Current Positioning
August 2024

James Hambro & Partners

The past month summed up

Markets shuddered momentarily in early August, a sign perhaps of increased concern that a slowdown may deepen into a recession. However, the fundamentals for the global economy and many companies continue to be pretty solid.

The rationale

Our central view remains that the interest rate hikes since 2022 have cooled an overheating economy without thus far sending it into recession. The likelihood is that as rates begin to be cut, as they already have in Europe and the UK, economies can maintain enough momentum to avoid a more pernicious decline. Although this has become the view across much of the market, the pessimists had what they might regard as a “told you so” moment in early August when markets had their biggest declines in months.

As regards the higher risk scenarios that we have outlined in the past, the chance that prolonged and possibly resurgent inflation keeps interest rates higher has steadily receded through the summer, a fact increasingly acknowledged by policy setters. On the other hand, the belief that interest rates above 5% have done more damage than is visible is gaining traction.

Indeed, one of the catalysts for the drop in the first week in August, where the S&P slid 6% and the NASDAQ 8%, was a weaker jobs report. It showed a decline in the number of new hires in the month of July to just 114,000, much lower than the 175,000 which had been predicted. The figure was significantly below the 12-month monthly average of 215,000 new jobs, while the unemployment rate climbed for a fourth month. The news had the effect of boosting demand from investors for what they consider the relative safety of government securities: 10-year US bond yields dropped from 4.2% in late July to 3.8% amidst a cacophony of pleas for emergency interest rate cuts.

The problem with the jobs report is that it could be both harbinger, and also cause, of a decline in US consumer spending. This is important as it accounts for about two thirds of the US economy and 18% of world GDP (the same as the entire EU).

Sustained consumer spending, held aloft post-pandemic by savings built up over lockdown, has been cited as one of the reasons for the continuing strength of the US economy, even against a backdrop of punitive interest rates. That savings pot is likely to be running low and there is much evidence that less well-off US consumers are reining things in.

Mickey Mouse

The FT has reported that US consumers are holding back now on travel and leisure, shrinking the earnings of some well-known consumer brands. McDonalds, Procter & Gamble and significantly Disney, a bellwether for the spending of the US middle-class, have all said recently their earnings have been affected by lower demand. Home Depot, which provides the US consumer with its domestic hardware, has now lowered its sales forecasts. The company cited higher rates as causing homeowners to put off renovations and improvements.

Extrapolating this to mean that the economy is in deep trouble however seems selective, especially given that the data is at worst mixed, and from some vantages still predominantly positive. The Commerce Department reported earlier this month that sales at US retailers unexpectedly advanced in July by 1% from June, when

there been a small decline. Overall gross domestic product increased at an annualised rate of 2.8% in the second quarter of the year, double the 1.4% pace of the January to March period and exceeding the 2% predicted by economists.

So, if the balance of data points towards a relatively robust economy, what of those inflation figures that have been the cause of central banks trying to slow things down? The good news here is that consumer prices in the US are climbing at their slowest rate since 2021, advancing just 2.9% over the 12 months to July and below the significant 3% hurdle posted in June. This could be the information that allows the Federal Reserve to start cutting interest rates when it meets in September, a boon to what appears an already reasonably healthy economic outlook. A survey of fund managers showed most still expect a soft landing – that gradual cooling of the economy without a slide into recession (although with the nervousness shown in the market decline, it is unsurprising that investor growth expectations have slid by the largest amount since March 2022).

Geopolitical headache

The question then is why did markets fall so spectacularly out of bed in the early part of the month, if the backdrop isn't that bad, and most investors remain relatively bullish. Various reasons have been cited: Analysis by respected investment strategists MRB point to a considerable amount of what they call speculative excess that had accumulated in equity markets in the past year – think the huge increase in the share price of some technology companies. Other analysts are suggesting traders are now particularly jittery amid a geopolitical environment where the Ukraine war is taking a new turn with the incursion into Russia, and the standoff between Iran and Israel in the Middle East risks boiling over. The febrile state of US politics can be seen in the fast moving pace of affairs, with the Democrats and Kamala Harris now seemingly in the ascendant just weeks after an attempted assassination of her rival Donald Trump.

Most significant may simply be the relatively light trading that takes place during the summer months. Unlike two decades ago, much trading today is systematic and automated which means that the slightest downtick of data can send a relatively thin wedge of shares into a chain reaction of steep declines. Indeed, as we write this most markets have recovered almost entirely from the earlier slide – thus our view is that this looks more like a momentary loss of confidence rather than the start of a prolonged downward spiral.

Not great expectations

One of the undeniable behavioural aspects of markets of late has been that of exuberance and speculation, particularly centred around technology shares. We highlighted before our caution about the ability to accurately identify the profitable winners of any artificial intelligence (AI) revolution. Much like the dotcom bubble a quarter of a century ago, the ultimate winners may not necessarily be those driving the technological change but a wider group that profitably harness it. There is a creeping feeling amongst some experts that expectations for AI may have been over-hyped.

Increasing scepticism about the potential for AI business cases rather than theoretical use cases, together with an economy that is gradually cooling, should prompt investors to consider a wider range of more resilient and currently profitable industries. We may see a shift away from some of the more expensive technology businesses as well as those consumer companies whose profits depend on the extra cash that consumers have discretion to spend in the good times.

Instead, it may prove a more fruitful environment for those businesses that are less reliant on the current state of the economy. We have seen signs of life in the healthcare sector – people get ill and need treatments in good times and bad, whilst longer term growth for the sector is underwritten by ageing western demographics and expanding wealth in developing nations.

Conclusion

We are mindful of individual bits of data that could prove signs of deeper problems for the global economy, but a holistic assessment continues to underline a robustness in the US alongside signs of life in the UK. However, as the cycle matures there will be changes in the way consumers behave that may give renewed health to sectors that have been overlooked. While we continue to believe that our overall balance of assets is appropriate for the current conditions, we are looking under the bonnet of our equity holdings to ensure the portfolio is properly tuned for how the opportunities in markets and economies could evolve.

This document is a Financial Promotion for UK regulatory purposes and is directed only at investors resident in the United Kingdom.

This document does not constitute investment advice or a recommendation.

Past performance is not a reliable indicator of future performance. The value of investments, and the income from them, may go down as well as up, so you could get back less than you invested.

This material has been issued and approved in the UK by James Hambro & Partners LLP, which is authorised and regulated by the Financial Conduct Authority and is a registered investment adviser of the Securities and Exchange Commission. It is listed in the Financial Services Register with reference number 513246. James Hambro & Partners LLP is a limited liability partnership registered in England & Wales with number OC350134 and registered office at 45 Pall Mall, London SW1Y 5JG. A list of members is available on request. The registered mark James Hambro ® is the property of Mr J D Hambro and is used under licence.