FlyingColours

Portfolio & Market Update

February 2024

Introduction

After a mixed January, February was characterised by a relatively good month for assets. Equities markets rallied strongly, while fixed income assets softened significantly. The geopolitical tensions at the beginning of the year appear to have been largely forgotten by investors.

While inflation rates are lower than in the last quarter, the latest numbers were disappointing, indicating that an interest rate cut in March will be unlikely. Markets have been disappointed by the inflation path which has pushed the expectation of a rate cut to later in 2024. At the same time, the US economy continued to show signs of resilience, while the rest of the world displayed signs of subpar growth.

However, there is a consensus that inflation has peaked globally. So, while some central banks maintained a cautious approach, signalling prolonged high interest rates, others indicated that the direction of travel is towards easing rates.

Markets

February was a mixed month for multi-asset portfolios as equity performance was broadly positive, while fixed income assets performed negatively. US equities offered a particularly positive return, and Japan managed to reach a level not seen since February 1990. Asia and Emerging Markets also returned positive performances.

In GBP (Sterling) terms, US Equity was the best regional equity at 5.88% followed by EM and Asia equities with returns of 5.32% and 5.03%.

Meanwhile, the FTSE 100 was flat and returned a negligible loss of 0.01%.

UK

The UK markets returned a flat performance with a loss of 0.01% for the FTSE100. The UK economy can be defined as still weak but improving.

UK house prices started to rise again for the first time in over a year, thanks to lower mortgage rates. The Bank of England is facing challenges in reducing inflation to its target level. This is due to a lack of consumer discipline, particularly in the services sector.

In fact, according to the Purchasing Managers' Index (PMI), business sentiment continued to increase to 53.3 in February (the highest since May 2023), which indicates that the economy is growing again. As a reminder, any score above 50 indicates an expanding market.

Inflation was unchanged at 4%, which was below the expectations of economists.

Europe

The European stock markets had a positive month, achieving 2.14% in February. Manufacturing activity in the eurozone continues to shrink, with the PMI Manufacturing index at 46.5. This is due to low demand, even though companies are hopeful about the coming year.

In the Euro area, inflation continued to decrease to 2.6% year-on-year, slightly above the market consensus and the central bank target. Again, the service sector continues to push prices higher, albeit at a lower rate than in the previous months.

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US

With the S&P 500 generating a positive return of 5.88% in GBP terms, it rallied to new all-time highs. The rally was driven by remarkably strong underlying economic fundamentals. S&P 500 companies have reported their second consecutive quarter of year-over-year earnings growth in the fourth quarter. Meanwhile, inflation reverted to 3.1%, which was nonetheless above market expectations.

Composite PMI declined slightly to 51.4, which is a small drop from the previous month. This is off the back of a weaker services sector, but nonetheless, is further proof of US economic resilience.

The US is in the expansionary phase for the 13th month in a row, supported by a strong, albeit cooling labour market. The unemployment rate remained unchanged at 3.7%, higher than the April 2023 low, but unchanged from the previous four readings.

Japan

Japan returned a strong performance of 3.12% in GBP terms for February. The PMI dropped back from 52.0 to 50.3, with services slowing down and the manufacturing sector falling to a 3-and-a-half year low. Despite action by The Bank of Japan, the stronger US economy led to an appreciation of the US dollar against major currencies, particularly the Japanese Yen. Yen depreciation is particularly good for Japanese stocks which tend to be big exporters.

Asia & Emerging Markets

EM countries had a positive month in GBP terms, returning 5.32%. The equity rally was supported by Chinese equity. This recovery followed a five-year low and was driven by strengthened activity data during the Lunar New Year holiday period, along with supportive interventions from the Chinese government. These interventions included a cut to the 5-year loan prime rate, restrictions on short selling, and stock purchases by state-owned investment firms. Despite these efforts, China's manufacturing sector contracted for the fifth consecutive month, with the official manufacturing PMI decreasing to 49.1 in February, a slight decrease from 49.2 in January.

Fixed Income

Fixed income had a challenging month in February. In the UK, gilt yields previously reached a three-month high due to concerns over inflation in Europe. In the US, strong economic data forced investors to push their expectations of a rate cut in 2024 to June, which has pushed yields higher.

Outlook

We continue to expect inflation to fall in all regions, albeit at varying rates. Our outlook is that there is still the potential for a global economic slowdown, but a recession is unlikely in the coming months. Central banks will continue the challenging task of balancing inflation and economic growth.

At Flying Colours, we continue to monitor the economic outlook and market signals to ensure that our portfolios are positioned in the best interests of our clients.

Our portfolios are designed for long-term investment, so they are managed with this in mind. Our approach is to manage the long-term risk and not to be influenced by short-term trends which could be costly for our investors. Our aim is to achieve carefully managed risk-adjusted returns, in line with our investment philosophy.