MONTHLY UPDATE

Latest views from the investment team

Yield Trouble

US government bond yields drifted higher over the first quarter and were jolted further in April, triggered by inflation nudging up again and exceeding economists' expectations. Market pricing now factors in one or two US interest rate cuts in 2024, compared with nearly seven cuts expected at the start of the year. While the steady rise in yields during the first quarter did not deter stock markets, the rapid rise in yields in April pushed the US dollar up and stock prices down.

Higher interest rates, all else equal, reduce the present value of future company earnings, while a stronger currency creates headwinds for the overseas profits of US multinationals. The decline in stock and bond prices (which fall as yields rise) in April was primarily triggered by US data, but adverse asset price movements were felt globally. Commodity prices, overall, are higher – reinforcing the message that global growth is in good health.

Strong economies, above-target inflation, and heavy upcoming bond supply (due to high government debt levels) all provide good reasons for bond yields to rise. However, recent history shows that there is little desire amongst authorities to allow yields to move too high, too fast. An example of this in the UK would be when bond yields spiked in Autumn 2022, after Truss and Kwarteng dented investor confidence by announcing hefty spending plans, resulting in the Bank of England launching an emergency bond buying scheme to calm markets and bring yields back down. This also chimes with the US in October 2023, when bond yields rose sharply, then retreated after the Federal Reserve adopted a more supportive tone. This makes sense since high rates also hurt government finances due to interest payments on ever increasing piles of government debt and little support from voters to rein in spending. Since these episodes, stock prices are much higher as earnings have proved buoyant, despite bond yields having drifted back up towards the previously troublesome levels. Evidence of US economic strength is broad with low unemployment, strong consumer spending and business confidence picking up. In the UK data is also pointing to a recovery from the technical recession recorded at the end of 2023, as stable rates and falling inflation have helped lift business and consumer confidence. This all demonstrates resilience to past rate rises; however, stability is desired, and the pace of any move up is important for confidence and stocks.

Corporate earnings season got underway in April. So far, earnings are, in aggregate, a little ahead of expectations. However, with stock prices near all-time highs, the guidance given seems to be having the most impact. Notably, stock prices in the US technology sector have been more volatile than in other sectors. While technology earnings remain strong and investment plans bode well for the future, a reality check on expectations is perhaps healthy given the sector's dominance over the last year.

Bottom Line

Recessions are typically catalysed by high interest rates or energy prices, both of which put pressure on spending power. Resilient data indicates interest rates are not yet seriously harming growth. Also, despite increased tensions in the Middle East after Iran launched missiles at Israel, oil prices retreated quickly after an immediate jump, as the prospect of significant retaliation faded. Finally, the economic cycle is likely to continue, providing broad support to multi-asset portfolios.

Month by numbers

Change in various markets over the month:

Asset		Change / Value
Equities		
UK	↑	2.79%
Europe	↓	-2.01%
US	↓	-4.15%
Emerging Markets	↑	1.40%
Japan	↓	-1.07%
Bonds / Rates ** Absolute change (%)*		
UK Base Rates	–	0.00% / 5.25
Fed Funds Rate	–	0.00% / 5.25
UK 10-Year Yield	↑	0.42% / 4.35
US 10-Year Yield	↑	0.47% / 4.68
Currencies		
GBP / USD	↓	-0.66% / $1.25
GBP / EUR	↑	0.15% / €1.17
DXY (USD Index)	↑	1.60% / 106.22
Commodities		
Gold	↑	2.37% / $2285.91
Oil (Brent)	↑	0.43% / $87.86
Noteworthy		
Coffee	↑	21.90%

Q&A

What's on your mind?

The FTSE has broken 8,000

The benchmark FTSE 100 index rose above 8,000 and to a new all-time-high in April – quite an achievement in a month of turmoil. It's hard to say that this says too much about the UK economy given the index is dominated by multinationals. Also, the joy is mainly felt by UK investors because, for US and European investors, the UK stock market has still not recovered from levels it reached prior to the Global Financial Crisis. However, while UK growth has lagged the US since the pandemic, inflation in the UK is still falling (whereas US inflation has stalled) and now sits below US inflation for the first time since 2022. This should enable the Bank of England to be more confident on their path to rate cuts and assist further stock market gains.

What is Bitcoin halving?

Bitcoin halving is when the reward for mining the cryptocurrency is split in half. This lowers the rate at which more coins are created, a feature that was set by the creators to limit supply and, therefore, support the value. It is effectively an in-built mechanism intended to protect Bitcoin from inflation. This process happens approximately every four years with the fourth halving having just occurred in April. The final halving event is expected to occur in 2140 - this is when the number of Bitcoins in circulation is expected to reach maximum supply. The process, which has happened three times previously (in 2012, 2016 and 2020) may have helped push Bitcoin to a new high in the first quarter in anticipation of the event. However, on the day, the price of Bitcoin barely moved.

What is happening with the Japanese Yen?

The Yen has declined over 40% against the US dollar since the Federal Reserve started raising rates in early 2022. Investors can borrow cheaply in Yen (where cash rates are still close to zero) and invest in the US (where cash rates are above 5%). This is an investment strategy that risks losses if the Yen appreciates, but the ongoing depreciation (and winning streak for these investors) has fuelled more of this activity, driving further Yen depreciation and US asset appreciation. The Yen is also at its weakest level for around 30 years against the Chinese Yuan, helping Japanese exports rise more than 7% in March from a year earlier while China's fell. The Bank of Japan are uncomfortable as a weak currency can hurt household confidence. They could raise rates to support the currency, but this may damage growth and push inflation down after a long battle to get it sustainably above zero. They face a difficult decision.

For more information, please contact your adviser.