

'YOU HAVE TO KNOW THE PAST TO UNDERSTAND THE PRESENT'

As we approach the end of the first quarter, the first real milestone in 2024, it's worth taking stock. It has so far been a year in which most stock markets have already met or exceeded their targets for the entirety of 2024. Some will see this as a sell signal and others, a buy signal. Well, that's what makes a market.

For me, I am still a little shocked at the step change in direction over the last two years. We certainly came from a dark place in 2022 with little to be excited about. Compared to now: a state of euphoria in which most stock markets have smashed all-time highs and completed their year-end targets in under three

months. As Carl Sagan put it, "you have to know the past to understand the present" and I think in the context of these markets it's quite easy to trace back and importantly ask the question: does that tell us a little about what might happen next?

Twelve months ago, markets were still reeling from a volatile 2022. Unsurprisingly, there was almost a uniform agreement from economists that 2023 would see a recession in Europe and the UK. With the US

economy subsequently slipping into an economic recession later in the year as consumers ran out of COVID stimulus cheques, unemployment rose, and the economy eventually begun to contract. Inflation was predicted to come down but would be sticky and problematic in getting below 3%, which would kill off any hope of a rate cut as the possibility of stagflation (rising inflation as economic growth contracts) loomed large. In short, without the aid of some very specific idiosyncratic events, 2023 was set up to look more like 2022. There are many economists who argue that it (2023) should have looked bad because we were not done with the cathartic "clearing out" process which comes with a bear market.

Firstly, Artificial Intelligence (AI) burst onto center stage and triggered the animal spirits of investors to pile back into the tech market. To say the "AI" trade went gangbusters is probably doing it a disservice with the likes of Nvidia rallying over 500% since the start of 2023. Its rally has certainly had the initial hallmarks of the classic "hype cycle" of disruptive innovation. Regardless, the emergence of what will likely be the next industrial revolution in AI essentially burst the 2022 bear market and without this intervention I think 2023 might have looked very different.

Secondly, SVB (Silicon Valley Bank) and Credit Suisse went bust under signs that stress from high rates was starting to break the economy. Had this happened in the gloom of 2022 there could well have been quite a serious sell off. Instead, the US Federal Reserve stepped in with lending facilities and consumer protection to staunch the wound. This single action sent a message that the central bank was, despite raising interest rates, still a friend of the market and here to help cushion the market from any adverse fall out (whether that's the role of a central bank is a debate for another day). Growth equities and bonds rallied sharply as investors assumed this support would be in the form of early rate cuts to prevent further stress. I don't mind admitting I certainly didn't see the collapse of SVB unfolding into a stock market rally and I would imagine I am not alone there.

So, in quick succession we had two major events which both served to solidify resolve and smash the negativity of 2022 to get investors back into rally mode. The omission here was that most of this positivity was aggressively funneled into 7 stocks coined the "Magnificent 7". These were all loosely tied to the AI theme so a lot of high quality, but non-AI companies didn't get the stock uplift they were hoping for, which is where this "concentration" risk came from. This concentration into a very narrow basket caught the active management community off guard, allowing passive investments once again to win the year with their static exposure to everything.

The final 2023 lever was pulled at the end of Q3 by central banks finally announcing they had vanquished the inflation dragon and a "pause" in interest rates was now in play. As we knew it would, the market took this "pause" as a tacit admission that interest rate cuts were going to come down the pipe in quick succession. The Q4 "everything" rally saw investors reaping some of the steepest gains over a two-month period in stock market history, except for cash, which prompted schadenfreude from those who chose to remain invested into the market over 2023 rather than move into cash.

To my mind, these single events were the chief agents identified behind the turn in positivity and sentiment which led us out of 2022 and into 2024, where we are now watching a seemingly unstoppable equity market and a healthy bond market that keeps smashing records across the globe. If you want evidence, look at Japanese stocks which are back with a bang after more than 20 years sitting on the

sidelines. Bitcoin, regardless of your view is surging along with Gold. Small caps are starting to shine once again, and the UK remains a great source of high-quality companies trading at "cheap as chips" multiples. It certainly feels like the type of market in which one just needs to buy something to make money.

One must also remember, as rates come down, those invested in cash funds will likely give up rowing against the tide and begin to move back into stocks and shares. This move alone could unlock trillions of dollars sat on the sidelines in cash funds. So, there certainly is dry powder to push this market higher and investors seemingly have the bit between their teeth for more gains.

So yes, it's a good market and one which is being driven higher by something I think is credible and reliable (cuts to interest rates this year). That's the chief reason why we have positioned our portfolios to go overweight equities, to capture as much of this positivity as possible, whilst we see it lasting.

Market insight written by James Penny, Chief Investment Officer at our investment management partner TAM Asset Management.

If you would like to speak with us about anything in this note, or to discuss our discretionary investment management services in general, please get in touch with our Head of Investment Phillip Hadley.

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