ROCQ CAPITAL

# Fourth Quarter 2023

It was a strong quarter for financial markets, despite an extremely poor month in October, in the final few weeks of the year movements in government bond yields provided the foundation for broader gains across credit and equity markets. In GBP terms, the MSCI World equity index rose by 6.2%, roughly in line with the US market, though the FTSE 100 lagged with an increase of 1.7%; the Global Aggregate index of bond markets rose by almost 8%.

Stock markets fell during October and it was notable that companies missing expectations when publishing their Q3 results were punished heavily by investors – there were some sharp sell-offs in individual shares and this translated into equity indices as well. Events in Gaza added to the list of geopolitical factors for investors to consider, but there was little direct impact even on the oil price which spiked initially before falling during the second half of October to end the month down around 10%. The key risk is of a broader conflict bringing in the US, Iran and other regional powers but there has been little sign of this level of escalation so far.

In November, investors' perceptions of central bank policy seemed to shift, resulting in a fall in bond yields which helped to buoy equity markets. Inflation showed further signs of moderation in most economies and is falling at a slightly quicker pace than had been expected, particularly in the Eurozone. This has encouraged a view that in 2024 central banks will have the latitude to cut rates, which if driven only by inflation would be positive for economic activity. Key to this was the US Federal Reserve's (Fed) latest policy announcement on 13th December which seemed to mark an abandonment of its plans for interest rates to be kept 'higher for longer' which had prevailed through the summer and into October. Instead, most committee members now expect rates to be reduced next year, such has been the progress on bringing inflation down to tolerable levels, and Governor Jerome Powell did nothing to dissuade investors from this view in his press conference.

As a consequence, yields – which had already been drifting lower for a few weeks – fell sharply which drove positive performance for global bond markets. With the potential for lower interest rates while economic activity is still robust, equity buying was also stimulated. Most regional stock markets added 3-5% during December, though Asian indices (notably China, once again) lagged.

While the Fed was the most important influence on markets, more evidence of disinflation emerged in the Eurozone and the UK in December which helped to buttress the above-mentioned moves across various assets. UK CPI inflation is now 3.9%, down from around 11% a year ago; while the Bank of England has a difficult job to balance inflationary pressures against low economic growth, there is clearly more scope to reduce interest rates in 2024 and the market has moved to price in over 1% of cuts ahead.

## Outlook

We had expected bond yields to fall, although the move in November and December was perhaps more rapid than we anticipated. As 2023 ended, markets seemed to find themselves in a sweet spot where disinflation has taken hold but accumulated interest rate rises over the past two years have not had a significant impact on economy activity in aggregate, particularly in the US which remains the key engine for growth and sentiment. We are unsure if the global economy will make it through 2024 without weakening, so remain slightly defensively positioned in terms of our equity weighting and via a sizeable portion of Alternatives, where appropriate. Within our equity allocation we have retained exposure to emerging markets and the UK, as generally valuations are attractive and certainly less stretched than in the US where the largest technology stocks have driven positive performance this year.

However, we have retained a high level of conviction in our bond investments, as we feel they have the potential to perform solidly in a range of scenarios. Returns would be less positive if inflation proves sticky and interest rates do not fall but, as mentioned last quarter, the running yield of high-quality bonds is elevated enough to make an allocation to fixed income attractive relative to other asset classes.

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