MONTHLY UPDATE

Latest views from the investment team

If only AI could control inflation and elections

Politics is taking centre stage over the summer. The rise of France's far-right party and concerns over their fiscal views caused some jitters in June. However, we saw inflation numbers that, if not dazzling (if inflation could ever be described as dazzling), continued to soften. So, although the EU's central bank was the only one to cut interest rates, hopes have been raised that the US and UK will follow this year. Markets responded with bonds and equities broadly rising over the period.

With 2024 being a big year on the political front, June was a busy month with notable elections in Europe, India and Mexico. Of those results, it was in Europe (France in particular) that markets found the most worrying. France's far-right National Rally party dominated in the European Parliamentary elections and led to President Macron calling for snap parliamentary elections. Battle lines are being drawn between the equally vocal far-right and far-left, with Macron struggling to be heard in the centre(ish). For markets, it raised fears that should the National Rally win then their generous fiscal plan, especially in regards to tax cuts, could ignite a Truss-like meltdown in France's bond market, which may have far-reaching ramifications.

Once again, all eyes were on the latest inflation numbers, with many bond traders eagerly seeking signs that central banks will soon lower interest rates. Whilst headline inflation thankfully remains far more subdued now compared to even six months ago, there are signs in the US and UK that core inflation (excluding energy & food) is proving sticky. It may be the case that the last mile in this story proves the hardest. As such, it was only Europe that reduced interest rates (by 0.25%). Nevertheless, bond markets broadly reacted favourably, with yields on government debt falling (and so prices rising) and expectations building for at least one interest rate cut in the US and potentially two in the UK this year.

The big news in stock-markets was Nvidia (the AI computing behemoth) briefly becoming the world's largest company and the US market hitting another all time high; it has now set c.30 all-time highs this year. This has raised questions over the longevity of the dominance of the US market, US companies now make up a near-record 64% of the global equity market. Whilst there are many solid reasons for this (recent presidential election debates not being one of them), there are rumblings in some quarters, especially amongst the bargain hunters, that a lot of good news may already be priced in. On a not unrelated note, it is interesting that rising consumer confidence in Europe is boosting sentiment, supported by a central bank that has proved willing to lower borrowing costs already.

As all eyes turn to the UK and French elections and we brace ourselves for the inevitable deluge of political doublespeak, we take comfort from the fact that politicians, thankfully, tend to have limited impact on markets.

Bottom Line

Notwithstanding the political backdrop, markets are gearing themselves up for interest rate cuts in the US and UK, and more to come from Europe. We would be hesitant to pin our colours to this, what may be an optimistically tilted, mast. Although cuts do seem closer than they did, the rate and scale has been pared back. Higher for longer (rates) may mean investors become more valuation sensitive again - value and defensive sectors/regions may be best placed in this environment.

Month by numbers

Change in various markets over the month:

Asset		Change / Value
Equities		
UK	↓	-1.04%
Europe	↓	-1.13%
US	↑	3.54%
Emerging Markets	↑	4.26%
Japan	↑	1.63%
Bonds / Rates		** Absolute change (%)*
UK Base Rates	–	0.00% / 5.25%
Fed Funds Rate	–	0.00% / 5.5%
UK 10-Year Yield	↓	-0.15% / 4.18%
US 10-Year Yield	↓	-0.12% / 4.37%
Currencies		
GBP / USD	↓	-0.63% / $1.27
GBP / EUR	↑	0.70% / €1.18
DXY (USD Index)	↑	1.14% / 105.87
Commodities		
Gold	↑	0.03% / $2326.96
Oil (Brent)	↑	5.87% / $86.41
Noteworthy		
Carnival PLC	↑	25.65%

Q&A

What's on your mind?

UK inflation reached the Bank of England's target rate in June, why didn't they cut rates?

In June, the UK reported 2% inflation, the lowest in 2 years. This confirmed inflation back at the Bank of England's (BoE) target rate. A day later the BoE's monetary policy committee met to make their monthly base rate decision - the consensus, with 7 of 9 votes, was for no change. The catch all answer, as to why the bank did not start cutting rates, is that they must be seen to be retaining political independence. A looming election in July reduced the chance of a rate cut at this meeting – with the bank fearing this would indicate political favouritism. Ultimately, the BoE also deem many of the underlying components of inflation (especially in services) as still too high and it's too early to take its foot off the brake.

Should I continue to hold cash if interest rates are expected to fall?

Clearly there are always going to many good reasons to hold cash, especially if an investor's risk appetite is very low and/or time-horizon short. However, from a purely investment perspective, interest rate cuts will be reflected very quickly in the cash rates on offer and there is no asset price that will benefit from this lowering of yield. In fixed income, broadly speaking, you would likely see yields fall but prices rise. In stock markets, as long as rates aren't being cut to support an economic collapse, lower rates can help lower corporate valuations and debt costs, and boost consumer spending. Cash funds/deposits can be a useful tool when rates are elevated, but are generally not a favourable asset to hold as a large weighting within multi-asset portfolios, over the long-term in providing real (inflation adjusted) returns.

What actually is Artificial Intelligence (AI)?

AI simulates human intelligence in order to perform tasks such as understanding language, recognising patterns and making decisions. AI can be divided into multiple categories: Machine Learning (ML), which enables systems to learn and improve from data without explicit programming; Deep Learning, a subset of ML that analyses complex patterns; Natural Language Processing, which focuses on the interaction between computers and humans through language; Robotics, applying AI in robots to help them understand the world around them; and Generative AI, which creates new content from analysing data. AI's global presence has revolutionised various fields by enabling machines to perform complex tasks, learn from data, and even mimic human interactions. Its continued development promises further advancement and application across numerous industries, from healthcare and finance to entertainment and automotives.

For more information, please contact your adviser.