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Investment Commentary

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Western economies remain averse to cutting interest rates

As expected, the major western economic blocs (US, UK and EU) kept interest rates on hold at their first meetings in 2024.

Last year markets were pricing in an almost certain recession. We are now reminded that nearly 60 years ago, the great economist Paul Samuelson joked that the stock market had predicted “nine of the last five recessions”. Stock market sentiment is now aligning with the so-called ‘Goldilocks’ scenario, where a stronger than expected economy (not too hot or too cold, but just right) more than likely rules out a recession in the US at least.

Under such conditions, cutting interest rates (despite being high relative to pre-COVID levels) would be like turning up your central heating during a hot-weather spell – uncomfortable and pointlessly expensive.

That belief in a more positive US economic outlook has been reinforced by remarkably strong GDP numbers for Q4 2023, along with jobs data that revised up the December figures for new jobs filled, and estimated January’s at more than 350,000 additions to payrolls.

Despite being subject to revision later, the latest numbers poured more cold-water on the prospects for a March rate cut.

Economic theory postulates that a rise in employment leads to a rise in inflation. This accelerates as employees negotiate higher wages to compensate. Indeed, the US jobs data does seem to show that average hourly earnings have increased, so at first sight these are hardly the circumstances that demand a rate cut. However, other research suggests that in real terms, most US workers have experienced no real rise in wages for over 3 years. This might explain why many Americans seem to irrationally perceive their economy as weak despite evidence to the contrary. A healthy economy is irrelevant if you’re not a beneficiary.

In the UK meanwhile, forthcoming gross domestic product (GDP) data - the sum of every good and service sold over a period - may show the UK was in recession in the second half of last year. However, January saw more positive signs of growth accelerating in the UK, with consumer confidence hitting a two-year high despite retail sales figures falling sharply.

Combined with shop prices showing a marked slowdown in retailers’ inflation, the data suggests consumers were staying at home, refusing to pay inflated prices.

This was insufficient to spur the Bank of England to consider cutting interest rates early. UK Gilts have responded accordingly, down up to 3% on the month.

Tech giants dominate western equity markets

Against this background western equity markets were relatively subdued, with the notable exception of Microsoft, Apple, Alphabet (Google), Amazon, Meta (Facebook), Nvidia and Tesla, collectively known as the "Magnificent Seven".

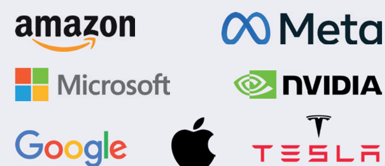
Of those companies, Tesla's share price fell 25% in sterling terms in January, but Magnificent Six doesn't have the same ring to it. Nvidia meanwhile was up another 24% over the month, following a 220% rise in 2023.

Last week we saw corporate earnings numbers published and as a result Microsoft is now worth

$3trillion

Meta's reported profits (and introduction of its first-ever quarterly dividend payment) saw its market value rise by almost $200 billion - roughly the current market cap of the whole of Astra Zeneca, the UK's second largest company. That's the largest one-day gain in value for any company ever. Meta is now worth twice as much as Tesla, and 35% more than it was a month ago. The Mag 6 are responsible for over 70% of the S&P's gain (4.8%) so far this year. In the UK, a country with virtually no technology companies of note, we saw equities falling a little over 1.5% over the same period.

The Magnificent Seven



These seven companies are jointly worth more than the combined annual GDP of New York, Tokyo, Los Angeles, London, Paris, Seoul, Chicago, San Francisco, Osaka, and Shanghai.

The increasing impact of geopolitics on markets

Geopolitics is becoming an important issue for fund managers. Despite fears of the Gaza conflict spreading, the importance of Houthi rebels' attacks on shipping have yet to have a serious market impact.

The oil price has risen a tad, but since many bulk carriers and the biggest supertankers don't go through the Red Sea and the Suez Canal, the market impact remains negligible for the time being.

And finally...

While Japan's stock market continues its healthy rise (up ~4% in sterling terms over January) China's economic woes continue.

In January, one of China's largest companies Evergrande Group was ordered by a judge in Hong Kong to liquidate, with over $300 billion in debt.

The Property development part of the business had opened over a thousand projects across hundreds of cities, taking money for apartments that had not been finished and leaving hundreds of thousands of home buyers waiting on their properties and apartments, along with contractors and builders who have not been paid for years. How China responds, e.g. via a bailout, could have a dramatic effect on foreign investors' already-battered confidence in China.

With an ageing population, high youth unemployment and a weaker economy, it is perhaps ironic that some commentators talk of a potential looming 'lost decade' for China, just as Japan re-emerges from three lost decades of its own.

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