HYMANS ROBERTSON

# Monthly Market Brief

February 2024

## February 2024 – highlights

- The second estimate of US growth in Q4 reaffirmed that the economy grew strongly at the end of 2023, with ongoing resilience in consumer spending. Growth in the US was much stronger than in Europe.
- Meanwhile, European data showed the UK entered a technical recession, as GDP fell 0.3% in Q4 following a 0.1% contraction in Q3. The eurozone economy flirted with recession, having stagnated in Q4.
- Flash composite purchasing managers' indices (PMI) suggest the worst may be over in Europe. Surveys indicated that UK growth accelerated for the fourth month in a row in February, powered by strong service-sector activity, while the eurozone downturn eased as the service sector stabilised.
- Despite pointing to a slightly slower pace of expansion, surveys indicate that the US economy continued to grow in February. Importantly, the US manufacturing sector returned to growth, alongside services.
- However, business surveys suggest inflation pressures are elevated in the labour-intensive service sector, particularly in Europe. Data released in February showed US CPI fell less than expected in January.
- Growth data in Europe improved, with expansion ongoing in the US. However, amid stubborn inflation pressures, the market became less optimistic about the scale and timing of interest-rate cuts.
- Market-implied interest rates and sovereign bond yields rose significantly. Meanwhile, on the back of positive activity data and strong earnings, equity markets extended year-to-date gains and credit spreads fell.

### Market performance to end February 2024

| UK | Q1 24* | Q4 23 | 2024 |
|---|---|---|---|
| EQUITIES | -1.1 | 3.2 | -1.1 |
| BONDS | | | |
| Conventional gilts | -3.3 | 8.1 | -3.3 |
| Index-linked gilts | -4.1 | 8.7 | -4.1 |
| Credit | -1.5 | 7.3 | -1.5 |
| PROPERTY** | 0.2 | -1.2 | 0.2 |
| STERLING | | | |
| v US dollar | -0.8 | 4.4 | -0.8 |
| v Euro | 1.3 | 0.1 | 1.3 |
| v Japanese yen | 5.3 | -1.3 | 5.3 |

| GLOBAL | Q1 24* | Q4 23 | 2024 |
|---|---|---|---|
| EQUITIES | 6.0 | 9.3 | 6.0 |
| North America | 6.9 | 11.8 | 6.9 |
| Europe ex UK | 4.8 | 6.9 | 4.8 |
| Japan | 13.6 | 1.9 | 13.6 |
| Dev. Asia ex Japan | 0.2 | 7.7 | 0.2 |
| Emerging Markets | 1.8 | 5.0 | 1.8 |
| GOVERNMENT BONDS | -0.6 | 5.3 | -0.6 |
| High Yield | 0.9 | 6.6 | 0.9 |
| Gold | -1.0 | 11.2 | -1.0 |
| Oil | 7.8 | -18.6 | 7.8 |

Percentage returns in local currency ($ for gold and oil). All returns to 29/02/2024, *apart from property 31/01/2024
Source: DataStream and Bloomberg. FTSE Indices shown: All Share, All World, W North America, AW Developed Europe ex-UK, W Japan, AW Developed Asia Pacific ex-Japan, Emerging, Fixed Gilts All Stocks, Index-Linked Gilts All Maturities, iBoxx Non-Gilts, S&P GSCI Light Energy, Crude Oil BFO, ICE BofA Global High Yield, Gold Bullion LBM, MSCI UK Monthly Property and BBG Aggregate Government Total Return.

## Fixed income markets

### Sovereign bond yields rise

Amid better-than-expected economic data, persistent inflation and a subsequent dampening of rate-cut expectations, UK and US sovereign bond yields rose 0.3% pa, to 4.1% pa and 4.3% pa, respectively. Equivalent German yields rose 0.2% pa, to 2.4% pa.

**UNITED STATES**

US yields **rose 0.3% to 4.3% pa**

**UNITED KINGDOM**

UK yields **rose 0.3% to 4.1% pa**

**GERMANY**

German bond yields **rose 0.2% pa to 2.4%**

### Inflation expectations

UK 10-year implied inflation – as measured by the difference between conventional and inflation-linked bonds of the same maturity – rose 0.1% pa, to 3.6% pa, as nominal yields rose more than real yields. Equivalent US and German breakeven inflation also rose 0.1% pa, to 2.3% pa and 2.0% pa, respectively.

### Credit spreads contract

Credit spreads fell notably across regions and credit ratings. Sterling investment-grade credit spreads fell 0.1% pa, to 1.2% pa, while US speculative-grade credit spreads fell 0.3% pa, to 3.3% pa. Equivalent European spreads fell 0.5% pa, to 3.4% pa. Despite spread tightening, sterling investment-grade total returns were negative, given the rise in underlying sovereign bond yields. Speculative-grade credit markets outperformed, with modestly positive total returns. This was partly due to greater spread tightening and income, but also attributable to these assets' much lower interest-rate duration than their investment-grade counterparts.

### Moody's expects defaults to fall

The global trailing 12-month speculative-grade corporate default rate reached 5% in January, the highest level since April 2021. However, Moody's estimates that this represents the current cycle's peak and that the default rate will decline modestly to 3.6% by the end of 2024. If this is realised, the default rate in 2024 will be close to its historical average of 4.2%. The forecast is underpinned by healthy corporate balance sheets, limited near-term refinancing requirements and anticipated easing in financial conditions.

### A fall in hard currency credit spreads offsets a rise in treasury yields

Despite a rise in underlying treasury yields, hard currency emerging market debt, as measured by the JPM EMBI Global Diversified Index, returned 1.0% in dollar terms as credit spreads fell 0.3% pa. Local currency debt, as measured by the JPM GBI-EM Global Diversified Traded Index, returned -0.6% in US dollar terms as yields rose modestly and index currencies, in aggregate, weakened against the dollar.

## Global equities

### Consumer discretionary and technology outperform

Consumer discretionary stocks led gains on the back of positive economic data. Technology also continued its year-to-date outperformance, as some high-profile US technology companies massively surpassed earnings expectations, benefiting the sector more broadly. Industrials was the only other sector to outperform in February, with all other sectors underperforming. The worst-performing sectors were telecoms, consumer staples and utilities, in that order – perhaps indicating that more defensive areas of the market underperformed amid improving sentiment. However, year-to-date laggard basic materials underperformed again, as did energy, healthcare and financials.

### Japanese equities lead the pack

Japan continued its year-to-date outperformance in February – a weak yen lent further support to the exporter-heavy index, but positive sentiment around corporate governance reform also gained momentum. Elsewhere, US equities outperformed too, given the market's large exposure to the technology sector. Emerging markets staged a modest recovery in February, performing in line with global benchmarks. Chinese stocks rebounded following a very weak start to the year on the back of better recent activity data and the announcement of further policy support.

### UK stocks lag

The UK was the worst-performing region over the month and remains the laggard year to date, given its above-average exposure to the poorly performing basic materials and energy sectors. Europe ex-UK also underperformed, despite better-than-expected business survey data.

## Currencies, commodities and property

**Crude oil prices rose 2.3%** amid ongoing tensions in the Middle East and continued disruptions in the Red Sea. The **Japanese yen fell 1.6%** as doubts grew about whether the Bank of Japan would exit its negative-interest-rate policy in the near term. The **US trade-weighted dollar rose modestly** as the prospect of imminent rate cuts faded, while the equivalent **sterling measure eased slightly** and the **euro rose 0.6%**.

The MSCI UK Monthly Property Total Return Index returned 0.2% in January, its first positive month since August, as income offset a further modest 0.3% fall in capital values in aggregate. Over 12 months, capital values fell most steeply in the office sector, declining 16.5%. Over the same period, retail capital values fell 5.4%, while industrial values rose modestly. However, commercial real estate transaction volumes remained low, with valuations based on a relatively small number of sales and purchases.

## The global economy

The second estimate of US Q4 GDP growth, released in February, reaffirmed that the US economy grew at a strong annualised quarterly pace of 3.3% at the end of 2023, amid ongoing resilience in consumer spending.

However, flash composite PMI data suggested the worst may be over in Europe. Surveys indicate UK growth accelerated for the fourth month in a row in February, on the back of strong service-sector activity. Meanwhile, the eurozone downturn eased as business confidence hit a 10-month high and the service sector stabilised. Despite pointing to a slightly slower pace of month-on-month expansion, surveys indicated the US economy continued to grow in February. The US manufacturing sector staged a welcome return to growth, with factory output increasing at the fastest rate for 10 months.

As backward-looking GDP and coincident survey data pointed to an economy with much stronger momentum than previously anticipated, consensus forecasts for year-on-year US GDP growth in 2024 leapt from 1.4% in January to 2.1% in February. While equivalent forecasts for the UK and eurozone are much weaker – at 0.3% and 0.5%, respectively – forecasters think the worst of the downturn in Europe is in the rear-view mirror and expect the majority of economies in the region to recover, albeit weakly, in 2024. Indeed, stronger-than-expected survey data suggests the UK recession may already be over, prompting upgrades to UK GDP growth forecasts for 2024.

However, business surveys also suggest that inflation pressures are elevated in the labour-intensive service sector, particularly in Europe. Meanwhile, February US CPI data showed inflation fell less than expected in January. January's year-on-year headline CPI inflation fell to 3.1% and 3.3% in the US and eurozone, respectively, while remaining at 4.0% in the UK. The equivalent core measures, which exclude volatile energy and food prices, came in at 3.9%, 3.3% and 5.1% in the US, eurozone and UK, respectively.

The Bank of England once again left rates unchanged ~at 5.25% pa in February. However, amid better-than-expected economic data and stubborn inflation, the major central banks continued to push back against market expectations of imminent rate cuts. In the US, short-term market-implied interest rates rose, with markets now expecting the first rate cut in June.


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