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Market Pulse

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EQUITIES RALLY DESPITE DELAYED RATE CUTS

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Global stock markets continued to rally in January amid robust US economic data and expectations of interest-rate cuts. Bond markets fell, however, giving back some of their strong gains from December as expectations of rate cuts were pushed out somewhat. Global activity data in January was indicative of continued economic health: US numbers were robust, while Eurozone data was mixed, with some improvements in the labour market and manufacturing. The US dollar rose against the euro, and commodities rallied as an escalating Middle East conflict pushed up oil prices.

Macro

Global activity data in January was indicative of continued economic health. US data was robust while Eurozone data was mixed, with some improvements in the labour market. Monetary authorities in both the US and the Eurozone were dovish, suggesting that while rate cuts were likely in 2024, they would come later than markets had expected.

Global PMIs for January were mixed but manufacturing improved in both regions. The US PMIs for manufacturing and services increased from November and were both in expansionary territory (above 50). The manufacturing PMI for the Eurozone was also up, but the services PMI fell, with both indices remaining in contractionary territory (below 50).

US

US GDP expanded by more than expected for the fourth quarter, rising by 3.3% quarter-on-quarter (q/q) annualised compared to consensus projections of 2.0%. The expansion was driven by increases in inventories, domestic demand and government spending. Labour-market data was also strong, with 216k non-farm payrolls added in December, above consensus expectations of 170k. Average hourly earnings also beat expectations, rising by 4.1% year-on-year (y/y), and the unemployment rate was unchanged from November at 3.7%, lower than the projected 3.8%. Job openings unexpectedly rose by 1.1% month-on-month (m/m) in December, signalling robust labour demand. Finally, in January, initial jobless claims fell to a low of 189k, the lowest level since September 2022. December retail sales rose by 0.6% m/m.

Headline inflation accelerated to 3.4% y/y in December – above market expectations and up from 3.1% in November – as energy prices rose more than anticipated. Core prices showed a continued downward trend, however, decelerating marginally to 3.9%. The Federal Reserve's (Fed) preferred measure of inflation – core PCE – also fell in December to 2.9% y/y. This was the first time the measure was below 3% since 2021. This backdrop suggested that a soft landing – slowing inflation and growth, but no recession – remains likely in the US.

Minutes from the Fed's December meeting were indicative of a more dovish attitude, with some committee members also suggesting that the pace of the balance sheet run-off (quantitative tightening, or QT) could be slowed before being stopped altogether in 2024. However, there were also some hawkish comments, with the suggestion that upside surprises to inflation left open "the possibility of further increases". Messaging at the Fed's January meeting, at which policy was left unchanged, was consistent with this. The central bank stated that rate cuts would only be implemented when the Federal Open Market Committee has "gained greater confidence that inflation is moving sustainably toward 2%." Chair Powell said this was unlikely to occur by the next meeting in March.

Europe

Fourth-quarter Eurozone GDP was flat q/q, which resulted in full-year 2023 GDP being up by 0.5% y/y. On a country level, activity was mixed. Germany's GDP fell by 0.3% q/q and France was flat, both in line with expectations. In Spain and Italy, GDP rose by more than expected (0.6% and 0.2%, respectively). Despite improvements in sentiment, manufacturing activity – like Eurozone PMI – continued to show weakness. Industrial production ex-construction fell by 0.3% m/m in November, following on from a 0.8% fall in September. This was driven by manufacturing production, which has also declined for three consecutive months.

The labour market was robust, with the unemployment rate falling to a historic low of 6.4% in November and remaining there in December. Spain and Italy contributed to the fall as their unemployment rates fell to 11.8% and 7.2%, respectively.

Meanwhile, the Eurozone's January CPI fell to 2.8% y/y from 2.9% in December. Core inflation slowed from 3.4% to 3.3%, suggesting that underlying price pressures eased further.

Minutes from the European Central Bank's (ECB) December meeting suggested policymakers remained hawkish. The ECB was concerned that the fall in yields and associated easing of financial conditions "could derail the disinflationary process", and so "it was widely regarded as important not to accommodate market expectations in the post-meeting communication". However, at its January meeting, the ECB was somewhat more dovish. The central bank left policy unchanged, but President Lagarde stated: "The disinflation process is at work" as "almost all measures of underlying inflation declined further in December".

China

China's fourth-quarter GDP rose by 5.2% y/y, slightly above the government's official 2023 growth target of "about 5%". December activity was mixed, with retail sales (7.4% y/y) below market expectations, while industrial production (6.8%) and fixed-asset investment (3.0%) were above. The manufacturing PMI remained in contractionary territory in January. This lacklustre backdrop led China's central bank to ease policy by more than expected. The reserve requirement ratio (RRR) for banks was cut by 50 basis points (bps) in an attempt to stimulate lending and boost economic growth.

Elsewhere, Taiwan's election gave victory to pro-independence DPP presidential candidate Lai, though the party fell short of a parliamentary majority. This could prove important for future relations with China.

MARKET ROUND-UP

Equities

Global stock markets continued to rally in January amid expectations of rate cuts in Q2 2024. The theme of AI was also supportive for US technology stocks, but some of these gains reversed towards the end of the month as earnings guidance for some companies disappointed.

The MSCI All Country World index rose by 1.3% (2.3% in euros) over the month. The MSCI USA rallied by 1.6% (3.3% in euros), while European ex-UK equities were up by 2.1% (2.0% in euros).

Emerging market (EM) equities underperformed developed markets in January, falling by 3.5% (-3.0% in euros). The asset class was dragged lower by China (-10.4%) amid concerns over the country's growth, with the Chinese authorities introducing limits on short selling towards the end of the month in an attempt to reduce selling pressure.

Small-cap equities fell by 1.9% (-1.1% in euros), underperforming large caps and giving back some gains from December as higher rates acted as a headwind for the asset class.

Bonds

Global bond markets fell in January, giving back some of their strong gains from December, as expectations of rate cuts were pushed further out.

The ICE BofA 5+ Year Euro Government bond index was down by 0.9% over the month.

European investment grade (IG) corporate bonds eked out a 0.1% gain, as the income yield offset the modest capital loss. Similarly, global high yield bonds returned 0.2%, despite yields being up by 9bps to 6.96%. Spreads widened by 8bps to 302bps.

CHARTS OF THE MONTH

Global Equities

Source: ILIM, Bloomberg. Data is accurate as at 31 January 2024.

Bonds – German 10-year yield

Source: ILIM, Bloomberg. Data is accurate as at 31 January 2024.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2023 Return (%)
MSCI Ireland	7.0	7.0	20.6
MSCI United Kingdom	0.3	0.3	10.3
MSCI Europe ex UK	2.0	2.0	18.5
MSCI North America	3.2	3.2	22.3
MSCI Japan	6.4	6.4	16.7
MSCI EM (Emerging Markets)	-3.0	-3.0	6.5
MSCI AC World	2.3	2.3	18.6
10-Year Yields	**Yield last month (%)**	**2023 Yield (%)**	**2022 Yield (%)**
US	3.91	3.88	3.87
Germany	2.17	2.02	2.57
UK	3.79	3.54	3.67
Japan	0.73	0.61	0.42
Ireland	2.60	2.38	3.13
Italy	3.72	3.69	4.70
Greece	3.22	3.06	4.62
Portugal	2.97	2.66	3.59
Spain	3.09	2.99	3.66
FX Rates	**End last month**	**2023 Rates**	**2022 Rates**
U.S. Dollar per Euro	1.09	1.10	1.07
British Pounds per Euro	0.85	0.87	0.89
U.S. Dollar per British Pounds	1.27	1.27	1.21
Commodities (USD)	**MTD Return (%)**	**YTD Return (%)**	**2023 Return (%)**
Oil (Brent)	6.1	6.1	-10.3
Gold (Oz)	-0.6	-0.6	13.1
S&P Goldman Sachs Commodity Index	4.5	4.5	4.3

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

THE ILIM VIEW – LOOKING AHEAD

With inflation having clearly peaked 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 modestly from current levels of 2.17% and 3.91% to 1.75% and 3.50% 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. It 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 we have increased confidence that, if economies falter, 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 valuations are slightly above long-term averages, and equities remain expensive against both bonds and cash given the high yields currently available on these assets. However, the outlook on a 12-month view is positive. Central banks are likely to pivot towards looser policy in 2024 as inflation continues to fall. An increasing probability of a soft landing with a rebound in both growth and earnings in 2024 should also provide support. 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 multiples. 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 returns on a 12-month timeframe.

THE MONTH AHEAD

FEBRUARY

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
	13 US Inflation Rate YoY GB Unemployment Rate	14 GB Inflation Rate YoY	15 GB GDP Growth Rate YoY Prel US Retail Sales MoM	16 GB Retail Sales MoM US PPI MoM
		21 US FOMC Minutes		23 DE Ifo Business Climate
	27 DE Gfk Consumer Confidence US Durable Goods Orders	28 US GDP Growth Rate QoQ		

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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