FlyingColours

Portfolio & Market Update

August 2024

Introduction

August started with a sharp shock in the equity markets, due to a combination of:

1. Growing concerns over a recession in the US.
2. An unexpected Japanese monetary policy move.
3. Disappointing earning statements from AI companies.

However, the markets calmed down quickly and finished the month positively.

Within the equity sectors, small cap stocks (those with low market capitalisation and the potential for strong earnings growth), started to outperform large cap stocks. This was due to a substantially more favourable forecast for inflation and expectations of an interest rate reduction in September.

Consequently, stocks which are sensitive to interest rates, such as small-cap stocks, yielded higher returns compared to their large-cap counterparts.

Commodity prices ended the month lower, reflecting signs of reduced demand from China.

In the UK, equity markets had a fairly positive month with large cap stocks generating a return of 0.86%.

The US market showed little movement, with the S&P 500 posting a slight increase of 0.06%, while the NASDAQ experienced a more noticeable drop of 1.14%, indicating investors' inclination towards value stocks.

Markets

August was marked by increased volatility, but this benefited multi-asset portfolios, as both equities and fixed income saw positive returns.

In GBP (sterling) terms, UK, European and Asian equities performed well, although Japan and Emerging Markets experienced slight declines.

Fixed income markets gained strength due to global interest rate cuts and decreasing inflation.

US

In August, the US stock market saw a modest rise of 0.06% in GBP terms and even more in USD terms. Federal Reserve Chair, Jerome Powell, suggested lowering interest rates, boosting the market.

However, there was a shift in market leadership as tech companies, which had performed well until early Summer, struggled in August. This underperformance reflects investor concerns about the future returns of AI investments.

Despite the strong US economy, investors remain concerned about its overall state.

UK

The UK's FTSE 100 closed the month on a positive note despite renewed volatility. The Purchasing Managers' Index (PMI) reported another month of economic growth, driven by increased demand.

Although early signs of a cooling labour market appeared, with slowing pay growth and lower permanent placements, the stable unemployment rate at 4.2% suggests a robust job market.

The recent below forecast inflation figure remained steady at 2.2%, giving the Bank of England reason to lower its interest rate for the first time since 2022.

It is now widely anticipated that the Bank will continue to reduce the rate in the coming months. However, the Labour Government is indicating “tough decisions” ahead with their first budget in October. We shall have to wait to see what impact these tough decisions will be and what impact these will have on the markets.

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Europe

European equity markets experienced a downturn during the global sell-off, but rebounded relatively swiftly from mid-month.

The annual inflation rate in the Eurozone decreased from 2.6% to 2.2%, approaching the European Central Bank's target of 2%.

Meanwhile, signs of weakness in European growth have become more apparent, particularly in the manufacturing sector where activity continues to contract. This situation is paving the way for a rate cut in September, and the market anticipates additional interest rate reductions over the next twelve months.

Japan

In August, the Japanese market faced substantial turbulence, dropping over 10% early in the month—the worst loss since 1987.

Although it ended the month negatively, it rebounded from its initial slump. The market shock followed an unexpected timing of an interest rate hike to 0.25% from 0.1%. This move surprised investors, causing panic until the Bank of Japan intervened.

Inflation hit 2.6% and is expected to stabilise at 2.0%, ending decades of low growth and low inflation.

Asia & Emerging Markets

In GBP terms, the Asian markets were muted in August, however they mirrored other markets' volatility.

Within Asia, China's struggles continued to persist as it deals with the consequences of the property bubble burst.

Korea saw declines as interest in tech stocks waned. Meanwhile, numerous EM and Asian central banks began lowering interest rates during the month.

Fixed Income

Fixed income saw gains in August despite significant fluctuations.

Early on, investors reacted strongly to recession fears, but as these proved exaggerated, bond interest rates began to stabilise. Additionally, rate cuts by the UK central bank and expected cuts in the US and Europe helped lower rates, benefiting the fixed income market.

Outlook

The outlook for the coming months suggests continued market volatility. We acknowledge that inflation is in a decreasing phase.

Our view 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.