BOWMORE
ASSET MANAGEMENT

GLOBAL MARKETS OVERVIEW

3RD QUARTER 2024

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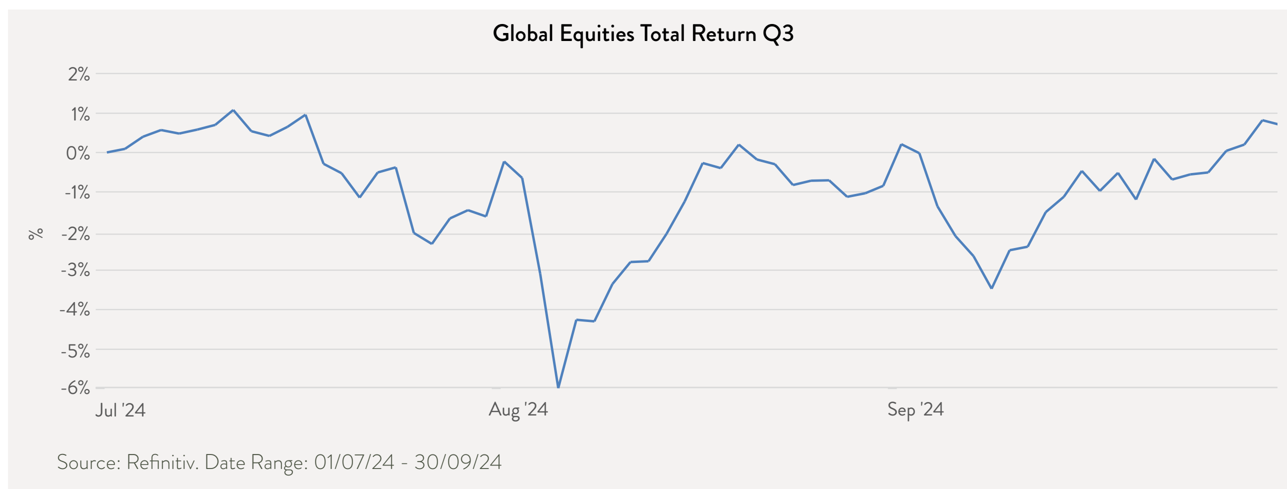
Global Equities
long-awaited reasons to be cheerful

Welcome to our quarterly investment review. This is a snapshot of activity in global markets and includes insights from our team and explanations of our stance in each sector. This quarter, we look at how global equity markets breathed a collective sigh of relief when the US finally cut interest rates after a tense six months. Plus we consider improving prospects in the UK, Europe, China and India, and highly encouraging developments in bond and property markets.



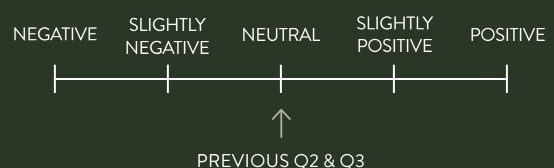
Source: Refinitiv. Date Range: 01/07/24 - 30/09/24

- In September, the US Federal Reserve eased interest rates, not just by the typical quarter percent, but by a half percent from 5.5% to 5%. This signalled a long-awaited reversal in the cycle of US rate hikes, which have made financial conditions harder for companies and consumers since 2022. We can now look forward to a more benign period with an anticipated series of rate cuts, making borrowing cheaper.
- Following the Fed announcement, the main index of global shares leapt to a new high of 841, which was a 19% rise on its value at the start of the year. The best performing sectors were property, utilities, telecoms and financials. UK shares did the best this quarter, with stellar gains form Unilever (+12%) and Rolls-Royce (+16%).
- Previously, the third quarter (Q3) had been marked by a dramatic V-shaped recovery - a sign of how jittery and uncertain global markets had become as expected rates cuts were repeatedly postponed. In August, major stock markets dropped 6%, due to fears of a "hard landing" recession, only to bounce back almost immediately. The Fed's interest rate cut helped shore up the recovery and push it further.
- Some weaker US data this year, such as higher unemployment figures, show there is still an outside chance of recession. However, there is now more confidence that the global economy will avoid this and instead enjoy a period of stable growth and controlled inflation. This environment should support "growth" stocks, including small and medium sized companies.

Our Stance

We've kept a neutral stance on global equities for now as markets have already priced in the central bank rate cuts. Recession fears have not dissipated entirely, and will vary by sector and region.

However, as the cycle turns towards growth, we are investing more in sectors set to benefit, such as fast-growing small and mid-sized companies.



- In August, the Bank of England also cut the price of borrowing to 5% - the first reduction since March 2020. And in September, the European Central Bank (ECB) cut rates, for the second time this year, to 3.5%. Alongside the Fed's move, these cuts should support much more growth in the global economy.
- The global recovery was cemented further by the Chinese government's introduction of an aggressive stimulus package in late September. This included cutting the cost of borrowing and injecting liquidity into the country's economy, aiming to boost consumer spending and put growth plans back on track.
- Growth in emerging markets had slowed this year, but a weakening US dollar should help improve balance sheets in developing countries. As their dollar liabilities decrease, more finance will become available to stimulate trade.
- Economics and central bank actions will continue to drive market movements in Q4 and beyond. The US election result in November will dominate the news, alongside geopolitical tensions in areas such as the Middle East. But we remain neutral on the election result.

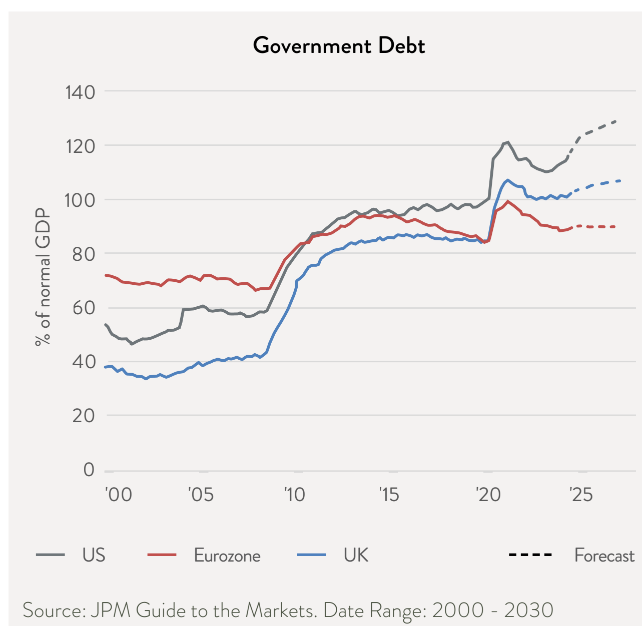
World Economic Outlook Growth Projections

(Real GDP, annual percentage change)	2023	PROJECTIONS '24	'25
World Output	3.3	3.2	3.3
Advanced Economies	1.7	1.7	1.8
United States	2.5	2.6	1.9
Euro Area	0.5	0.9	1.5
Germany	-0.2	0.2	1.3
France	1.1	0.9	1.3
Italy	0.9	0.7	0.9
Spain	2.5	2.4	2.1
Japan	1.9	0.7	1.0
United Kingdom	0.1	0.7	1.5
Canada	1.2	1.3	2.4
Other Advanced Economies	1.8	2.0	2.2
Emerging Market and Developing Economies	4.4	4.3	4.3
Emerging and Developing Asia	5.7	5.4	5.1

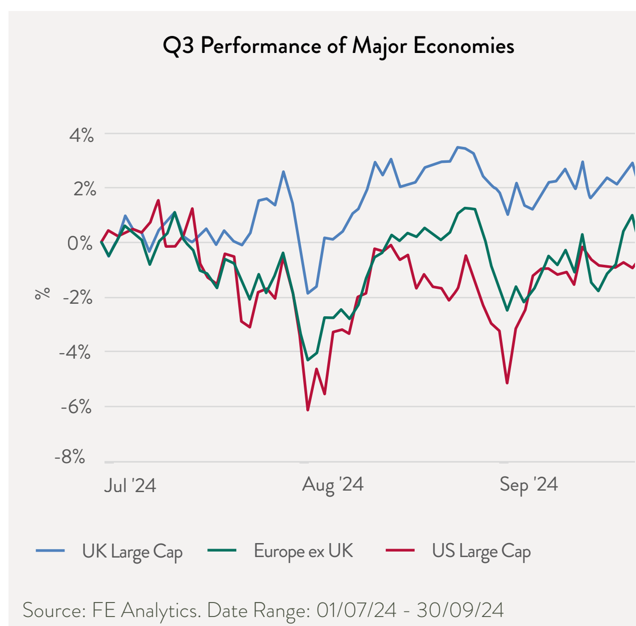
Source: IMF

UK and EU set for a healthy growth spurt

- The IMF expects Eurozone GDP to grow by just under 1%, and the UK to grow by 0.7% in 2024. But next year, the fund expects the Eurozone and the UK to almost double that expansion rate, to around 1.5%.
- The US has higher absolute growth numbers – currently at 2.6% for 2024 - but is decelerating. We're more interested in the reversal of these trends, making the UK with its accelerating growth and better valuations a more compelling investment.
- The IMF is positive about UK and Eurozone growth because neither experienced a post-pandemic spending boom in the same way the US did. That means US consumers have depleted their savings, while UK and Eurozone consumers have not – so spending confidence in those regions should be higher.



Source: JPM Guide to the Markets. Date Range: 2000 - 2030



Source: FE Analytics. Date Range: 01/07/24 - 30/09/24

UK and Eurozone debt on a steadier course than US

- One potential obstacle to growth is higher debt levels. In Europe, Italy's high debt-to-GDP led the EU to recommend special procedures to bring its debt ratio down, which the country appears to be following. Meanwhile, investors are increasingly concerned about lending to France as pressure grows on its government to fix the country's creaking finances.
- On the UK's current spending trajectory, debt-to-GDP will rise from 100% to 274% in 50 years. So current spending is not sustainable, and markets will want to see the new Chancellor balance spending with raising taxes responsibly in her Autumn Budget.
- The US electorate seem less concerned about growing debt levels. Neither presidential candidate look likely to reduce the country's projected budget deficit of 6% of GDP, compared to the long-term average of 3.3%. That percentage is predicted to rise to 7% under Harris and 8% under Trump. Such higher deficits typically occur in years of recession or financial upset, such as the Great Financial Crisis in 2009. As this chart shows, total debt is therefore projected to rise much higher in the US compared to the UK and Eurozone.

UK equities have a storming quarter

- For some time, we've been highlighting that the index of large UK companies has been undervalued and was due an uplift.
- It finally started delivering on this promise in Q3, becoming the top performer among major economy large-cap indices.
- This was led by expectations of a strengthening economy; an uptick in merger and acquisition activity; and some spectacular stock performances, especially from Rolls-Royce.

US Equities
a quarter of volatility

Despite falling more than 6% in the first week of August and a further 4% in the first week of September, US equities ended the quarter on a high note after the Fed cut rates on 18 September. The S&P 500, the main US stock market index, has repeatedly hit new highs this year and gained over 21% since 1 January 2024.

However, this boom has made US shares expensive compared to their "fair value" based on corporate profits and other financial data. Positive – some might say excitable - investor sentiment created the demand that chased up prices. But it means US shares face more risk of contraction on any bad economic news.

Before 18 September, US share price instability left investors worldwide feeling nervous. The VIX index, which measures volatility in US stocks, spiked this quarter - especially in August when it reached its highest level in nearly two years due to wavering confidence in the US economy.

The quarter began positively in July with news that inflation was decreasing. However, August saw a major sell-off triggered by rising unemployment and decreasing job openings, reigniting fears of a recession. Then in August, these trends reversed, the market rebounded, and investors treated the dip as a buying opportunity.

During the quarter, the US index suffered from its overexposure to tech stocks, which underperformed other sectors. But, overall, US company earnings remained incredibly resilient. At the time of writing, the estimated year-on-year earnings growth for the S&P 500 in Q3 was 4.6%, which would mark its fifth quarter of earnings growth. Real estate performed especially strongly, with homebuilders such as Lennar responding well to expected rate cuts and ongoing housing shortages. It posted earnings of $4.26 per share for the quarter, beating average analyst estimates of $3.63 per share.

In November, all eyes will be on the US election. We believe neither candidate is necessarily better for share prices than the other, with both likely to pursue a growth agenda. So we remain neutral on the election result. There is some evidence that US stock prices gain before an election and wane after it. However we expect the US economy to drift until election day on 5 November, as few companies will want to make big decisions before that. We will review our portfolios around that time.

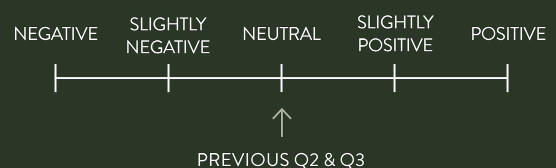
One positive we do expect from the US is for the recent tech-led rally to broaden to the rest of the market rather than being concentrated in the "Magnificent Seven" companies – the seven largest stocks by company size. We see it spreading to smaller companies, in the US and beyond, as the mid and small cap users of artificial intelligence (AI) begin to implement and adopt the technology, boosting profit margins.

We have therefore redistributed some US equity to our iShares S&P 500 Equal Weight fund. Spreading exposures more evenly among sectors avoids the risks of over-concentration on the Magnificent Seven.

Our Stance

We believe the US will continue to be a strong market but that it won't outperform the rest of the world by as much as it has done in recent years. Earnings expectations are incredibly high, and for good reason, but it makes it difficult for companies to continue to beat expectations.

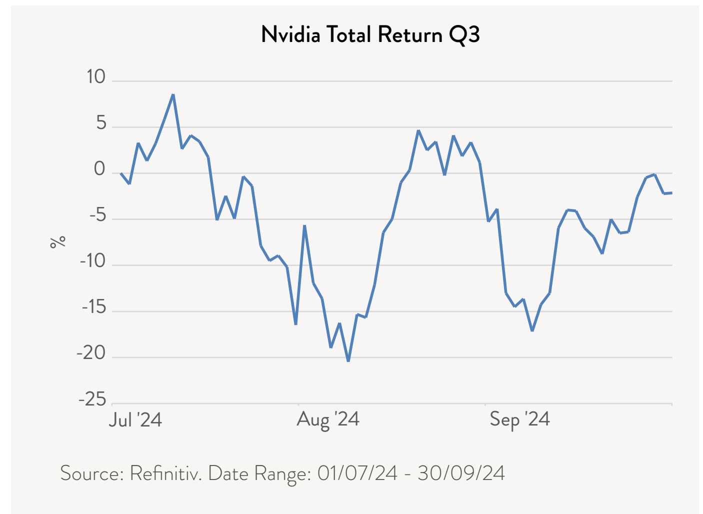
This quarter, we reduced our US equity exposure to take some profits and guard against the potential impact of overvaluation. It was only a small move as we are optimistic about a soft landing in the US, with inflation coming down and economic growth continuing.



A closer look at chip maker Nvidia's share price (see chart) shows why this diversification is so important. A large part of the S&P's recent eye-catching performance was driven by Nvidia, as it rode the wave of booming interest in AI.

But in Q3, Nvidia's price started swinging wildly - more than 20% up and down across the quarter. Then on 4 September, Nvidia posted the largest one-day crash in value for a single stock in history, an astonishing loss of $279 billion.

This happened despite Nvidia smashing earnings expectations this year. We believe AI will still be a potent growth driver. But the erratic reaction to Nvidia's performance highlights the extent of stretched valuations in the US market, where an "elastic band" effect can quickly whip prices back based on market fears that AI hype has created an investment bubble.



Source: Refinitiv. Date Range: 01/07/24 - 30/09/24

UK Equities
a storming quarter with more to come

Rolls-Royce led the charge in UK equities this quarter, posting a 16% increase. This capped a stratospheric rise of 650% over 23 months. A deal for Rolls-Royce's mini-nuclear reactor technology, plus increased demand for defence products, have helped the company keep its foot on the accelerator.

More widely, UK outperformance has been a by-product of sector exposures in its top performing shares. Compared to other indices, the UK's largest share are well represented in previously underperforming sectors such as consumer staples, utilities, and financials, which all did well in Q3. It has comparatively less exposure in sectors that underperformed this quarter, such as technology.

Rolls-Royce may be a little overvalued by now, and UK shares more generally are trading at 20.6x earnings compared to a long-term average of around 15. But we think there is an enormous amount of quality in the UK market, and shares of companies such as NatWest, Standard Chartered, Oxford Instruments, and 3I are still good value.

Source: Refinitiv. Date Range: 01/07/24 - 30/09/24

In July, Labour's election victory led to an uptick in business confidence. In November, all eyes will be on the Autumn Budget with Chancellor Rachel Reeves facing a stiff challenge to balance more spending on public services with controlling debt; and making the UK a good place to live, invest and do business.

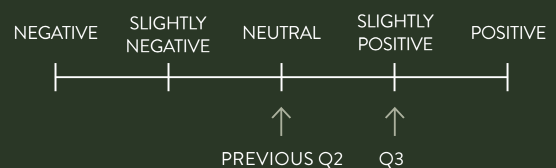
She will face pressure from the left of the party in areas such as employee rights, more of which could deter business growth and foreign investment. But Labour has a strong majority and a good opportunity to spend responsibly and promote policies that support sustainable growth.

We think the UK is set to post solid GDP growth in the second half of 2024 and into next year.

Our Stance

UK shares offer exciting growth opportunities at a reasonable price.

UK shares have been unloved and some are still trading below fair value, despite the index's superior performance in Q3. This means they are less likely to fall and more likely to rise in Q4 compared to other markets such as the US. So we have moved our view from neutral to slightly positive.



European Equities
a runway for growth

Headline inflation % change year on year

		2022				2023												2024							
		Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Eurozone	Eurozone	9.9	10.6	10.1	9.2	8.6	8.5	6.9	7.0	6.1	5.5	5.3	5.2	4.3	2.9	2.4	2.9	2.8	2.6	2.4	2.4	2.6	2.5	2.6	2.2
	France	6.2	7.1	7.1	6.7	7.0	7.3	6.7	6.9	6.0	5.3	5.1	5.7	5.7	4.5	3.9	4.1	3.4	3.2	2.4	2.4	2.6	2.5	2.7	2.2
	Germany	10.9	11.6	11.3	9.6	9.2	9.3	7.8	7.6	6.3	6.8	6.5	6.4	4.3	3.0	2.3	3.8	3.1	2.7	2.3	2.4	2.8	2.5	2.6	2.0
	Italy	9.4	12.6	12.6	12.3	10.7	9.8	8.1	8.6	8.0	6.7	6.3	5.5	5.6	1.8	0.6	0.5	0.9	0.8	1.2	0.9	0.8	0.9	1.6	1.2
	Spain	9.0	7.3	6.7	5.5	5.9	6.0	3.1	3.8	2.9	1.6	2.1	2.4	3.3	3.5	3.3	3.3	3.5	2.9	3.3	3.4	3.8	3.6	2.90	2.4
	Greece	12.1	9.5	8.8	7.6	7.3	6.5	5.4	4.5	4.1	2.8	3.5	3.5	2.4	3.8	2.9	3.7	3.2	3.1	3.4	3.2	2.4	2.5	3.0	3.2
	Ireland	8.6	9.4	9.0	8.2	7.5	8.1	7.0	6.3	5.4	4.8	4.6	4.9	5.0	3.6	2.5	3.2	2.7	2.3	1.7	1.6	2.0	1.5	1.5	1.1
	Sweden	10.3	9.8	10.1	10.8	9.6	9.7	8.1	7.7	6.7	6.3	6.3	4.5	3.7	4.0	3.3	1.9	3.4	2.6	2.3	2.4	2.5	1.4	1.7	1.3
Developed	Switzerland	3.2	2.9	2.9	2.7	3.2	3.2	2.7	2.6	2.2	1.8	2.1	1.9	2.0	2.0	1.6	2.1	1.5	1.2	1.1	1.4	1.5	1.3	1.2	1.0
	UK	10.1	11.1	10.7	10.5	10.1	10.4	10.1	8.7	8.7	7.9	6.8	6.7	6.7	4.6	3.9	4.0	4.0	3.4	3.2	2.3	2.0	2.0	2.2	2.2
	US	8.2	7.7	7.1	6.5	6.4	6.0	5.0	4.9	4.0	3.0	3.2	3.7	3.7	3.2	3.1	3.4	3.1	3.2	3.5	3.4	3.3	3.0	2.9	2.5
	Japan	3.0	3.7	3.8	4.0	4.3	3.3	3.2	3.5	3.2	3.3	3.3	3.2	3.0	3.3	2.8	2.6	2.2	2.8	2.7	2.5	2.8	2.8	2.8	3.0

European stock markets were largely flat in Q3. However, there are plenty of reasons for optimism in the region.

The Eurozone is in a low-rate, low-inflation background that lays a smooth runway for growth, and allows for healthy consumer spending and other economic activity. Consumer demand should increase further as the ECB continues to cut interest rates aggressively, with the next one likely in December or perhaps even before that.

One risk is persistent wage growth, which remains the biggest cause of inflation. As people receive higher wages, they spend more, which could kickstart an inflationary cycle again.

On a stock level, one risk in European markets is that they are heavy on consumer discretionary items. For example, the French stock market includes many luxury brands like Kering, which have slowed this year because people have had less disposable income; and because China, one of its main markets, has struggled.

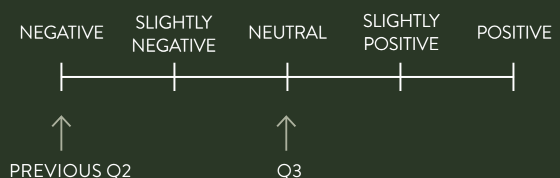
However, we are active managers in European stocks. Both the funds we use - Waverton European Capital Growth and Blackrock Continental European - have a growth bias. They are also highly concentrated, which means they only invest in a relatively small number of stocks with a firm conviction. Both funds agree with our views on Europe and are allocating away from stocks and sectors that rely on discretionary spending. Instead, they are focusing on other areas of the European market that we prefer, such as renewable energy and technology.

For example, Waverton has a significant holding in Siemens, which is one of the world's biggest wind turbine manufacturers and is also set to benefit from increasing moves towards automation and digitisation. And BlackRock has a substantial holding in ASML, a semiconductor firm expected to post strong earnings growth in the next few quarters.

Our Stance

Moving up to neutral

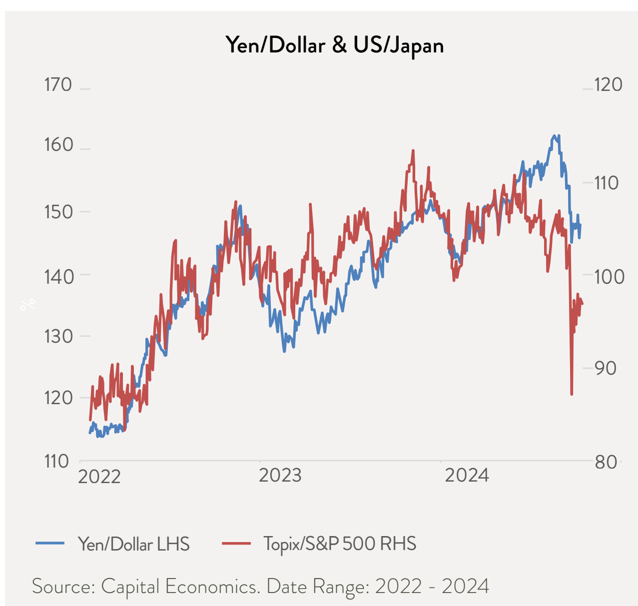
We've bumped European shares up from negative to neutral based on the region's improving growth trajectory. It faces many challenges, but the European Central Bank has a sizeable buffer to work with given the current low-rate low-inflation environment. So we agree with the IMF's prediction that GDP will accelerate in Europe over the next two years.



Japanese Equities
temporarily hindered by currency issues

Japan is in a different economic cycle compared to other parts of the world and is challenged by currency-related issues. On 5 August, the Japanese stock market experienced its largest one-day fall, surpassing even Black Monday in 1987. But then it also posted the strongest bounce back of all major economies.

We believe Japan's dramatic correction was not linked to the country's economy or corporate earnings, but rather to the cheapness of its currency. Investors have been borrowing the yen at its extremely low interest rate of 0.25%. They used the money to buy US tech stocks and other higher-returning investments, hoping to leverage profits.



Source: Capital Economics. Date Range: 2022 - 2024

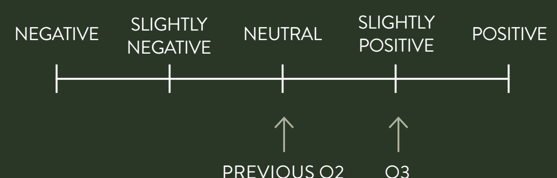
This so-called "carry trade" drove the value of the yen up. However, when US tech stocks sold off in August, investors had to sell their yen to cover those losses, leading to a massive sell-off. One problem is no-one knows exactly how many investors are still holding such positions, and so how much further the carry trade could unwind.

This chart shows the yen-to-dollar exchange rate (blue line) and the stock market performance (red line). The stock market performance appears to have had a strong inverse correlation to the yen's movements over the last two years. This suggests the weakening yen contributed to Japan's strong performance over this period, and then vice versa in August.

Currency aside, corporate governance is constantly improving in Japan and companies are finally recognising the need to return value to shareholders. Share buybacks and dividends are growing at record pace and this will only push the Topix higher. 40% of listed companies in Japan plan to increase their dividends for the fiscal year ending March 2025 with total dividends growing 8% on the previous year.

Our Stance

We're keeping the currency situation under close review as fluctuations in the yen are causing spikes of volatility in portfolios. However, the quality of companies on offer and ongoing corporate reform means we are keeping our overweight stance in the region for now.



Asia and Emerging Market Equities
a late rally from China but spotlight still on India

China looked like it would finish the quarter down before a 21% rally in the final week of Q3 allowed it to catch up with and overtake India's 27% return so far in 2024. The US dollar has softened over the last year, which should boost emerging markets. A weaker US currency reduces the burden of debt repayments for emerging economies on their dollar-based borrowing, making more money available to invest in growth.

However, Asia and emerging markets is an eclectic sector, so we take a selective approach.

After a weak Q2, economic activity in China regained momentum and this should continue thanks to a punchy fiscal support package from the government, plus healthy demand for its exports. Chinese shares responded positively to the government's aggressive moves to cut interest rates and inject liquidity into the economy, aiming to boost consumer spending and help keep the country's 5% growth target on track.

Export values grew at their fastest pace in 17 months and volumes hit record highs this quarter. However, a second Trump presidency in the States would bring uncertainty for China, particularly given his pledge to increase tariffs on Chinese goods. Kamala Harris has criticised Trump's pro-tariff approach. But if elected, we believe she may collaborate with allies to constrain China, which may be worse for the country longer-term.

China is fighting back by looking to drive trade deals with other emerging nations to make it less reliant on America. These moves could weaken the dollar further. China also aims to achieve self-sufficiency in its semiconductor industry, rather than relying on global competitors. But its productivity and innovation levels in this industry are behind those of competing nations, so it could struggle with this strategy unless it catches up soon.

While developments in China are encouraging, we are keener on India, which has strong domestic demand, a rapidly expanding population, increasing urbanisation, and a growing middle class. India currently has a services-based economy, so is benefiting from developments such as the digital banking revolution.

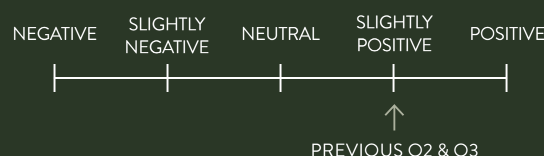
But it also aspires to become one of the world's leading manufacturers by capturing a sizeable portion of production from China. Sino-Indian relations are thawing, and China is looking to upskill its workforce. So we believe China will be content to offload some of its manufacturing to India. This would boost India's economy significantly - allowing it to become a hub for both services and production.

India may even be able to "play both sides" by developing relations with China while simultaneously benefiting from offshoring opportunities with friendly Western countries.

Our Stance

India still spearheading growth

We're keeping minimal exposure to China, but we are optimistic about India's prospects. Our overweight in India has served us well this year and we think this will continue as it is still set to achieve a predicted 6.8% growth in 2024. However, we are neutral on Asia and emerging markets overall' to 'We remain slightly positive on Asia and Emerging Markets, given our active asset allocation in the region.



Government Bonds
their best value in 15 years

US 10-year Treasury yields declined from 4.5% to 3.7% over Q3, marking an 18-month low. Over the last four years, US Treasuries have made a slight loss (just below 0%), as a negative capital return has offset the yield. But investors can now secure a coupon just below 4%, with the potential for an increase in capital value too, as interest rates fall. When rates fall, that's good for existing bondholders as it increases bond values.

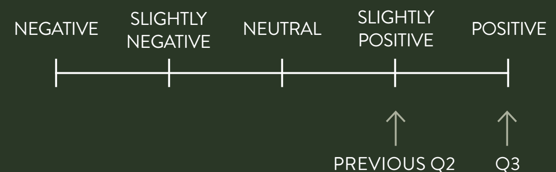
This combination of factors means Treasuries offer the most enticing potential returns in 15 years.

In the UK, 10-year Gilt yields decreased from 4.3% at the start of the quarter to 3.8%, the lowest point since February. We have increased the duration in our UK government bond holdings to lock in higher yields and benefit from continuing interest rate falls. As rates decrease, values of longer duration bonds tend to rise more than those with shorter durations.

Our Stance

A much-needed return to form

We're strongly positive on government bonds based on these much better expected returns. Volatile US equities might be expected to achieve between 0% and 5% returns based on their current valuations. Returns of 4% to 5% from ultra-low-risk government bonds look highly attractive by comparison.



Investment Grade and High Yield Bonds
an opportunity for equity-like returns

We recently added a significant amount of high yield bonds to our portfolios, and plan to add more. High yield bonds offer a greater return than other fixed income investments because they involve lending to companies with lower credit ratings and so carry more risk. However, compared to equities, they are much less likely to lose value; and their returns are more stable and predictable.

Some high yield bonds currently yield 8% to 9%, which means they are providing equity-like returns but with much less risk. This combination means the high yield sector is currently highly compelling.

Until now, the interest rate cycle has been a major risk for bonds. When the market anticipated rate cuts but they didn't materialise this year, bond values suffered. Timing was crucial, and we had to wait for clear direction on rates before we could access the attractive yields on offer.

Risks remain in high yield bonds. Companies paying 9% on debt is great for investors, but challenging for the companies themselves. Default rates - the number of companies going insolvent - are expected to rise as a result. But we believe most companies can manage these higher rates.

Investment grade bonds (issued by companies with higher credit ratings) rose around 2.25% on the quarter, outperforming global equities and all major markets except the UK stock market. Since interest rates went up, companies started buying back their debt because it's become more expensive to service. The stock of investment grade debt fell considerably, reducing supply and providing a fantastic boost for bond valuations.

There had also been a fear investment grade companies would be unable to refinance their loans as interest rates rose over the last two years. But that worry has subsided as most companies needing to refinance managed to do so.

In 2022, as inflation and interest rates surged, equities and bonds dropped in value together and became increasingly correlated. However, as inflation subsides and rates decrease, bonds have become effective diversifiers again.

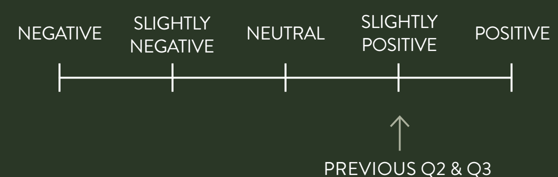
Our Stance

Bonds have become our most bullish asset.

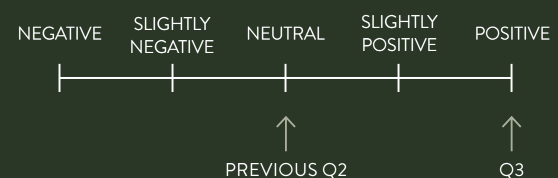
Following a muted decade, fixed income now looks likely to start contributing strongly to portfolios – particularly on a risk-adjusted basis.

We rate high yield a strong positive, due to the yields on offer. Investment grade bonds are slightly positive based on their diversifying qualities and potential for capital appreciation.

Investment Grade



High Yield



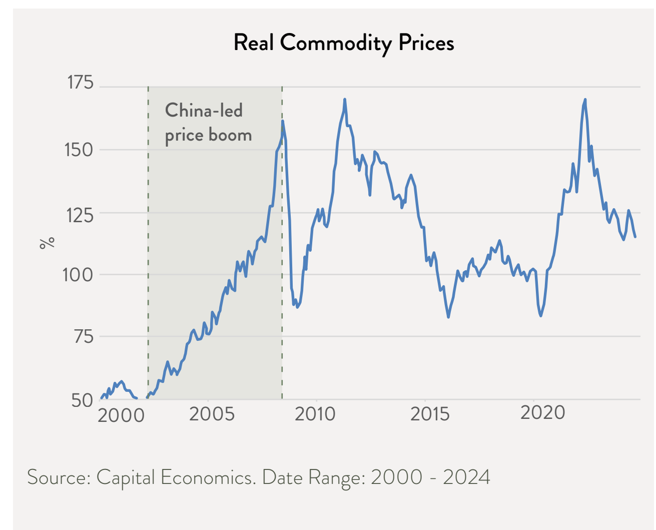
Commodities
eyeing an India-led boom

Commodities forged ahead this quarter, with gold hitting another all-time high, following its previous record in Q2. This rise was driven by investors seeking the perceived safety of gold during heightened economic and geopolitical turmoil. However, the future trajectory of these tensions remains uncertain. Commodities encompass a broad range of sectors, making it hard to generalise. But we can expect a more positive movement in specific areas like Indian agriculture.

Longer-term, India is poised to kickstart the next commodity surge, much like China did in the early 2000s. This chart illustrates the explosion in commodity prices during that period, driven by the "China price boom" as it became the world's manufacturing hub.

We may not see the same impact with India, given its more services-based economy. But the country is entering a significant growth phase, with its population expected to grow by 350 million over the next two decades. This growth could lead to a new boom in commodities such as wheat, rice, and coal, which the country consumes in vast quantities.

India's potential to be a "friendshoring" partner could also help it advance its position as a major commodities supplier to Western companies.

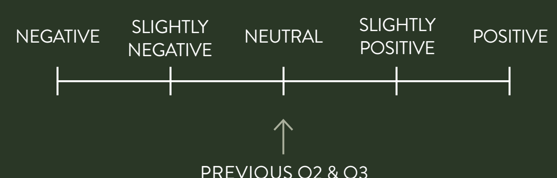


Source: Capital Economics. Date Range: 2000 - 2024

Our Stance

Commodities to get a selective boost

We previously had no significant exposure to commodities, due to the long-term nature of returns in this sector. But we have become more optimistic based on the predicted swelling of Indian commodity consumption.



Property
strong showing in the UK market

When we hear about the UK property market, we usually think of privately owned homes and rented houses. The residential market faces challenges, such as the government proposing to end no-fault evictions and to allow tenants to challenge rent increases.

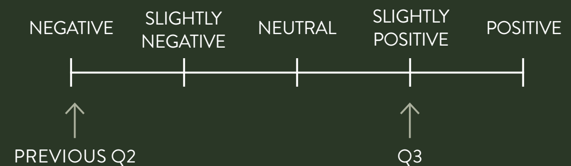
However, the property exposure in Bowmore portfolios is actually commercial property, focused on the industrial, office, retail and leisure sectors with tenants like B&Q and DHL.

In commercial property, interest rate cuts have made yields look attractive compared to gilts. The consequent demand helped our property real estate investment trusts (REIT), provided by Picton, climb 13% in Q3. As gilt yields continue to fall, the performance of REITs could rebound even further.

Another reason for the exceptional performance in UK property more widely is two major acquisitions of REITs in the last quarter. These rates had been trading on a 33% discount. Others are now around an 18% discount, which is still attractive to acquirers.

Our Stance

Property has been an unloved asset class in recent years as the yield on cash and gilts has outweighed the yield on property without the risk. However, we have moved from negative to slightly positive as we enter a rate cutting cycle and property rebounds from the deep discount it finds itself on.



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