

Market Commentary from Morningstar

Market background

Global equities were more subdued in Q2 compared to the prior quarter, while global bonds ended the quarter flat as concerns about US inflation at the start of the quarter caused investors to reconsider their expectations on interest rate cuts. In Europe, despite the European Central Bank moving ahead with a 25bps rate cut in early June, European yields rose on stickier-than-expected inflation, the fallout from the EU parliamentary elections, and the resultant announcement of a snap election in France.

Having experienced a technical recession in the second half of 2023, the UK rebounded in Q1 having recorded GDP growth of 0.7%, although recent data suggests that growth stagnated in April. The latest inflation numbers came in at the 2.0% target for the first time since July 2021, with the Bank of England continuing to preach caution as services inflation (although falling) remains high, with wage growth being a key driver.

In equity markets, Asian equities led the way, driven by strong returns in Taiwan, India and China. The sustained AI tailwind continued to benefit the Taiwanese market while India benefited from continued economic momentum and a positive outlook. Chinese equities locked in strong gains in Q2 as cheap valuations spurred investors to return to the market. US equities continued to be buoyed by AI-related stocks despite initial skittishness over worries of an overheating economy. The UK also saw positive returns over the period as economic conditions improved. Japan was the notable laggard in equities with a depreciating yen being a major driver of negative returns in the major currencies. Japanese companies reported stronger-than-expected results as they saw growth in sales and improved profitability, but market sentiment was ultimately weighed down by conservative earnings guidance for the next year.

Style-wise, growth continued to outpace value, particularly in the US, driven predominantly by the technology and communications sectors and this also benefited large-cap growth stocks, which produced positive returns while mid- and small-cap related stocks were down over the quarter.

In terms of fixed income, global high yield outperformed its investment grade counterparts, while corporates outperformed treasuries as yields rose with investors reconsidering their interest rate cut expectations.

Quarter performance

Over the second quarter of 2024, the models were all up but trailed their passive composite benchmarks (which replicates the indices used in the strategic asset allocation).

In government bonds, US Treasuries were the only major sovereign market to deliver positive returns over the quarter. In the UK, sticky services inflation dashed hopes of a June rate cut in the UK, yields rose over the quarter and UK gilts delivered negative returns. Allianz Gilt Yield performed in line with the gilt benchmark, though has since been

removed from the models and replaced with Royal London UK Government Bond.

The sterling investment grade credit market fared slightly better, and both active fund selections, Invesco Corporate Bond and Royal London Corporate Bond, outperformed the index.

In Global Bonds, BGF Sustainable World Bond achieved a positive return owing to the broad nature of its sector exposure versus government bonds, but this was offset by the sterling hedged share class of BNY Mellon Global Bond fund, which was a significant drag on returns. The fund has since been removed from the models and replaced with a passive strategy.

Developed market equities delivered positive returns over the quarter. These returns were concentrated in large caps, while rate-sensitive small caps suffered from confirmation of the higher-for-longer interest rate environment. This performance was concentrated in the US though, and value stocks outperformed growth stocks over the quarter in Europe, Japan and the UK.

In the UK, all fund selections underperformed the FTSE All Share index. For Liontrust UK Growth, underperformance was attributable to the month of April, from both sector allocation differences and negative stock selection within those sectors.

Excess returns were also negative from both Janus Henderson European Select Opportunities and Fidelity Emerging Markets.

On the positive side, the newly implemented fund blend of JPM Japan and Man GLG Japan CoreAlpha achieved a positive overall excess return versus the index due to the offsetting nature of the two investment styles.

Market outlook

Despite continued concerns over inflation, stocks have continued to climb in Q2, buoyed by the AI theme that has swept the markets over the last 18 months. On account of stickier-than-expected inflation, markets have revised down expectations of interest rate cuts to one or perhaps two in 2024, which will be unwelcome for economies and sectors that have borne the brunt of the stress of higher interest rates.