Current Positioning
October 2024

James Hambro &Partners

The past month summed up

A half-point cut in US interest rates combined with better-than-expected economic data shifts the balance further in favour of a more positive soft-landing scenario.

The rationale

Our central view remains that higher interest rates have succeeded in slowing inflation without damaging the global economy and sending it into recession. The past month has seen a shift in outlook as concerns about the weakening of the jobs market have given way to a more positive view.

The pendulum of likely scenarios that we outlined earlier in the year continues to swing with the changes in monthly data. At the core remains our regularly cited soft landing, where we see some moderation in the overactivity that contributed to surging inflation two years ago but slowing to a healthy pace of growth to allow the Fed to cut rates further without the risk of a return of inflationary alarm bells.

The most likely downside scenario is still that the economy suffers a more emphatic deceleration, with the threat that the slowdown will snowball into a more sustained slump. This will be most clearly seen in rising unemployment. This scenario looks less likely than it did just a month ago.

What has shifted sentiment back towards the 'just right' to getting warmer viewpoint? Three key factors: first, relief that the Federal Reserve actually started its rate reduction programme: second, positive economic data with few signs of a recessionary outlook; third, news that the Chinese authorities are starting to respond to their economic woes more seriously.

Overall, the major event last month was the emphatic nature of the Fed's announcement on September 18, where policy makers cut rates by half a percentage point, down from their highest level since 2001, and suggested there'd be more to come.

Still, what on the day had been a strong consensus towards continuing cuts has since tapered on the back of the most positive data seen in months (Fed Chair Jay Powell has now said the central bank is not in a hurry to cut rates quickly). The US added more than a quarter of a million new jobs in September – the 254,000 posts not that far off double the 140,000 that had been predicted by economists, and much healthier than the 159,000 jobs added in August, a number itself which had been revised up. Concurrently the unemployment rate fell to 4.1%. The US services sector is also powering ahead, with a purchasing managers index climbing to 54.9 in September from 51.5 in August, well ahead of the estimates of 51.7, according to the Institute of Supply Management. As analyst Ed Yardeni puts it, the economic data has laid to rest the warnings of those predicting a recession.

But what of inflation, the phenomenon that led to those higher rates in the first place? Overall, it's a positive picture, in that US consumer inflation fell to a 2.4% annual gain in September, below August's rate of 2.5% – a trend downward even if it remains above the long-term target of 2% (this is still on our radar as an acceleration would shift the pendulum once again).

Effect on assets – more vodka into the equity punch bowl?

This then has consequences for the assets that we invest in. Significantly we appear to have left behind the multi-decade ultra-low interest rate, ultra-low inflation cycle that preceded the burst of inflation in 2022. Instead, we are probably in a more "normal" environment where inflation will ebb and flow depending on the state of economic activity. With labour and services data powering ahead this would suggest a more active economy with higher associated rates.

Given the fixed returns from bonds, the precise level of inflation and interest rates becomes even more important. The more positive market sentiment we are now witnessing – ably demonstrated by a decline in investor cash levels, according to Bank of America data – increases expectations for equities, and dims the relative attractions for fixed income in a higher return world. As you will know from previous missives, we trimmed our US Treasuries holding last month from what we felt were frothy levels. The past month's increase in yields from 3.6% to above 4%, and consequent decline in prices, means that decision has been rewarded.

At the other end of the performance spectrum, gold has continued its long march forward, climbing almost 40% over the past year on what analysts suggest is surging demand amongst Asian consumers for gold jewellery – the FT reported recently that Indian gold imports were at their highest level on record in dollar terms in August at more than $10 billion. With an exceptional return on this investment, we have decided to trim our position and pocket some profits.

Given the positive economic environment, falling rates, and positive corporate momentum, it makes sense now to consider a small increase to equity holdings. We see the greatest range of opportunities in the US, given that it is the fulcrum of the global economic framework and the most buoyant market in the G7, while also being home to more than half of the biggest 500 firms in the world. While other nations and regions struggle – European growth is sluggish and its biggest economy Germany is set to contract in 2024 – the US continues to power ahead with a thriving economy and world-leading companies. But what of the world's second-largest economy?

The end of China crisis – wishful thinking

Something unusual has happened in China in recent weeks – its key indices soared after the government there undertook a number of measures to rekindle growth in what had been a moribund economy. The stimulus plan included a cut in the country's main interest rate, reductions in the reserves banks must hold (which allows them to lend more), as well as funding to boost the stock market and the country's property sector. All well and good? Not quite. The index has pared back some of those gains in the past few days.

The problem is China is suffering from a slow-motion version of our great financial crisis – assets, particularly property, have been falling in value with consumers cowed into cutting their spending, prompting a vicious circle of decline. We have little confidence in the potential for China to decisively arrest its economic malaise and create an environment to promote the attractive balance of risk and return for our clients. Adding to that is the uncertainty associated with the authoritarian nature of the regime, where only recently teachers have been asked to hand in their passports. If a country can arbitrarily do things like that to its own citizens, the rights of international investors would seem of little weight.

That doesn't mean we don't think there are opportunities in the region – Asia is a broad market beyond China and there are rich possibilities there that may in the longer term take up an increased share of our equity deployment.

Conclusion

The tone of the market has shifted again, something that could continue in the months ahead as we move from economies at extremes to those where we are watching for signs of momentum in the marginal data. Looking forward it seems that the US economy and its consumers are in a healthier shape now than had been feared. This has shifted the balance in favour of equities.

We are slightly increasing our equity holdings, funded by profits generated from an extremely successful investment in gold. However attractive China might have become relative to its fortunes just a few weeks ago, the steps taken by the government there are not yet enough, so any new equity deployment from us will continue to flow to the home of the most successful and innovative businesses in the world – the US.
