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June 2024
Quarter in Review

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GLOBAL EQUITIES STRONG ON RATE CUTS AND AI PROFITS

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Global equities broadly rallied over the second quarter, buoyed by a combination of prospective monetary easing later in 2024 and continued optimism around artificial intelligence (AI) and its potential to increase corporate profits. In Europe, there was increased volatility around the surprise announcement of a snap parliamentary election in France and a potential victory for the far-right National Rally. Meanwhile, the European Central Bank (ECB) cut interest rates for the first time since 2019, although both the ECB and the Federal Reserve (Fed) suggested that policy rates may need to stay 'higher for longer' to get inflation back to target. This, along with increased political risks in Europe, pushed bond yields higher.

US economy

Data in the US showed signs of slowing activity. US GDP rose by an annualised 1.4% quarter-on-quarter (q/q) in Q1, less than half the rate in Q4 2023 (3.4%). Elsewhere, the Senior Loan Officer Survey (SLOOS) showed that credit conditions had continued to worsen in Q1 as lending standards were tightened and loan demand fell, suggesting that financial conditions were increasingly restrictive.

In Q2, there were mixed indications in the labour market, which had been robust in Q1. In June, initial jobless claims increased to the highest level since August, and continuing jobless claims rose to their highest level since 2021. The unemployment rate rose to 4.0% in May. However, May non-farm payrolls were strong, with 272k jobs added, comfortably above consensus projections, and average hourly earnings rose by more than expected.

US inflation

Focus remained on inflation, which was sticky through April. The quarterly measure of inflation (PCE) accelerated from an annualised 2.0% q/q in Q4 2023 to 3.7% in Q1, higher than consensus expectations. This suggested that inflationary pressures remained.

However, price pressures eased in May. Consumer prices rose by 3.3% y/y and core prices were up by 3.4%. Both were lower than market expectations and down from April levels. In addition, the monthly rise in core prices (0.2% m/m) was the lowest since August 2021.

Federal Reserve policy

The Fed began to walk back its guidance around rate cuts in Q2. In April, Fed Chair Powell and Vice Chair Jefferson said that recent inflation data meant that the central bank was likely to delay its rate cuts. Moreover, after it left the federal funds rate unchanged at 5.25-5.50% at its April/May policy meeting, the FOMC's statement cited "a lack of further progress" in getting inflation to the 2% target. Powell stated: "It is likely to take longer for us to gain confidence that we are on a sustainable path down to 2% inflation". At the same time, he played down the potential for further rate hikes, saying that it was "unlikely" that this would be the next policy rate move. The Fed remained cautious through the quarter and also made no policy changes at its June meeting.

The central bank's revised projections suggested one rate cut in 2024, down from three estimated in March forecasts. This and subsequent speeches from Fed officials implied that rates are set to remain 'higher for longer'.

Eurozone economy

Q2 data from the Eurozone continued to suggest an economic recovery, with March industrial production rebounding from a fall in February. Investors' assessment of current and future conditions in Germany also improved amid positive views on domestic conditions, with the ZEW economic sentiment index rising to a two-year high in May. Eurozone retail sales recovered in March, aided by a rebound in Germany. Taken together, this further supported the idea that growth momentum in the region had picked up in recent months. Indeed, Q1 GDP expanded by 1.3% q/q annualised compared to a 0.2% contraction in Q4, aided by strong expansions in Spain and Ireland.

However, there were some signs of moderating activity ahead. The Ifo business surveys in Germany weakened by more than expected in June and suggested weaker orders. Furthermore, the Eurozone composite PMI index fell to a three-month low in June and suggested the outlook may have softened somewhat compared to early Q2.

ECB policy

Inflation in the Eurozone is expected to fall close to the ECB's 2% target late next year. Moreover, inflation falling to a low of 2.4% y/y in April gave the central bank sufficient confidence that the start of a rate cutting cycle was warranted.

As a result, the ECB reduced its deposit rate by 25 basis points (bps), to 3.75%, at its June meeting, its first rate cut since 2019. However, it was a 'hawkish cut' as ECB speakers subsequently emphasised data dependence and dampened expectations around the scale of further rate reductions in 2024. Indeed, data has since showed that inflation remains somewhat sticky. Eurozone headline consumer price prices rose by 2.5% y/y, decelerating from May while core prices were unchanged at 2.9% y/y. However, services inflation remained elevated at 4.1%, the same as the seven-month high in May.

MARKET ROUND-UP

Equities

Over the second quarter, global equities, as represented by the MSCI All Country World Index (ACWI), rose by 3.5% (3.8% in euro terms).

The backdrop of still healthy activity, despite some slowing in the US, and the potential for rate cuts in the coming 12 months was supportive. Meanwhile, the AI theme was a major contributor, and this helped push equity indices to new historical highs over the period. Indeed, the rally in Nvidia's share price meant it temporarily became the largest publicly listed company in the world, moving above Apple and Microsoft.

Small cap equities fell by 1.9% (-1.9% in euros) amid higher bond yields, which could hamper small caps given their higher leverage levels and larger share of variable rate borrowings.

Emerging market equities were up by 6.3% (5.9% in euros) over the quarter. The asset class was supported by positive sentiment towards technology stocks, which was reflected in a 16.8% rise in the MSCI Taiwan.

Bonds

The ICE BofA 5+ Year Euro Government bond index fell by 2.3% as German 10-year yields rose from 2.30% to 2.50%, due to a reduction in the magnitude of expected 2024 rate cuts. Moreover, the equivalent French government bond yield rose from 2.81% to 3.30% over the period amid increased political risks.

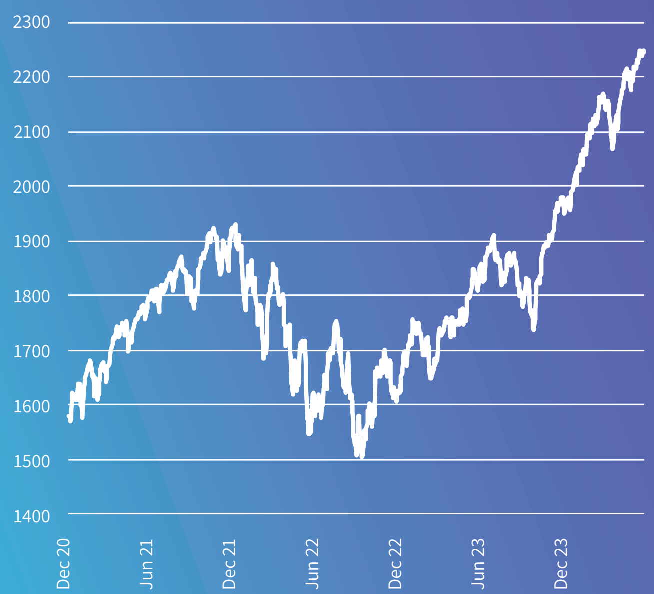
European investment grade (IG) corporate bonds returned 0.1% over Q2, supported by income yield, which offset capital losses. IG yields rose by 12bps to 3.87%, and spreads widened by 5bps to 117bps. Global high yield bonds returned 1.2%, with yields up slightly over the period, by 3bps to 6.93%, and spreads narrowing by 11bps to 250bps.

EM local debt returned -0.9% in Q2 as the income yield partly offset a modest capital loss, with yields rising by 32bps to 6.62%. EM hard debt returned -0.1% and yields increased over the period, by 15bps to 7.48%.

Meanwhile, peripheral Eurozone bond spreads widened as political risk in the region rose amid elections in France. Italian 10-year spreads over the equivalent German bunds increased by 19bps to 157bps, while spreads for Spanish government bonds were up by 6bps to 92bps. Among core markets, French spreads rose from 51bps to 80bps.

CHARTS OF THE QUARTER

Global Equities



Source: ILIM, Bloomberg. Data is accurate as at 30 June 2024.

Bonds – German 10-year yield

Source: ILIM, Bloomberg. Data is accurate as at 30 June 2024.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	QTD Return (%)	YTD Return (%)	2023 Return (%)
MSCI Ireland	0.4	18.9	20.6
MSCI United Kingdom	4.5	10.2	10.3
MSCI Europe ex UK	0.9	9.5	18.5
MSCI North America	4.6	17.8	22.3
MSCI Japan	-3.5	9.7	16.7
MSCI EM (Emerging Markets)	5.9	11.0	6.5
MSCI AC World	3.8	15.0	18.6
10-Year Yields	**Yield last month (%)**	**2023 Yield (%)**	**2022 Yield (%)**
US	4.40	3.88	3.87
Germany	2.50	2.02	2.57
UK	4.17	3.54	3.67
Japan	1.06	0.61	0.42
Ireland	2.95	2.38	3.13
Italy	4.07	3.69	4.70
Greece	3.75	3.06	4.62
Portugal	3.25	2.66	3.59
Spain	3.42	2.99	3.66
FX Rates	**End last month**	**2023 Rates**	**2022 Rates**
U.S. Dollar per Euro	1.07	1.10	1.07
British Pounds per Euro	0.85	0.87	0.89
U.S. Dollar per British Pounds	1.26	1.27	1.21
Commodities (USD)	**QTD Return (%)**	**YTD Return (%)**	**2023 Return (%)**
Oil (Brent)	-1.2	12.2	-10.3
Gold (Oz)	4.3	12.8	13.1
S&P Goldman Sachs Commodity Index	0.7	11.1	4.3

Source: ILIM, Bloomberg. Data is accurate as at 1 July 2024.

THE ILIM VIEW – LOOKING AHEAD

With inflation having fallen significantly and central banks now suggesting rates will be cut in 2024, bond yields are expected to decline over the next 12 months. On a 12-month view, our base case is that German and US 10-year government bond yields fall from current levels of 2.50% and 4.40% to 1.75% and 3.75%, respectively. We believe fixed income offers a strong risk-reward profile at this stage in the cycle, with the potential to offer protection if the economy slows, and is attractive from an income perspective while also providing potential for capital gains via falling yields. We believe that the risks of materially higher bond yields have reduced and, if the economy falters, major central banks will be able to cut rates to support growth. In that scenario, we would expect bonds to outperform to a greater extent.

Global equities have been resilient in 2024 as recession fears have receded and a peak in central bank policy rates has likely been reached. While global earnings fell by 0.1% in 2023, they are expected to grow by 11.4% in 2024 as growth remains firm and margins improve. Global equities valuations are above long-term averages, trading on a 12-month forward price-to-earnings (P/E) multiple of 17.8x against a long-term average of 16.0x. Equities remain expensive against both bonds and cash given the high yields currently available on these assets. Despite this, the outlook on a 12-month view is positive. Central banks are likely to pivot towards looser policy in 2024 as inflation falls. An increasing probability of growth remaining firm with a recession being avoided and a rebound in earnings in 2024 are supportive. Over the medium term, the rollout of AI should boost efficiencies and earnings across the whole market and allow equities to trade at higher valuation levels. The ongoing green-related capex cycle could also boost earnings over the medium term. Any short-term volatility in markets is likely to be offset by the above factors, resulting in positive global equity returns on a 12-month time frame.

THE MONTH AHEAD

JULY

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
				5 US Non Farm Payrolls US Unemployment Rate
	9 US Fed Chair Powell Testimony	10 CN Inflation Rate YoY	11 GB GDP MoM US Inflation Rate YoY	12 US PPI MoM Michigan Consumer Sentiment Prel
15 CN GDP Growth Rate YoY CN Industrial Production YoY Retail Sales YoY	16 DE ZEW Economic Sentiment Index US Retail Sales MoM	17 GB Inflation Rate YoY	18 GB unemployment rate EA ECB Interest Rate Decision	19 GB Retail Sales MoM
		24 DE GfK Consumer Confidence	25 DE Ifo Business Climate US Durable Goods Orders MoM US GDP Growth Rate QoQ Adv	26 US Core PCE Price Index MoM US Personal Spending MoM
	30 EA GDP Growth Rate YoY Flash US JOLTS Job Openings	31 US Fed Interest Rate Decision JP BoJ Interest Rate Decision EA Inflation Rate YoY Flash		

Source: tradingeconomics.com

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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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