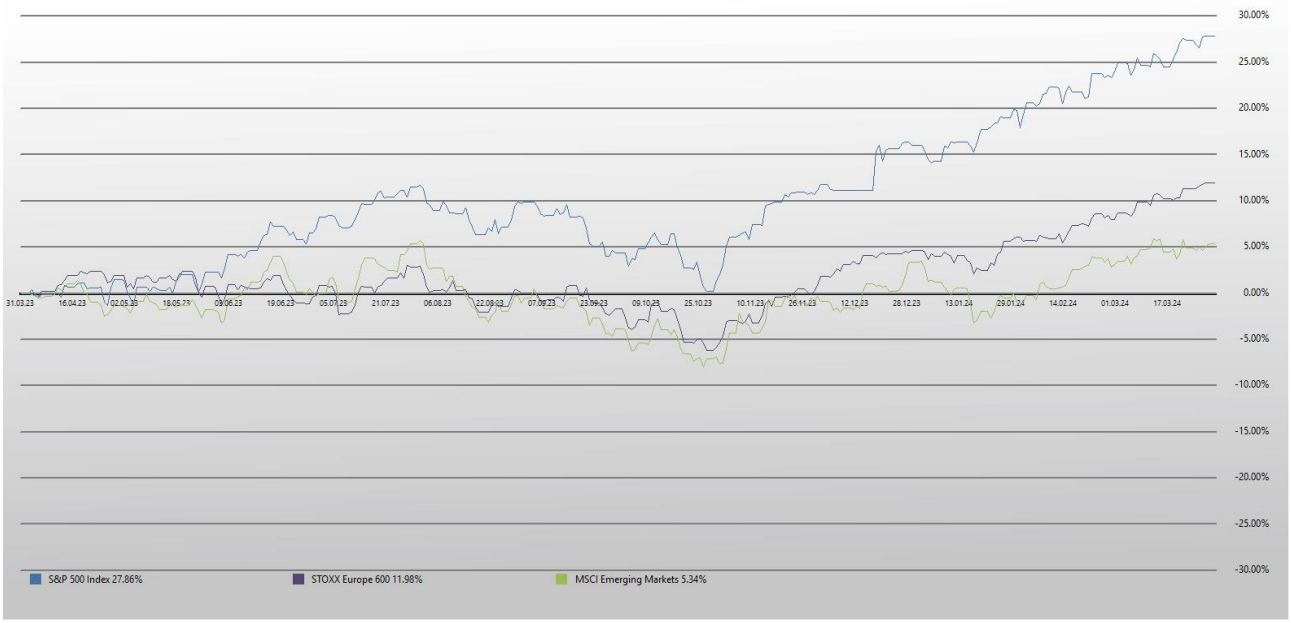
Kestrel Wealth Management

Quarterly Financial Market Update, March 2024

Overall, 2024 started with good auspices for risk assets. Similar support mechanisms that drove the equity markets at the end of last year, such as anticipations of cuts in benchmark interest rates and declining inflation, continued during the first quarter, although recently it has appeared that investors need to take a breather.

From the start of the year to the end of March, the global equity market posted a return of about 8%. Once again, the US stocks led the pack, with the S&P 500 Index generating a performance of 10%. Chinese stocks recovered from a very weak start to the year (-7% at the trough), up 2% year-to-date following some announcements from the government and the People's Bank of China regarding supporting measures for the economy in general. This helped the overall emerging markets to also end the quarter in positive territories with a 2%-return.

Equity Index Performance, rolling 12 months (%)



Source: Kestrel Wealth Management

Over the past few weeks however, the equity markets have been on a consolidation mode, as investors are awaiting further catalysts. The Information Technology sector was a strong engine to the upward move so far in 2024. We think that shares of more cyclical-oriented companies could take up the baton as central banks, such as the US Federal Reserve (the Fed), are likely to become more accommodating.
The US inflation figures were somehow disappointing for the past couple of months. However, the recent comments from Fed's officials are still pointing to an overall decline in the prices paid by consumers. Thus, we believe that a potentially renewed confidence in the downtrend of the inflation rate would also lead to higher stock prices.

Gold performed well too. The price of the precious metal went up by about 7% during the first three months of the year, breaking the USD 2'200.-/oz. threshold during the quarter. This was mostly driven by fears of ongoing, if not escalating, geopolitical tensions across the world, as well as a high likelihood that interest rates would fall from current levels.

As far as geopolitical risks are concerned, they have unfortunately not receded. On the contrary, the war rhetoric has increased, in particular on the Ukrainian front. Indeed, French President Macron mentioning the possibility of sending troops and Mr. Putin responding by the threat of nuclear strikes only added to the anxiogenic environment. The recent terrorist attack in Moscow could also serve as an excuse for Russian President Putin to step up the war.

This year will be an election year in many countries, with the most awaited one being in the US in November. A battle between Mr. Trump and Mr. Biden is today the most likely scenario. Independently of the winner, it should not alter the underlying trends of the overall US economy. However, it will raise uncertainties for investors.

Thus, after a relatively quiet period, volatility is likely to return. All else being equal, we would consider periods of high volatility to invest in equities. Indeed, we believe that the equity markets should continue to do well, driven by a further normalisation in inflation and in the benchmark interest rates.
Regarding the former, inflation rates have been on a downtrend for more than a year and a half now in the UK, in the Eurozone and in the US. In the latter for example, the Consumer Price Index stands at 3.2%, down from a peak of 9% in June 2022. Whilst the pace of the decline has slowed down over the past few months, the rate is still expected to be at 2.5% in a year's time.
In turn, if evidences of ongoing declines in inflation continue to be released, this will lead the central banks, such as the Fed, the Bank of England and the European Central Bank to become more accommodating in their respective monetary policy by reducing the benchmark interest rates in order to support their domestic economy. This move has already been done by the Swiss National Bank (SNB). The SNB surprised the market by cutting its rate by a quarter of percentage point to 1.50%, mentioning that the inflation was at an adequate level (1.2%) and that it was now time to support the Swiss economy.

Switzerland does not drive the financial markets, but the US do. Currently, the upper bound of the US benchmark rate stands at 5.50% (and 5.25% for the lower bound). We believe this is not sustainable in the long-term for some US companies with relatively weak balance sheets and in a declining economic environment, in particular amongst the small- and mid-size companies. Thus, we expect the Fed would start to decrease rates in late spring or in early summer.

Thus, a more accommodative monetary policy in the US should support the equity market globally, despite valuations not particularly cheap by Uncle Sam. For instance, the S&P 500 Index trades at an estimated forward P/E of 21x. The consensus is expecting earnings to grow 9% over the next twelve months. Positively, we see these estimates as achievable and could be even revised upward, if we are indeed in the scenario of a soft-landing of the economy. On the contrary and this is the major risk for financial assets overall, if a severe recession (i.e. a hard landing) appears to be the most likely scenario over the next months, which is currently not the case, then stock prices would fall materially from today's levels. This is a risk that should not be overlooked. Latest readings on the US Consumption showed a bigger decline than anticipated, perhaps as early signs that the consumers are running out of fuel. Should this happen, a soft-landing scenario could become less likely.

More accommodative monetary policies from the major central banks should support the overall bond markets too, as they would lead to lower interest rates.
In the US, interest rates have risen slightly since the start of the year. For example, the yield on the US 10-year government bond reached 4.20%, up from 3.88% at the end of 2023. This has driven bond prices a bit lower overall, down about 2% over the period, globally.
We believe building a solid bond exposure for diversified portfolios is paramount in a world as uncertain as we are living in currently. Thus, given the overall attractive yields, we believe investing in high quality bonds today will pay off over the years to come.