden

Macro summary

Equities

While most of the S&P 500's gains in the first half of the year can attributed to just a handful of stocks, namely the Magnificent Seven, August proved the importance of diversification. As the BoJ raised rates for the second time this year, it indicated a more hawkish tone. This led to a sharp rally in the Japanese yen, resulting in a sharp global equity market sell-off, as investors reduced exposure to leveraged bets. Japanese equity markets suffered particularly with the Nikkei falling 12% on 5th August, finishing the quarter down 3.6%. However, as this sell-off had more to do with technical reasons and not fundamental causes, the market rebounded strongly from the lows of early August to hit new highs in recent weeks.

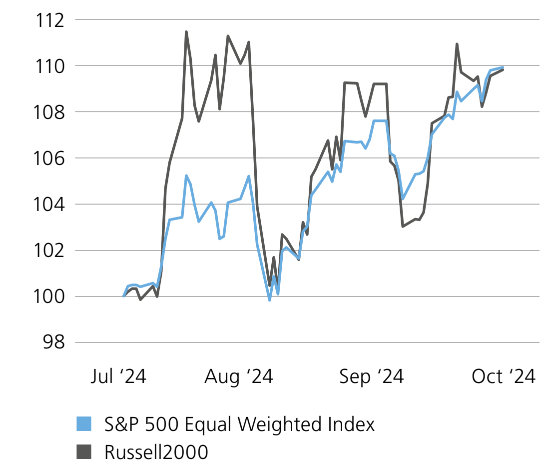
Yen vs Nikkei (Nikkei indexed to 100)



Source: Bloomberg

Despite growth concerns mounting, the S&P 500 finished the third quarter up 5.9%, compared with around 9% for both the S&P 500 Equal Weight and the Russell 2000 smaller caps index. Ten-year Treasury yields fell over 0.6% over the quarter, ending just below 3.8%.

Equal weight S&P vs Russell 2000 (indexed to 100)



Source: Bloomberg

Politics

An assassination attempt on Republican candidate Donald Trump in July seemed to swing momentum in his favour before tilting back towards Kamala Harris, who became the Democratic nominee once President Joe Biden stepped out of the race. Harris has garnered support, particularly after a strong performance against Trump in a debate in September. Nonetheless, the November election remains too close to call and will come down to a few crucial swing states.

Meanwhile in the UK, euphoria around Labour's landslide victory was short-lived. Prime Minister Keir Starmer and his cabinet claim a GBP 22 billion hole in public finances leaves them with no alternative but to raise taxes in the October budget.

Rate-cutting cycle starts

The central bank cutting regime picked up steam in the third quarter, with the Fed kick-starting its rate cutting cycle with a half-point reduction. There was equity market volatility leading up to the Fed's meeting, with expectations gyrating between a 0.25% or a 0.50% cut. The Fed's decision to go with the larger half-point reduction underlines their focus on the labour market as inflation concerns fade. The Fed's projections now indicate rates may fall by a total of 2% by December 2025, including September's reduction.

The Bank of England (BoE) also lowered interest rates in August for the first time since 2020 to 5% from 5.25% while the European Central Bank (ECB) engaged in its second 0.25% rate cut this year to 3.5%. This saw the dollar fall versus other currencies, with sterling strengthening close to 6% over the quarter.

China

After a year of paltry returns and stagnant growth, China's 5% GDP growth target looked unachievable, with many economists downgrading their outlook for the region. This prompted China's central bank and financial regulators to announce a combination of bold policies, which appear to have gone beyond market expectations. With sentiment in the region at historic lows, along with the stock market trading at levels seen in 2019,[1] the authorities needed to act in order to stabilise the economy and restore confidence.

The People's Bank of China (PBoC)'s economic policies include reducing short-term lending rates; cutting the amount of cash banks are required to hold; reducing both the average interest rates on existing mortgages and downpayments for second home purchases; and injecting over USD 100 billion to help bolster equity markets. These larger-than-expected policies had an immediate impact, with both the Hang Seng and Shanghai Composite surging, bringing their third quarter gains to 21.7% and 14.3%, respectively.[2]

The impact of this stimulus could go beyond the mainland's borders—China is a major market for commodities, raw materials, construction, automo-

[1] Bloomberg
[2] Bloomberg, Deutsche Bank

tive and luxury goods, so renewed investor interest in China could in our view undoubtedly lift these sectors as well.

Oil prices remained in flux, notably with the prospect of additional supply from Libya and Saudi Arabia. Ongoing Middle Eastern tensions means a resolution appears unlikely. Copper prices rose 9.8% in September, rebounding from losses earlier this year on the back of the recent news from China.

> “As the Fed’s focus shifts from inflation to the labour market, inflation targets among other central banks will likely result in more measured cutting cycles.
>
> Sanjay Rijhsinghani, Chief Investment Officer

Conclusion

Concerns remain over the US labour market, and it remains to be seen whether the Fed has engineered a soft landing. As the Fed’s focus shifts from inflation to the labour market, inflation targets among other central banks will likely result in more measured cutting cycles.

We are cautiously optimistic about China and Asia more broadly, as we believe China’s recent policy measures should support the economy and there are plans for further policy measures.

The US election remains a global wildcard. As always, we continue to monitor geopolitical risks while constructing portfolios, but our focus remains on quality companies able to withstand political turbulence and deliver solid returns over the medium to long-term.

Fixed income

This quarter marked a change in the investment landscape we have become accustomed to over the past few years. While most central banks globally had been grappling with high inflation since the pandemic, these fears now shifted towards growth.

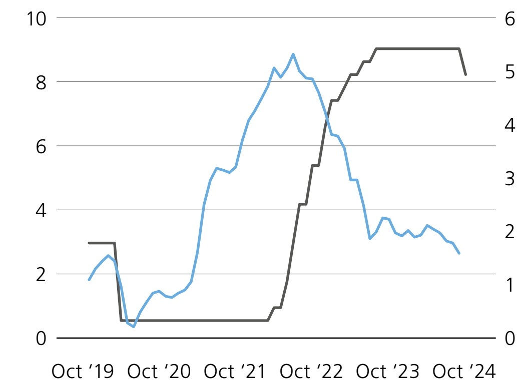
At its July meeting, the Fed gave the strongest indication cuts were coming in September. Investors expected them to embark on a series of 0.25% cuts, as headline CPI shifted towards three-year lows of 2.5%, giving the Fed room to cut rates from their restrictive stance. However, increasing concern over the softening labour market quickly overshadowed the steady progress on inflation. Even though the volatile nature of the closely watched nonfarm payroll report can impact markets, the job openings report showed consistent labour market deterioration. Except during the pandemic, the job market hiring and quits balance hit multi-year lows. This was however, also made less extreme by extremely low separation rates. Given these trends, investors remain worried about a sharp uptick in layoffs should growth slow.

Given the increased focus on the economy relative to inflation, this resulted in volatility during the quarter as investors were uncertain whether the Fed would opt for jumbo rate cut of 0.50%. Ultimately, the Fed went with the larger-than-expected cut, trying to ensure that US economy does indeed experience a soft landing. Going with the larger-than-expected cut was not a unanimous decision, representing the first dissent since 2005.

Meanwhile, on 1st August, the Bank of England (BoE) voted 5-to-4 – a real knife-edge decision – to cut rates from 5.25% to 5%, representing the first cut since 2020. Governor Andrew Bailey remained ambiguous about future rate cuts, emphasising the bank’s data dependence. Most investors expect another quarter of percent cut from BoE at their November meeting. The European Central Bank (ECB) has lowered rates by 0.25% for a second time this year in September and guided towards a gradual approach. However, slowing growth moment and headline inflation falling below 2% for the first time in three years may increase pressure on the ECB to either lower rates in their next meeting in October or go bigger in December.

Other central banks’ cutting regimes picked up pace, with the Bank of Canada cutting rates for the third consecutive meeting, bringing the central bank’s benchmark rate to 4.25%. In contrast, Brazil opted to raise rates and upend its cutting cycle. Rates remain in double-digit territory but political intervention paired with currency weakness has put this central bank on a different path.[3]

US CPI vs Federal Funds Target Rate



US CPI (YoY%) (LHS)
Federal Funds Target Rate (RHS)

Source: Bloomberg

[3] www.brasildefato.com.br/2024/09/19/in-oposite-direction-to-the-us-brazil-raises-interest-rates#:~:text=On%20Wednesday%20(18)%2C%20the,first%20recorded%20since%20August%202022

East/West central bank divide

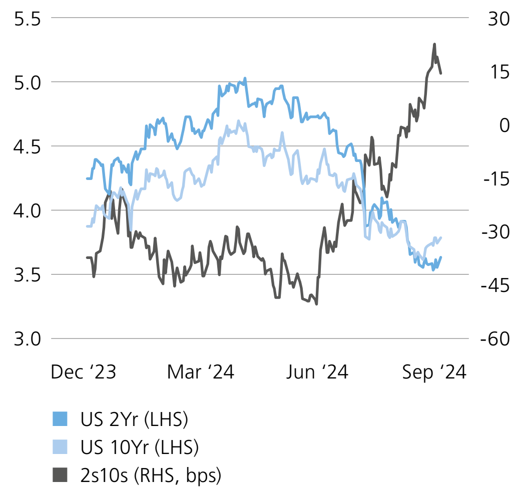
Another central bank on a different path is the BoJ. Their desire to normalise their ultra-loose stance led to them raising rates to 0.25% from 0.1%. The July increase was the BoJ's second this year and contributed to the yen's increase against the dollar from 38-year lows. The strengthening yen led to a global equity market sell-off as investors unwound their leveraged bets. Ten-year Japanese government bonds traded around 1.1% and fell to around 0.8% after the bets unwound.

Meanwhile in China, the central bank lowered the borrowing costs of its seven-day reverse repurchase agreements, part of its larger-than-expected stimulus package aimed at supporting the economy. The seven-day repo-rate has been lowered to 1.5% from 1.7%, efforts to ease monetary conditions to support the economy and inject liquidity into the system. It appears the PBoC are keen to stimulate the economy but so far remain wary of overstimulation.

Normalization of yield curves

The anticipation of the Fed's September cut led to the normalisation of the yield curve with 10-year Treasury yields moving above two-year maturities for the first time since 2022. Global government bonds experienced a strong rally over the quarter with Treasury and Gilt indices gaining 4.7% and 2.5% respectively. Ten-year gilt yields moved 0.17% lower over the quarter and ended at 4%, higher than US peers. German equivalent bonds moved to 2.12% from 2.5% over the quarter, while French debt lost its fervour as the realities of political gridlock continue to concern investors. While the traditional 60/40 portfolio suffered heavily in 2022, as inflation fears have shifted towards growth, this portfolio construction has shown its merits this year.

US 2s10s vs US Treasuries YTD



Source: Bloomberg

A steady environment for corporate debt

While the unwinding of leveraged bets did result in corporate bond spreads widening, this was short-lived as investors sought to take advantage from the potential opportunities this presented. With government bond yields moving lower, issuers rushed to refinance debts at lower yields. Demand was strong as declining central bank policy rates can typically see investors withdraw from money market funds and lock in yields elsewhere. Overall, in our view the environment can be characterised as one where the yield, rather than spread compression, is driving returns.

Equities

International Equities

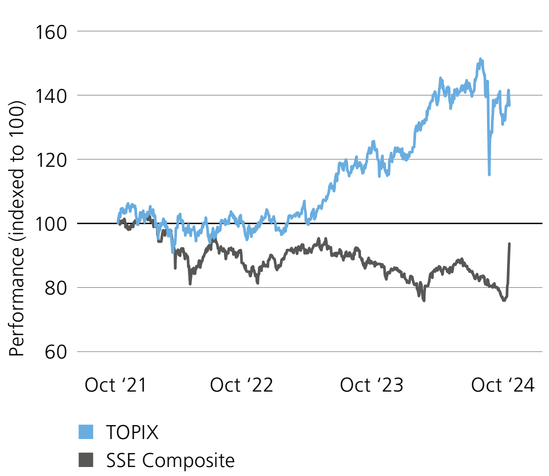
This quarter was the fourth consecutive quarter of robust global equity market performance. With China as the standout market with strong equity performance, mainland equities were on track to finish the quarter down 10%. However, the announcement of a larger-than-expected stimulus package at the beginning of September, paired with lower rates, meant the Shanghai Composite and the tech-heavy Shenzhen indices surged and finished the quarter up 12% and 16% respectively.

The last time Chinese indices were at these levels was in the summer of 2023, though the fact they were also at this level in 2015 *and* 2007 shows quite how much of a lost decade-and-a-half it's been for investors in China. The Hang Seng index in Hong Kong did even better, rising 19% in the quarter, adding almost a fifth to its value. When woeful performance and terrible sentiment meet determined government stimulus, the inevitable short-term reaction can be a very rapid game of catch up. Whether this lasts, of course, depends on exactly how the Chinese economy and corporates respond.

In contrast to China, Japan's Topix Index fell -6% after an incredibly volatile August where investors unwound leveraged bets, although this is after a superb first half where it rose almost +20%.

Compared to the excitement in Asia, the +6% increase in the S&P 500 in the US seems sedate, although that's only because of the unusually high returns the US has been posting for the past year. The fact is, it's a more than impressive number for just a quarter. Equally pleasing and broadly positive is that having spent much of the year discussing how narrow the stock market rally had become with artificial intelligence (AI) and the Magnificent 7 leading

TOPIX vs Shanghai Composite



Source: Bloomberg

the way, this time it really was different. Indeed, the equal weighted S&P 500 index (where the Magnificent 7 behemoths sit but it should be remembered are only seven of many hundreds of companies listed) gained 9%. This was further reflected in the tech-heavy Nasdaq index rising only +2% and Microsoft, Nvidia, and Alphabet all losing market capitalisation. The Fed rate cut benefitted the debt-laden utilities sector (+18%) but the +10% increase in financials is unusual given lower rates tend not to be positive for banks' economics. This is likely a consequence of growing confidence that the Fed will orchestrate a soft-landing.

In contrast to most everywhere, the MSCI Europe managed a +2% gain. Luxury French brands such as LVMH increased following the China news, but not enough to offset previous weakness. The Chinese stimulus also wasn't enough to lift European car companies such as Mercedez-Benz and Stellantis (Fiat, Peugeot and Citroën, among others), which reported sharply falling profit margins, with the two falling -11% and -32% respectively.

UK Equities

The FTSE All-Share index rose by a modest +1.3% in the three months ending 30th September, lifting its year-to-date gains to +6.6%. Including dividends, this return is an improvement of almost 10%.

The UK stock market trades at a healthy discount to other leading global equity markets and this has encouraged a noticeable spate of corporate bargain hunting. Data from the stockbroking firm Peel Hunt suggests that there were 40 bids for UK-listed stocks in the first nine months of 2024, worth GBP 47 billion on aggregate.

The recent approach for property portal Rightmove by their Australian equivalent, REA Group, was withdrawn after the two parties failed to agree on terms, but Peel Hunt's data suggests that there are still 19 ongoing bids for FTSE 350 stocks. That is a noticeable increase on the 2023 total of just two similarly sized bids.

The UK financial sector continues to be rated lowly relative to history. There have been no takeover offers of size in the sector this year, but we have seen a strong revival in the price of the life assurance group Prudential –a market leader in Asia- after China's stimulus announcement.

These announcements have also resulted in a re-appraisal of large London-listed resource stocks such as Rio Tinto and BHP. These companies are global leaders in the iron ore market, with their mining activities accounting for a high proportion of profits for both groups.

China has an outsized influence on the iron ore price, accounting for circa 70% of the global seaborne market for iron ore.[4] This reflects the fact that it has few iron ore deposits within its own borders.

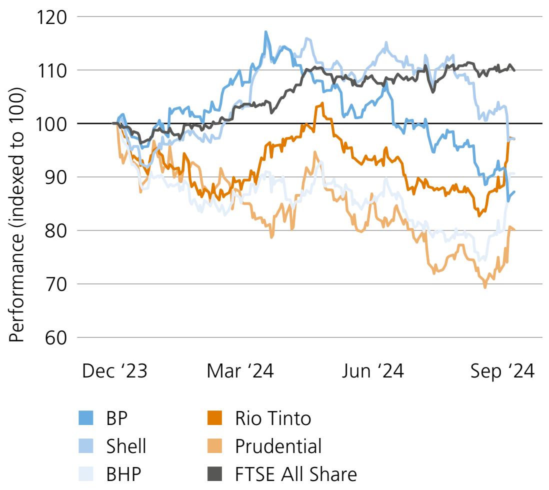
China's stimulus measures also buoyed copper prices, another key commodity for London-listed commodity majors. Copper's thermal conductivity and malleability mean it is used extensively in air conditioning and refrigeration. Its resistance to corrosion also makes it essential in construction, but around 60% of total global demand is based on electrical usage.

This means copper is a vital material for urban and industrial growth, as well as a critical component in renewable energy, electric vehicles, and datacentres. The outlook for demand is generally considered to be robust, with supply unlikely to match expected demand growth.

[4] Reuters

The other large London-listed resource groups include the oil majors Shell and BP. Both were heavily out of favour over the course of the summer, as oil prices fell on oversupply concerns. But they have been among the best performers in the first few days of the new quarter following renewed hostilities in the Middle East between Iran and Israel.

BP, Shell, BHP, Rio, Prudential vs FTSE All-Share YTD



Source: Bloomberg

Both groups have recently focused on the cost efficiency and quality of their operations, resulting in breakeven prices that are now well below (no oil pun intended) prevailing prices for international benchmark grades like Brent. This has resulted in large operational cash flows. Robust financial resources can lead to ill-advised spending, but because of some tightly enforced discipline on investment in new projects, Shell and BP are generating very strong free cash flows. They continue to trade at significant discounts to US peers such as Exxon and Chevron and are using their financial strength to implement large share buyback programmes.

Events in the Middle East may prove pivotal to how the UK market performs over the final quarter, but the forthcoming budget may also prove to be a major influence on the more domestic FTSE 250 mid-cap index.

It is well known the last 14 years have resulted in five prime ministers and seven chancellors of the exchequer. Quite obviously, it is too early to say whether the next 14 years results in greater stability, and a sea-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. UK mortgage approvals picked up to 69,400 in August 2024, their highest level since September 2022,[5] but UK consumer confidence is fragile and at risk from tax revenue enhancing measures that the new administration is clearly mulling.

> "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.
>
> James Follows, Head of UK Equities

[5] Bank of England

Key market data

Key market data (as at 30 September 2024)

Asset class	Level	1m %	3m %	6m %	1y %	3y %	5y %	YTD %
Equity indices (total return) *								
FTSE All-Share (GBP)	4511	-1.44	1.34	3.99	9.30	11.14	11.06	6.59
S&P 500 (USD)	5762	2.02	5.25	9.89	34.38	33.78	93.58	20.81
Euro Stoxx 50 (EUR)	5000	0.86	1.43	-1.63	19.78	23.53	40.09	10.59
Nikkei 225 (JPY)	37920	-1.88	-4.32	-4.73	19.03	28.75	74.30	13.31
MSCI World (USD)	2890	1.54	4.48	8.39	31.03	34.64	90.44	19.16
MSCI AC Asia Pacific ex Japan (USD)	726	6.67	7.76	15.00	26.51	12.71	46.43	20.43
MSCI Emerging Markets (USD)	71281	5.60	6.48	13.58	25.43	10.16	45.73	18.73
10 year bond yields **								
UK	3.99	0.03	-0.27	0.06	-0.41	3.05	3.53	0.46
US	3.79	-0.13	-0.69	-0.54	-0.79	2.26	2.11	-0.09
Germany	2.12	-0.16	-0.47	-0.18	-0.70	2.31	2.70	0.11
Japan	0.86	-0.04	-0.21	0.12	0.10	0.79	1.08	0.25
Commodities (USD)								
Gold	2636.10	5.72	13.25	17.87	42.64	50.65	80.41	28.21
Oil	71.77	-8.92	-17.12	-17.90	-24.70	-8.33	18.43	-6.57
Currency								
GBP-USD	1.34	2.06	6.08	6.77	9.90	-0.52	8.85	5.22
GBP-EUR	1.20	1.23	1.99	2.79	4.25	3.30	6.33	4.15
EUR-USD	1.12	0.83	4.02	3.87	5.41	-3.70	2.37	1.03
USD-JPY	143.04	-1.76	-11.52	-5.68	-4.14	28.20	32.35	1.46

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.

> “The last time Chinese indices were at these levels was in the summer of 2023, though the fact they were also at this level in 2015 *and* 2007 shows quite how much of a lost decade-and-a-half it’s been for investors in China.

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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