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WEALTH MANAGEMENT

Investment Outlook 2024

If 2023 was the beginning of the new investment story, then 2024 is certainly the middle – but importantly, not the end. In 2023 the leading characters were inflation and interest rates, and as we proceed into 2024 this will remain the case. Later in the year equity prices may better reflect company earnings, but in the meantime macro-economic forces will continue to drive markets.

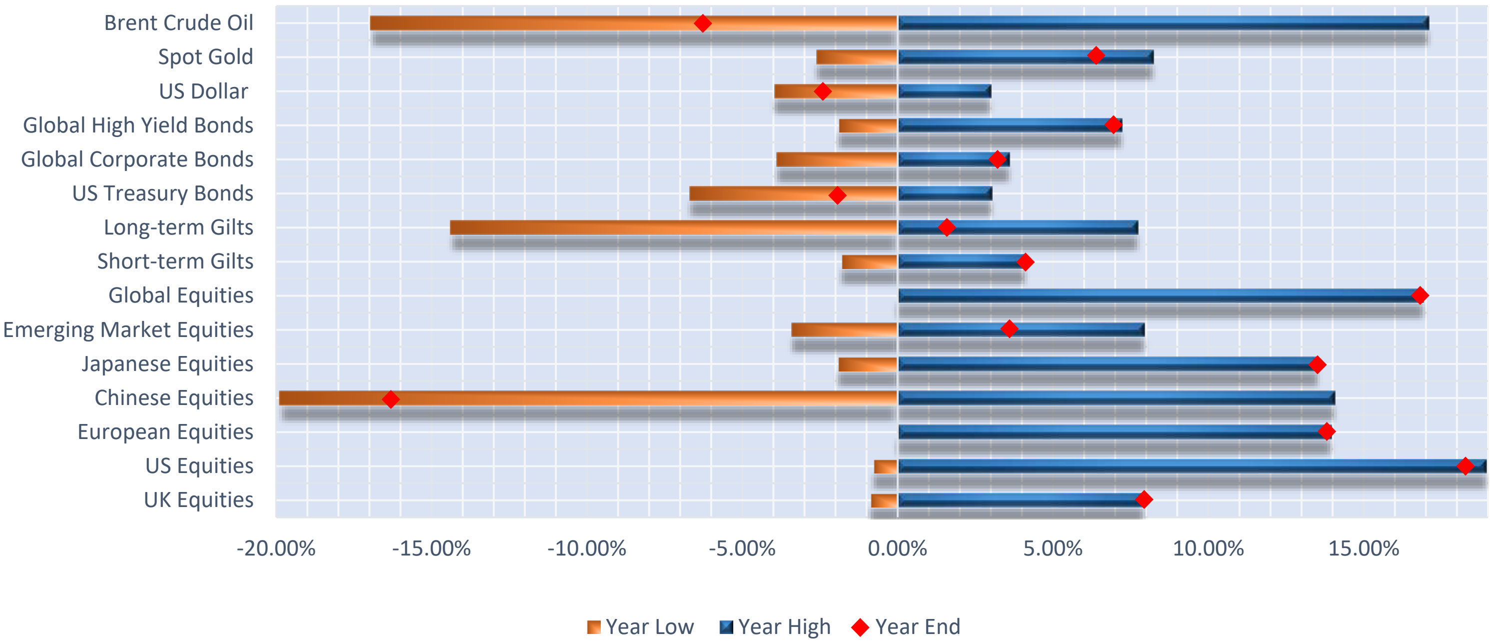
We will continue to see, as we did in 2023, widely differing opinions from market commentators, and so it is important to stay diversified and not bet too heavily on any particular outcome. Attempting to "predict" what will happen is likely to leave one at the mercy of unpredictable events.

Nonetheless, experience does help and it is useful to look ahead at the scenarios we can envisage in 2024, both likely and unlikely. We think we will see key structural drivers influencing markets, but that their effects will run out in the long-term and will not fully materialise anytime soon.

Looking back, 2023 was another year of volatility with the main features being as follows:

- Central banks spent the year raising interest rates, with the ECB rate rising to 4%, the Fed funds rate rising to 5.25% to 5.50% and the BoE base rate reaching 5.25%.
- Global inflation rates started the year well above central banks' 2% target before dropping back down, closer to target but not yet there.
- In the UK the CPIH rate of inflation (which includes housing costs) started the year at 8.8% before dropping back to 4.2% in November. In the US, CPI started lower at 6.4%, before ending in November at 3.1%.
- With investors deciding that central banks had reached the end of their rate hiking cycle, December returns were positive across most markets and asset classes, with equities rising and bond yields falling.
- Economic growth in the UK remained stagnant throughout most of the year, while the real surprise was the resilience of the US economy – many commentators last year were predicting a recession. On the face of it the US economy grew by an annualised rate of 4.9% in the third quarter, although as we are still in the shadow of the pandemic this may not be as strong as investors originally thought.
- The chart below shows the range of investment returns across the year for different asset classes. Comparing this to a mid-year chart, the year end returns are markedly different to returns earlier in the year, highlighting investor uncertainty.
- Against expectations, the "magnificent seven" technology companies drove US equity returns on the back of the new AI theme, averaging 75% over the year. The S&P 500 ended the year up 17.22%, but an equally weighted version of the index (removing the outsized influence of these seven companies) only grew by 6.79%, highlighting the influence that the largest companies have on US equity index returns.

- The conflict in Israel caused concerns about rising oil prices, although these have not yet materialised.
- The Chinese economy continued to be weighed down by its struggling property sector, with deflation creeping in towards the end of the year. Political tensions weighed heavily on investors' minds, namely China's relations with the US and the risk of military action over control of Taiwan. Despite starting the year strongly, China ended up being one of the worst performing equity markets.
- Japanese equities were popular throughout the year with multiple tailwinds giving investors confidence. Prices finally started rising, monetary policy is still loose and corporate reforms look to improve business practices.
- Emerging market economies saw mostly positive double digit returns as these countries' central banks raised interest rates earlier than developed economies, and are therefore further ahead in their interest rate cycle. Performance picked up in December due to forecasts that US interest rates could drop sooner than expected.



Selection of assets 2023 calendar year returns and range of returns (the two ends of the bars represent the range of YTD returns and the red dots represent the current YTD return). Indexes used: FTSE All-Share, Russell 3000, STOXX Europe 600, MSCI China, MSCI Japan, MSCI Emerging Markets, FTSE UK Conventional Up To 5 Years, FTSE UK Conventional Over 15 Years, ICE BOFA US Treasury, ICE BOFA Global High Yield, ICE BOFA Global Corporate, US Dollar Index, S&P GSCI Gold Spot, S&P GSCI Brent Crude Spot. Returns hedged back to GBP with exception of US Dollar which is in US Dollar terms. Data from FE Analytics and MarketWatch.

2024 Outlook

The first half of the year will likely be driven by interest rate expectations as investors consider that central banks have reached the end of the interest rate hiking cycle. The early forecasts are that interest rates will fall in March with continued cuts through the rest of the year. Central banks have pushed back on the idea of rate cuts anytime soon, insisting that until inflation is further towards their target, rates will remain higher.

As the US economy is still growing, the Federal Reserve has some room to keep rates higher. Its main objective is to see inflation coming down further and remain sustainably low, and seeing a weaker labour market will be key before it is likely to bring rates down.

General elections in the US will undoubtedly add volatility to markets, while the election in the UK is unlikely to cause any major market moves.

There has been less discrimination between companies over earnings projections, especially in the smaller companies (or “small cap”) end of the markets, and this will again come into focus when interest rates are at lower levels.

There is much debate over whether the “magnificent seven” can justify their high valuations. There is no doubt that they are profitable companies, but these high prices are paying dearly for value in the future. The common theme is that their values reflect technological advancements which, for the majority (if not all) of them, means Artificial Intelligence.

Research by PwC forecasts that by 2030, the yearly economic value of AI will be $17 trillion. To put that into perspective, the value of global GDP each year is currently $110 trillion. It is predicted that the level of innovation that will be driven by AI will be exponential, and so the value of any company operating in this space should be high.

That said, these companies are not without their own headwinds. Several governments are looking to crack down on their monopolistic practices and smaller less known companies may prove to be just as valuable in the future.

Markets have been more volatile than they have been for a long-time and as we see it, the key drivers below will only serve to keep this elevated volatility in play.

This has implications at a portfolio level and in our view, rebalancing will become more important – prior to 2020, simply buying and holding investments without rebalancing would yield only a slightly lower return (when compared with rebalancing bi-annually, the return would have been around 1% pa lower). Between 2020 and 2023 however, buying and holding investments would have returned around 2% pa less than rebalancing once or twice a year.

Rebalancing is therefore an effective investment management tool for maintaining a consistent return, as high volatility will otherwise quickly distort portfolios from their intended allocations.

Other factors such as shrinking workforces and decarbonisation are long-term structural issues that will affect markets throughout the next year and beyond.

An important country to keep an eye on this year will be China, which struggled throughout 2023 and any deterioration of the relationship with the US could put more strain on global trade.

Again, a bottom up selection will be important with high volatility a common theme in the market once more. High volatility isn’t all bad though, as it can mean upwards movements in price as well as downward movements.

2024 Key Drivers

- Interest and inflation expectations during the first half of 2024
- In the US and to some extent the UK, general elections causing political risk
- Company fundamentals with a focus on earnings growth (this will become a larger driver if and when interest rates fall)
- Use of AI and any developments in this area
- Shrinking workforces
- Decarbonisation
- De-globalisation with economies re-shoring and near-shoring
- US trade tension with China and the risk of China invading Taiwan

UK

UK inflation looks to be under control for now, as headline CPI rose by 3.9% in the 12 months to November 2023. While this figure is still above the central bank's target of 2%, it marks a huge decline from highs of over 11% in 2022 and brings the inflation rate back into line with other developed nations. Nevertheless, investors will be keeping a watchful eye on the Bank of England – especially in the first half of 2024.

While narrowly avoiding a recession, the UK economy struggled with stagflation for most of 2023. Slow GDP growth looks set to continue well into 2024, with research from KPMG suggesting that the UK economy will only grow by 0.5% in 2024. A weaker economy could force the Bank of England to reduce interest rates at a faster pace than other developed nations – particularly the US, where economic activity is proving more resilient.

After a volatile year, the FTSE 100 increased by 7.93% over 2023. This marks a respectable annual increase for the index, and although we are cautious there is the potential for further growth this year.

Having traded at a large discount relative to its US counterpart, investors in UK markets will be hopeful that lower interest rates will help UK equities in 2024. The FTSE 100 index is currently trading at a 12-month forward PE ratio of approximately 10.5. This is 15-20% below its long-term average and around one-third lower than global equities, making it potentially good value.

Should interest rates fall as they are expected to and investors place more importance on earnings, UK equities may benefit accordingly. Despite slow GDP growth, Swiss Bank UBS forecasts that the FTSE 100 earnings will grow by 5% in 2024, having declined last year due to falling commodity prices.

Whilst there is a potential for undervalued UK equities in 2024, investors should question whether there is a solid reason for this. The UK stock market has struggled to attract any substantial technology companies in recent times, and this needs to be addressed if UK markets are to benefit from global trends such as the rise of AI.

Falling interest rate expectations drove returns in the bond market over the final quarter of 2023. The ICE BofA UK Gilts All Stocks index increased by 8.11% during Q4 while the ICE BofA Sterling Corporate bond index increased rose by 8.47% over the same period. The yield on 2-year UK gilts has already retreated to 4.25%, down from 2023 highs of over 5.48%.

Cautious investors, who traditionally have a higher exposure to the fixed-income sector, have witnessed larger-than-usual decreases in the value of their portfolios over the past two years as rates increased rapidly to counter inflation.

With rate cuts now widely anticipated this year, in our view, there is the potential for better returns from the bond sector during 2024.

While a deep global recession looks to have been avoided for now (a so-called "soft landing") there is no guarantee that this will continue to be the case. Any recession which does materialise is likely to put further pressure on interest rates and bond yields, which is positive for capital values in the bond sector. Whilst this will be positive for the sector, investment grade and government bonds are preferred in an environment where defaults could arise.

US

Last year caught many investors off-guard, with surprisingly positive performance after what looked like an impending recession and potentially poor market returns. High inflation, increasing interest rates, and a recession just around the corner was the situation at the beginning the 2023.

The surprising US market optimism was mainly driven by the resilience of the US consumer and advancements in artificial intelligence technology – the technology stocks which benefitted from this trend make up an outsized proportion of the US market, so their good returns were enough to help US equities gain value overall.

Looking forward to 2024, markets will likely be driven by monetary policy, political uncertainty, and the ongoing structural themes. The Federal Reserve continues to manage falling inflation whilst not over-tightening into a severe economic slowdown. The US election also looms as American voters are polarised on key policy issues. Longer term, structural themes such as technology and demographics will continue to be priced by markets.

We expect interest rates to ease steadily throughout the year, but it is unlikely that we will re-enter the zero-rate environment that we have experienced for much of the last decade. The "higher for longer" narrative may be true – however, peak rates are more likely to be seen in the rearview mirror before too long.

The Fed should have room to reduce rates as inflation falls closer to its 2% target – in November, inflation was 3.1%. Economic growth may also slow as the lag effects of the fastest rate hiking cycle in 40 years kick in. The real question from here on will be whether the Fed has done enough to put the inflation genie back in the bottle, whilst not bringing about a recession? It seems as if the elusive soft landing has been achieved, for now. Bear in mind however that a true "soft landing" has only been achieved once since the end of the second World War (this was in 1995).

The coming year is set to be the biggest election year in history with over half the global population voting. The U.S. is one of these nations, with what looks to be a Biden vs Trump Round Two on the cards.

The outcome is unsure but the potential for elevated volatility is present. Statistically, election years tend to be positive for US markets. There have been 25 elections since the S&P 500 index began and the average election year return has been 11.57%, 15.3% if a republican was elected and 8.43% if a democrat was elected. Although returns in election years have been positive in 20 out of the last 24 cases, this is far from guaranteed and returns vary significantly.

Technology stole the show in 2023 and we believe that this will continue to be the case. Companies that are investing heavily into this trend have seen huge increases in valuation over the last twelve months, but we must wait to see if they will able to justify these high valuations. Advancements like these tend to send shockwaves into other industries that can also benefit, such as healthcare with biotechnology, automobiles with automation, and manufacturing with robotics, to name a few. Other themes to follow in 2024 include aging demographics, decarbonisation, and geopolitical risk.

Equities:

In our view the most successful returns will come from a bottom-up approach to US equities in 2024, with S&P 500 earnings growth turning positive after three consecutive quarters of decline. As mentioned, last year's stock market rally was very concentrated to the "Magnificent Seven" and we believe that this trend could now broaden out to include some of the less favoured names in the sector.

The relatively expensive 12-month forward price-to-earnings ratio of the S&P 500 retreats to a more reasonable 16.5 from 18.7 if you take out these seven stocks. This is not to say that we believe the Magnificent Seven are overvalued, in fact, quite the opposite could be true with the strong balance sheets and competitive positioning for future technological advancements.

The next aspect that could drive equity market returns relates to the coming decrease in the risk-free rate (that is, the yield on US Treasuries).

Investors can currently pick up a return of around 5% from fixed interest securities – this is over half of the historical average return for the S&P 500 with only a fraction of the volatility that comes with equity investments. There is also the opportunity for capital growth, as prices move inversely to yields, which are predicted to fall as the year goes on.

However, if bond prices come down and yields start to diminish, equities start to look comparatively more attractive again. This is not to mention the nearly $6 trillion currently sat on the sidelines in cash-like money market funds.

Fixed Interest:

Fixed interest prices had a tough 2023 as the base rate increased successively all the way through to the Fed's last rate hike in July. This has been somewhat forgiven by investors – November proved to be one of the best-performing months in almost 40 years as the 10-year yield retreated from 5.02% to 4.25%. From here, bonds still look very attractive in our view. If bond yields decrease, gains will be seen via capital appreciation, whereas if bond yields move higher, the capital depreciation will be offset by the healthy yields on offer.

Much like equities, returns will be highly affected by monetary policy with inflation and growth determining the Fed's path and forward guidance.

Currently markets price in over 1% of cuts in 2024 but these expectations can quickly turn around if inflation rears its ugly head again. Elevated rates should be able to keep a lid on inflation, but as we have found out over the past few years, supply chains can be very fragile and subject to unexpected shocks.

Over the longer term, onshoring should reduce this risk but in the short term set up costs will likely put upward pressure on inflation – so it remains a complex picture. Again, our long-term view is that inflation will continue to fall as a result of the hugely-deflationary force of new technologies.

Europe

Eurozone inflation fell rapidly in 2023. With a December inflation figure reading of 2.9%, the region looks set for interest rate cuts in 2024 despite the ECB's continued tough rhetoric. Investors are currently pricing in at least five interest rate cuts over the year, commencing (potentially) as soon as March.

Eurozone GDP was under pressure for most of 2023, with many of its constituent economies either in a recession or poised to go into one. The German, French and Italian economies have all stalled, showing either zero or slightly negative growth over 2023. Spain's GDP growth remains positive, albeit only 0.3%, fuelled by a recovery in tourism to the country.

While the economic outlook looks rather bleak for the region, there is some hope. Economists are confident that consumer confidence in the region will rise in 2024 as a result of easing price pressures.

In line with almost all securities, the likelihood of interest rate cuts in 2024 pushed European equities higher in the final quarter of the year. The European STOXX 600, which is a reliable indicator of overall European stock market performance, rallied on the back of dovish comments from the FED – increasing 6.64% over the final quarter of last year.

With clear signs that the European economy is bottoming out, investors are optimistic about future short-term returns in the region. The anticipated loosening of monetary policy in 2024 may result in a renewed focus on valuations and an increased appetite for equities in general. Both would represent good news for relatively cheap European equities, particularly if the dollar weakens.

Evidence that the ECB's tighter monetary policy has worked to tackle inflation is mounting. With the consensus view being that interest rates will begin falling in 2024, there is some potential for gains in the fixed income market. This realisation led to significant positive gains in European government bonds during the final months of 2023. Corporate bonds also increased over the final quarter due to falling risk premiums. With low default rates (the proportion of companies which fail to repay their debts), European companies appear to be coping relatively well with the weakness in the wider economy.

There is a question as to whether investors are being too optimistic about interest rate cuts in 2024. Given the bloc's recent strong labour market and high wage growth data, the ECB may have to keep rates higher for longer.

In addition, with technical indicators such as a weak Purchasing Manager's Index and an inverted yield curve still pointing to a recession in the near future, there could be difficulties with defaults ahead. While high yield bonds outperformed in 2023, in our view it is unlikely that this will continue to be the case going forward. With volatility on the horizon, European government and investment grade bonds are preferred.

While not widely anticipated, investors should be very aware that inflation could tick back up. The effects of geopolitics and trade disruptions caused by the recent attacks on shipping in the Red Sea could cause some major economic shocks that are currently not priced into the market.

Japan

The 2024 economic outlook for Japan is filled with uncertainty. It is predicted, however, that there will be two major economic drivers over 2024.

The first is an improvement in corporate governance. There is growing evidence that Japan's planned corporate governance improvements are working. Dividends continue to rise and plans to carry out share buy-backs are mounting – this should increase Foreign Direct Investment (FDI) into the economy and boost the value of companies in Japan.

The second driver is expected to be a clear shift from long-term deflation into more of an inflationary environment. A weak Yen and a spike in global energy prices during 2023 led to a substantial increase in Japan's inflation rate during 2023. With the latest annual inflation rate of 2.8%, the Bank of Japan have announced that they need to see further evidence of sustained inflation in the economy. A key indicator to watch in the short term will be Japanese wage growth, as this will confirm that inflation is here to stay.

Japan's major stock market index, the Nikkei 225, performed very well in 2023 – growing 28% over the year. Looking forward to 2024, the outlook for Japanese equities remains uncertain. It does seem unlikely that Japan will continue its outperformance this year, however.

It remains unclear how the termination of Japan's yield curve control and negative interest rates will affect equity prices. On one hand, a move to a level of inflation near the Bank of Japan's target is likely to help stock prices since internal demand will increase.

On the other hand, an increase in interest rates will strengthen the Yen. Given the export heavy nature of the Japanese economy, it is likely that a stronger currency would damage equity values. Slower global growth could also damage the economy as exports reduce further.

It is expected, however, that valuations will be boosted by an increase in corporate governance, with more capital being employed into the market. If this factor alone can offset the reduction in equity prices due to increased borrowing costs is yet to be decided.

While other indices have remained relatively flat at the start of 2024, there has been increased volatility in the Japanese market. The Nikkei 225 gained almost 4% in the first two weeks of 2024. Perhaps surprisingly, this was caused by the New Year's Day earthquake in Japan which largely reduced investors' expectations of rate rises in the region throughout the year.

The fact that some companies are implementing shareholder-friendly corporate governance policies to a greater extent than others reiterates the need for bottom-up stock selection within the region. In our view, active investment management is preferred in Japan during this volatile period.

With the removal of the Bank of Japan's yield curve control policy and an increase in interest rates on the horizon, Japanese bonds may end up being one of the few constituents of the fixed income market that fall in value over the year.

China

At the start of 2023, China was tipped to be one of the main drivers of global growth because of the country's reopening after the zero-covid restrictions.

Unfortunately, this recovery never really got started. This was evident from the continual weak economic data throughout the year, a property market crisis, and escalating geopolitical tensions, especially relating to Taiwan. Along with these factors, debt, deflation, and demographics will be key going forward.

The MSCI China index ended the year down 16.05%, one of the worst performing assets even after exploding upwards by 14.07% in January, fuelled by the reopening optimism. Throughout the year we have discussed the ongoing property sector crisis, and we believe that this will continue into 2024; however, the more important aspect to watch will be the government's policy reaction. The problem that needs to be fixed is the debt many property developers owe. Although local governments are downplaying the issue, the central government will likely step in to help with the refinancing.

The Chinese central bank is reluctant to raise rates as this will put renewed downward pressure on an already depressed Yuan. As one of the central bank's only tools, investors expect rates to be cut in 2024 as this will not only ease financing pressures for the property sector but could also spur on inflation, which China is in desperate need of. Consumer Price Index inflation is currently running at just -0.3% and PPI at -2.7%. A large stimulus package looks to be on the cards in attempt to prompt a rebound, as otherwise sustained deflation leads to increased household savings and the cycle becomes self-fulfilling.

China's GDP growth for the year slightly exceeded its 5% target, although it must be noted that the "base effect" from 2022 flatterers the figures. This is all with exports decreasing for the first time since 2016, showing a fall of 4.6%. With trends in deglobalisation, we do not expect this to rebound swiftly. China is an exporter that many developed nations want to distance themselves from after using its cheap manufacturing base for most of the 21st century so far. Unfavourable politics and cheaper prices elsewhere being the main rationale.

The final key factor for China will be how it manages its long-term demographics problem. Strong demographics has been a big reason for the rapid growth China has experienced, becoming the second largest economy in the world in a relatively short period of time.

A large population – over 1.4 billion people – is very advantageous when it comes to economic growth as you can boost output with a huge workforce. However, this effect is certainly dwindling as fertility rates have now dropped to 1.2. Bear in mind that a birth rate of 2.1 tends to be the replacement rate and in China's case, was over 6 in the 1970s. Forecasts suggest that the overall population will shrink by 113 million between 2020 and 2050.

Of course, with all problems also comes opportunity. As one of the first large nations to experience a shrinking population, they will likely have to pioneer the strategy to deal with this. The most feasible strategy to continue to grow GDP with a shrinking population is to increase either debt or productivity. Increasing debt further will not be sustainable, so productivity will be the focus and gains in this variable will almost certainly have to come from technology.

China currently leads the world in various technological fields including electric batteries and communication technology such as 5G and 6G. Artificial Intelligence also has the potential (in theory, at least) to replace the workers lost due to the shrinking population. A bottom-up approach will certainly be necessary whilst investing in China during 2024 with pockets of value available. Select companies could be set to perform better in the year as the most recent downturn now prices in most of the systematic risk.

Emerging Markets

When we think about growing and emerging economies over the past 40 years, China takes the limelight. After all, China has accounted for a huge proportion of global GDP growth each year and now makes up over 30% of the MSCI Emerging Market index.

Aside from China's dominance, however, the Emerging Market sector is made up of lots of countries – each with their own headwinds and tailwinds. One of the most common obstacles to growth has been (and in all likelihood, will continue to be) a strong US Dollar, at least until the end of the first or second quarter of 2024.

Many emerging governments and companies borrow using the US Dollar as the currency, as this is a more stable currency and therefore offers cheaper financing rates. The downside for the borrowing country is that it must rely on exchanging its local currency for US dollars to make the repayments.

When the US dollar is strong it makes the interest payments more expensive, lowering companies' earnings. With potential falls in US interest rates and falling bond yields to come, this will keep pressure on the US dollar and thus act as a boost for emerging companies.

As EMs carry more risk, their financing costs are generally much higher and we often see countries struggling to pay their debts. One country in particular this year will be Kenya, which is forecast to default on its government borrowing. Investors generally shy away from companies or governments which have borrowed at an interest rate of above 10%.

With global interest rates forecast to fall this year, we will likely see increased activity in EM debt issuance as they take advantage of cheaper borrowing costs (and to some degree this effect is already evident, as yields have come down in recent weeks).

Other tailwinds include a pickup in investor risk appetite as interest rates fall, making emerging markets relatively more attractive. If investors continue to be downbeat on China, money will likely flow into other emerging markets.

Last year also saw governments attempting to "re-shore" their import needs, such as manufacturing and energy, reducing the reliance on countries like Russia and China and more fractured or expensive global supply chains.

It is unlikely that the US will be able to re-shore all of its needs domestically, and instead "near-shoring" will be a more viable solution. Latin American countries are the most likely to benefit from this, in our view.

Tie in the high level of in demand commodities such as lithium and copper, and the impetus for stronger performance from these economies is more compelling. These could act as near-term tailwinds for the coming year, but we must also be aware that their full effect will not materialise in the short-term.

A major risk to EMs is how global growth plays out in 2024, as emerging economies have a strong link to the strength of global growth. If major economies are struggling and hence importing less, emerging markets will probably still suffer despite the elements in their favour. This is a big risk – if investors forecast that the US will not achieve the so-called “soft landing” we are likely to see falls in emerging market equities.

That said, some countries which look brighter for investors in 2024 are India, Taiwan and South Korea.

As we have written about before, India has huge prospects over the coming years, albeit in 2024 investors should remain cautious as headwinds persist amid forecasts that the equities are over-valued. Over the past five years the MSCI India has returned 110.97%, compared to the MSCI World which returned 79.36%.

In our view both things can be true – similar to the “magnificent seven” technology stocks, the price may be high but the value that you get for that price is also high.

The most attractive feature of India is the economic potential of the country. With the world’s largest population, the potential for urbanisation, economic trade, a shift in income classes and infrastructure development represent huge tailwinds. With the 5th largest economy in the world and still being an emerging market, the long-term potential is clear to see.

The key risk here is that this economic potential may not materialise, or will take a longer than expected to do so. There are also many other political risks to bear in mind when investing in an emerging market, often making this asset class relatively “risk-inefficient” (i.e. the return does not fully compensate for the level of risk taken).

As the world is becoming increasingly technology-oriented, Taiwan and South Korea, whose equity markets are composed of 70% and 50% of technology stocks respectively, have the potential to benefit from this move.

For example, Taiwan Semiconductor Manufacturing Company is the second largest semiconductor manufacturer in the world, and is a key part of the global technology supply chain. This must be balanced against the widely-known geopolitical risks, as tougher rhetoric from China (or even a potential invasion) cannot be ignored.

On balance, there are multiple reasons to be optimistic about emerging markets over the next year. A focus on technology, potentially lower interest rates and economic growth forecasts higher than developed market forecasts all serve as potential drivers of performance.

There are also many idiosyncratic and market-wide risks to be aware of, including weak global growth and increased political risks. The long-term potential for growth is present, but whether this continues in 2024 is very much in the balance.

Commodities

The commodity markets offered mixed returns during 2023 after being one of the best performing asset classes in both 2021 and 2022.

With continued supply chain issues and heightened geopolitical tension, last year was set to be another year of rising commodity prices. However, these hopes turned out to be false, with the S&P Goldman Sachs Commodities Index down 4.27% over the year. A warmer than anticipated winter in Europe, the great Chinese reopening story not panning out as anticipated, and central bank tightening (leading to a stronger US dollar) all proved to be headwinds.

For 2024 we take a cautious view on most major commodities. One of the main reasons for this is the ability for global supply chains to adapt to sanctions, bans, and other restrictions imposed on trade which will keep commodity supplies plentiful throughout the year (albeit with a slight concern about shipping in the Red Sea). The effects of central bank monetary policy may well also do their job to dampen demand.

That said, we also see tailwinds coming into the year. For example, a weaker dollar due to reducing interest rates in the US and geopolitical escalation could both be bullish catalysts for commodity prices. Of course, when analysing commodities, each must be looked at individually as different commodities will have varying market dynamics at play.

Oil:

The OPEC+ group will mostly decide the price of oil in 2024 as its policy continues to have the greatest influence on supply and hence price levels. We believe that the group, led by Saudi Arabia, will continue to support prices with supply and export cuts to balance their books and fund the large infrastructure spending that is currently taking place. Towards the second half of the year, this may prove more difficult as other members will likely want to utilise some of their spare capacity. Developments in the Middle East must be viewed as a key risk with the US threatening tighter restrictions on Iran, which would in turn restrict supply further.

Gas:

The gas market seems relatively balanced going into 2024 with Europe starting the major heating season with full storage. This was not the case last year and had it not been a milder winter, there could have been real difficulties in the European energy market. In the US, liquified natural gas (LNG) export demand is strong which is likely to lead to a tighter gas markets. In Asia, particularly Japan and South Korea, demand has come under pressure as nuclear and renewable power generation becomes more available. Gas markets will remain very seasonal with higher prices during the winter months.

Base Metals:

Metal prices will likely look towards China for direction. In our view, this is likely to mean there will be no significant recovery as China's property sector continues to struggle. In 2024, most base metals are expected to be either balanced or in a small surplus. Over the longer term, several metals, such as copper, will benefit from fundamental demand increases as more copper will be required to meet the demands driven by the need to decarbonise economies.

Precious Metals:

Precious metals look set to continue their positive momentum after rising 11.51% in 2023 (as measured by the S&P GSCI Precious Metals). Gold currently sits just below all-time highs and is poised to do well as expectations of interest rate cuts by the US Federal Reserve increase demand. This will also be combined with central banks buying gold at record rates. Silver tends to follow the price of gold, although it is worth noting that silver has more practical uses and is therefore partly influenced by global demand as well.

Grains:

Grains were the worst performing commodity in 2023 as the market experienced strong supply growth from other key exporters despite the worsening situation in Ukraine. Food protectionism has also gained traction following the Russian invasion of Ukraine and this will likely persist as most developing nations have elections this year. Corn prices will continue to be under pressure as stocks rise, whilst the global wheat season is forecasted to be tight.

Soft commodities:

With the volatility inflicted by the El Nino weather pattern, the supply of soft commodities was a concern throughout last year. This put significant upward pressure on prices and made this sector the best performing commodity of 2023. Going into 2024, prices will likely remain elevated until the start of the Brazilian harvest, which is set to be another big crop. Cocoa is set to stay volatile and at record highs after a third consecutive deficit. Sugar also remains in a deficit as Asian output looks weak. Soft commodity supply generally takes longer to swing around than other commodities (such as metals) owing to its seasonality.

Property

2024 should be a return to normalisation in property markets after what has been a whirlwind period triggered by the 2020 pandemic and the response to it. Performance will be uneven with some subsectors, such as data centres, benefitting from evolving environment whilst others, such as retail, likely being adversely affected. Continued volatility is to be expected and a case-by-case approach will be favoured.

Residential:

For the residential sector, global inflation looks like it has peaked and construction costs will start to ease, even if they remain higher than before the pandemic. This will likely allow more supply (of residential homes) to enter the market, although property development can experience significant lags because of building time scales. This supply side dynamic will also be interreacting with increased demand due to the interest rate cutting cycle, making the cost of borrowing more affordable. For this reason, in our view house prices will likely creep higher as buyers become more active again and the predicted easing of construction costs may not show until the end of this cycle.

Offices:

Commercial office utilisation has also stabilised globally with office re-entry levels at 85% in Asia-Pacific and 75% in Europe. The US on the other hand seems reluctant to return with a 55% re-entry level. This can be attributed to the historically tight labour market, giving employees leverage to stay at home as the option to find a more accommodating employer is more available. For this reason, US commercial property is oversupplied and looks unattractive, especially in large metropolitan areas.

Retail:

Increased workers in the office will also have marginal knock-on effects to retail space, although we believe that this will not be a large enough bump to offset the ongoing shift to e-commerce and online deliveries. High street rents remain stubbornly high with the return earned through trading diminishing in favour of online alternatives. Retail space will be dependent on location with extremely popular areas, such as London, still being able to deliver attractive returns.

Industrial and Logistics:

A beneficiary of this trend however will be industrial and logistics facilities. A growing focus going into 2024 is “regionalisation” and bringing production closer to the end customer, partly a delayed response to the supply-chain difficulties seen post-pandemic. This has been enhanced by consumers prioritising fast delivery not just in urban areas but more rural areas too. These types of facilities will experience higher volume, which may lead to more pricing power and ultimately higher yields.

Data Centres:

Data centres are forecasted to be one of the fastest growing sectors of the property market in 2024. This trend will play out over all different geographies because most countries will need to increase their capacity to deal with the exciting and fast-moving developments in technology. And, we think, the rise of protectionism will make choosing a cheaper geography to host your data too risky in the current environment.

Sustainability:

Finally, a focus on sustainability will be a key trend in 2024 as regulations and corporate disclosure requirements around sustainability are mounting up. With today's infrastructure these requirements and targets will not be met. This poses a great opportunity for the development of sustainable buildings or upgrades to existing properties, and indeed corporate tenants will begin to demand sustainable properties. Although this will come with increased capital expenditures in the near term, getting ahead of this trend will pay off as laggards will become forced buyers further down the line.

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