HFP
Independent Financial Advice and Planning

in association with

BROOKS MACDONALD

Market Commentary and Positioning

'Markets are having to contend with a number of unexpected global political events.'

In the UK, a general election has been called for 4 July. While the current opposition Labour party has been leading in the polls for some time now, the accelerated timetable has reinvigorated the examination of competing party policies around fiscal policy and tax and spend priorities. In Europe, the European parliamentary elections have delivered a somewhat expected, albeit still a market-unwelcome shift to the political right in France. This has catalysed a snap French parliamentary election, where the risks of a far-right party gaining power in a G7 country has led to sharp falls in French banking stocks in particular. Meanwhile, in the US, we have seen a criminal conviction earlier this month for a past US president for the first time in US history. Despite this, expected Republican presidential challenger Donald Trump continues to lead Democrat President Joe Biden in the polls ahead of a November election later this year. To add, we have seen market volatility around election results further afield in India, South Africa, and Mexico in recent weeks.

Weighing the negative of aggregate political uncertainty, at a fundamental level the tailwinds that have supported markets so far this year have continued. From a corporate perspective, in the US, which accounts for close to two thirds of global equities' market capitalisation, company earnings continue to paint a constructive picture. According to Factset, with nearly all the US S&P 500 equity constituents having reported calendar Q1 results, 79% of companies have reported earnings ahead of consensus expectations. This is a run-rate that is above all of the 1-year, 5-year, and 10-year averages. Not only that, but the scale of the 'beat' is also above the 10-year average. Supporting our thematic, longer-term, through-the-cycle investments in technology and healthcare in particular, it is pleasing to note that these two sectors delivered the highest percentages of companies reporting earnings above estimates across all sectors of the market. Pushing back against those worried about the risk of a US recession, US companies' mention of 'recession' on Q1 earnings results calls has now fallen for the seventh quarter in a row and stand at a count of less than half of the 10-year average.

From an economic perspective, we have seen belief in so-called 'goldilocks' continue, where higher-for-longer interest rates do not derail economic growth more broadly. Over the last month, we have seen the Bank of Canada and the European Central Bank cut interest rates for the first time in their current monetary policy cycles. Underlying inflation readings have in aggregate continued to moderate despite the well-known disconnect between falling-and-low goods inflation versus stickier services inflation persisting. This remains a challenge for central banks in terms of communicating the pace and scale of interest rates to come. However, while traditionally it has been key for investors to focus heavily on the interest rate cycle in timing rotation across asset classes and investment styles, fiscal policy is arguably upending this approach. Far from holding to the received-wisdom of a counter-cyclical fiscal policy, instead, we have pro-cyclical fiscal policy. In the US, unemployment is at historically low levels, wage rates are still running above pre-pandemic averages, and economic growth estimates for this year are above the US Federal Reserve (Fed)'s longer-run assumption. Nonetheless, we have a US budget deficit running at more than 6% of Gross Domestic Product (GDP). Whilst this begs the question as to whether such spending can continue, this scale of government support, a theme to various degrees reflected in other developed countries globally, explains in large part the resilience of the consumer, and thereby corporate outlooks in turn.

From a market perspective, we continue to see a broadening out in performance across developed equity markets globally. While US equity markets, and mega-cap technology stocks in particular, have led gains over the past year, global ex-US equity markets have matched the total return performance of US equities so far during calendar Q2. Given our regional equity allocation positioning (where for example we have a positive outlook for both UK and US equities), alongside our global equity barbell balance between growth and value investment styles, we believe our current asset allocation settings are well-positioned to capture these latest market shifts.

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