Current Focus

January 2024

A monthly market comment from Rivers Capital Management. Views expressed here are subject to change and for professional advisors only

INTELLIGENT INTUITIVE INVESTING

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Summary

- Economic outlook in 2024 is cautiously optimistic.
- Economic growth was better than expected in 2023, especially in the US.
- Inflation fell in the final quarter of 2023 and is expected to continue falling in 2024.
- Inflation falls restricted by low unemployment and ongoing geopolitical shocks
- Mega-cap equities overvalued and risk of correction is high in the coming months.

Market Comment

As we enter 2024, the global economic landscape is changing. The past five years have upended economies globally, as the pandemic resulted in unprecedented monetary and fiscal stimulus policies, followed by decades-high inflation, and then the sharpest monetary policy tightening in 40 years. The riskiest geopolitical circumstances in decades compounded this sense of upheaval. That said, economic growth remained remarkably robust throughout 2023, especially in the US, and remains better than expected across the world. At the start of 2024 we maintain a moderately cautious outlook compared to an optimistic consensus. Optimistic expectations of rate cuts and continued economic strength have led parts of the equity market to all time highs. We think this may be overdone and prefer caution especially given high risk free returns. This month we look back on 2023 and Focus on what we can expect from 2024.

In 2023, US growth unambiguously surprised to the upside despite continued and unflinching monetary tightening by Central Banks. This may have been a result of consumers depleting Covid induced excess savings and unsustainable fiscal stimulus but it did beat all expectations. In the UK, economic growth was not in the same league – flatlining at best – but performed better than recessionary expectations. UK growth fell short of the US, but from a European perspective was not an outlier. The German, French, and Italian economies are all struggling for momentum in the face of higher interest rates. Having absorbed 14 interest rate hikes since December 2021, taking the base rate from 0.10% to 5.25%, the UK economy has proved more resilient than many expected, even allowing for the likelihood that the impact of rate rises has not yet been fully felt.

In addition to growth bettering expectations, news on inflation, which wobbled a bit over the summer, was reassuringly positive in the final quarter of the year. UK inflation – which continues to lag drops in the US and the EU - fell to 3.9% in November, well below economists' forecasts of 4.4%, while core inflation (which strips out volatile food and energy prices) dipped to 5.1%, its lowest level since January 2022. Meanwhile rates in the US and EU fell to 3.1% and 2.9% respectively, both lower than expectations.

Falling inflation is, given the implications for interest rates, the biggest investment news at the start of 2024. It is fair to say, with some

Source: The Economist

considered caveats, that inflation's grip on the global economy seems to have been broken. Fading inflation pressures across the world have put rate cuts firmly on the agenda in 2024, which was the source of marked seasonal joy for investors in December. Federal Reserve Chair Powell commented that the US benchmark rate was now "likely at or near its peak for this tightening cycle", along with the Fed's "dot plot" chart that showed most Fed officials expected the fed funds rate to sit at 4.5%–4.75% by the end of 2024, implying cuts this year, triggered a sharp end-of-year rally in both equity and bond markets. The S&P 500 Index hit its highest level ever, recently breaking the level set in January 2022, while the FTSE 100 Index finished 2023 at a seven-month peak.

Notwithstanding the caveats that inflation may be sustained due to historically low unemployment, or reignited by some further geopolitical shock, we do think some near-term caution is merited over these present equity market levels. At current levels it appears that investors are pricing for recession-like cuts in interest rates without the requisite recession-like slowdown. We advocated adding risk at the start of November, but in the recent frenzy, investors have got ahead of themselves, particularly on the question of interest rate cuts. Central banks are likely to be cautious about declaring victory over inflation and will take their time in adjusting policy unless growth turns sharply negative. Indeed, we

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believe Bank of England Governor Bailey's December comments that rates will need to be kept "high for an extended period of time" should be taken at face value. Therefore, there is significant potential for the current stock market optimism, which has built very quickly, to evaporate just as speedily.

Looking ahead, unless there is a deflationary recession it will be difficult for Central Banks to justify cutting rates aggressively. With Fed speakers already rolling back on the 3 to 4 cuts indicated by Powell in December it is hard to imagine market expectation of 5 to 6 cuts being correct. Afterall, why would they need to risk a return of inflation by simulating a still growing economy. One explanation given is that inflation is already set to fall below Central Bank targets but data released in January does not support this. The possibility of a strange deflationary period without recession is theoretically possible but given current levels of employment and ongoing global supply constraints looks increasingly unlikely. However this outcome appears to still be driving the investment market. It may be too good to be true but it does explain the remarkable growth in the valuation of the tech behemoths that make up the Magnificent Seven. With this near perfect outcome already priced into these valuations it seems to us the upside from here, in those particular stocks, is outweighed by potential disappointment.

While we remain optimistic that the election rich year of 2024 will be positive for investors overall we think better opportunities to add risk, at lower valuations, will occur in the coming months. Current positive risk free returns do allow for, and justify, investor patience.

Market Returns (£) - 31st Dec 2023	1 Month	3 Months	YTD	1 Year	3 Years	5 Years
Anchors						
Cash	0.5%	1.4%	4.7%	4.7%	6.0%	7.3%
Inflation Linked UK Bonds	7.0%	9.4%	0.7%	0.7%	-31.5%	-18.8%
Gilts	5.8%	8.6%	3.6%	3.6%	-26.5%	-14.3%
Global Government Bonds (hedged)	2.9%	5.3%	5.8%	5.8%	-8.4%	1.2%
Enhancers						
Global Corporate Bonds (hedged)	3.8%	7.3%	8.0%	8.0%	-9.4%	7.5%
Global High Yield (hedged)	3.8%	7.5%	12.6%	12.6%	0.9%	16.8%
Emerging Market Bonds (hedged)	1.6%	1.5%	1.6%	1.6%	1.5%	9.1%
FTSE 100 TR Index	3.9%	2.3%	7.9%	7.9%	33.9%	38.9%
FTSE All-Share	4.5%	3.2%	7.9%	7.9%	28.1%	37.7%
Global Equity (MSCI)	4.2%	6.7%	16.8%	16.8%	32.4%	82.5%
European Equity (MSCI)	4.2%	6.4%	13.3%	13.3%	24.2%	50.3%
US Equity (S&P)	3.8%	6.8%	18.6%	18.6%	40.7%	101.8%
Japan Equity (Topix)	3.9%	3.4%	12.8%	12.8%	9.5%	36.5%
Pacific Ex Japan Equity (MSCI)	1.8%	0.7%	-2.8%	-2.8%	-20.7%	11.3%
Emerging Market Equity (MSCI)	3.2%	3.3%	3.6%	3.6%	-8.3%	19.7%
Chinese Equity (Hang Sang)	-0.5%	-7.7%	-13.6%	-13.6%	-26.5%	-22.0%
Indian Equity (Nifty)	7.4%	7.1%	14.0%	14.0%	50.5%	74.3%
Diversifiers						
Commodity Index	-3.4%	-8.7%	-13.1%	-13.1%	45.7%	41.6%
Gold	0.4%	6.6%	6.5%	6.5%	15.0%	52.9%
Silver	-6.4%	2.6%	-5.9%	-5.9%	-3.7%	45.5%
Brent Oil	-3.4%	-8.7%	-13.1%	-13.1%	45.7%	41.6%
UK Property	-0.1%	-0.3%	-0.2%	-0.2%	2.9%	2.0%
Global Property Shares	9.8%	18.9%	10.7%	10.7%	-2.8%	6.8%
Rivers Model Portfolios						
Rivers Preservation Portfolio	1.4%	3.0%	6.0%	6.0%	1.1%	10.7%
Rivers Cautious Portfolio	2.0%	3.0%	6.6%	6.6%	5.2%	23.5%
Rivers Balanced Portfolio	2.3%	3.4%	7.1%	7.1%	6.9%	30.6%
Rivers Adventurous Portfolio	3.5%	4.3%	7.0%	7.0%	7.6%	36.5%
Rivers Aggressive Portfolio	3.7%	4.3%	6.0%	6.0%	8.4%	40.1%
Rivers Cautious Income Portfolio	2.7%	4.0%	4.0%	4.0%	-2.0%	9.3%
Rivers Balanced Income Portfolio	2.6%	3.7%	3.3%	3.3%	1.1%	15.1%

Source: Financial Express in GBP (unhedged unless stated) as at 31st December 2023. *Rivers Portfolios since launch June 30th 2016

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