Investment Outlook 2024

Tomorrow Begins Today

The value of investments can fall as well as rise, and you may not get back the full amount you invest. Past performance should not be taken as a guide to future performance. Eligibility criteria, fees and charges apply. You should continue to hold cash for your short-term needs.

Investment Outlook 2024

Global markets recovered well towards the end of 2023. And with some central banks pausing interest rate hikes towards the end of last year, there are signs that they may have reached their peak. So, what does 2024 hold for financial markets? And where should investors look for opportunities?

Our Investment Outlook 2024 sums up the issues that affected the global economy in 2023 and looks ahead to where the best prospects of 2024 might lie.

A quick look at last year – when rising prices were put in their place.

As we entered 2023, US inflation was on its way down after going up for months in the previous year – reaching levels not seen for 40 years. Central banks like the Bank of England, responsible for ensuring the economy doesn't get out of control, had been putting up interest rates to push down rising prices – and it appeared to be working. For example, in the US – the most important market for global investors – inflation fell from its peak of 9.1% in June 2022 to 3.2% in November 2023.

Have interest rates peaked?

This all impacted – in fact dominated – the world of investing for much of last year. High interest rates can hit both share and bond prices, so the main question on investors' minds was: when will they stop going up? In fact, the US recession did not play out and the US equity market rose through the course of the year.

Markets ended the year strongly

But by November, it looked like central banks' efforts to rebalance their economies had succeeded and, while interest rates would need to stay higher for longer, they had indeed stopped rising.

This was good news for company forecasts, bond prices and therefore investor confidence, and markets ended the year strong.

Mortgages played their part

Interest rates impact rising prices because they reduce how much extra money people have to spend. The order of events typically goes:

1. Central banks raise rates.
2. Loans, including mortgages, cost more, while savings accounts generate more interest.
3. People have less money to spend and are encouraged to save rather than spend.
4. Economic growth slows.
5. Prices go down as people spend less.

This broadly lays out what happened in the UK, which saw sluggish economic growth last year. But crucially, despite high inflation and interest rates, the US economy stayed remarkably resilient.

A key factor behind this difference comes from mortgages. In the UK, two and five-year mortgages are common, so lots of people had to renew at a higher rate last year. But in the US, you can lock in a mortgage for 30 years, so rising rates affected fewer homeowners.

The US job market stayed strong too, so people had jobs and money to spend.

What next for stocks and bonds?

History shows US stocks tend to perform well the year after the last rate hike from its central bank the US Federal Reserve (Fed), as long as its economy avoids a recession. The experts at Coutts, the bank behind our investments for customers, think it's possible the US could avoid such a downturn this year. And even if it does have a recession, it may well be quite mild.

The importance of bond yields

As for bonds, now that it looks like we've reached the peak in interest rates, what central banks do next will be very important. Bond yields (the fixed income you get from a bond) and their price (how much you can buy and sell them for in markets) have an inverse relationship. If yields go up, prices go down.

The table below shows what could happen to bond prices if yields change. At the time of writing, US government bond yields are 5%. So if US government bond yields were to go up by 1% over the course of a year, the 12-month return on the bond (including coupons) would be expected to be -2%. However, if yields fall by 1%, the 12-month return would be expected to be 12% – an impressive figure. So what happens with interest rates this year will play a big role on bond returns. On balance, we expect yields to fall further – and prices to rise – this year.

10-year bond returns over the following 12 months

Starting yield	Change in government bond yields				
	-2%	-1%	0%	1%	2%
3%	17.0%	10.0%	3.0%	-4.0%	-11.0%
4%	18.0%	11.0%	4.0%	-3.0%	-10.0%
5%	**19.0%**	**12.0%**	**5.0%**	**-2.0%**	**-9.0%**
6%	20.0%	13.0%	6.0%	-1.0%	-8.0%
7%	21.0%	14.0%	7.0%	0.0%	-7.0%

Source: Bloomberg, Coutts.

Note: this assumes there would be a parallel move in bond yields and ignores second order effects.

US businesses look to rebuild

While US businesses have managed to stay profitable despite the economic challenges, shareholders generally want to see growth – and that was lacking last year.

History tells us that, following tricky periods like we've seen recently, profits tend to rebound. Typically, companies cut costs when they see their earnings fall. So when economic conditions improve, they see higher profits. And we're seeing promising signs of potential growth ahead.

Here are some key areas to watch in 2024:

Mega-cap tech

Artificial intelligence (AI) boomed in 2023 and many of the tech giants managed to ride the wave. After very good performance in 2023, investors question whether the positive trend will continue this year.

Healthcare

With the Covid-19 pandemic mostly behind us now, the healthcare sector is getting back to normal and showing signs of growth in 2024.

Financials

At the other end of the spectrum, expectations are low for this sector, which includes banks. After a difficult 2023, it faces further issues such as slowing loan growth and rising credit concerns.

UK falls behind but could improve

The UK's stock market is trailing its global peers. This is mostly because of the breakdown of sectors within it. While technology had a stellar year in 2023, and accounts for nearly 30% of the MSCI US stock index, it accounts for less than 1% of its UK counterpart – a heavy loss of potential returns.

Equally, financials had a number of challenges last year, and that sector accounts for 18% of the MSCI UK, whereas it's 12% for the MSCI US.

The tide could change though once economic conditions improve in the UK, making it more appealing to investors. And the government's tax cuts announced in last year's Autumn Statement may help with this.

Until then, UK investors will most likely be picking cheap stocks that deliver attractive dividends.

Our asset allocation

The Coutts team has positioned our funds to lean into the positives that should come from current market conditions.

Bonds

This year, we believe Europe is much closer to a recession than any other leading economy, and so is more likely to see bond yields fall. Remember, when yields go down, prices go up. So we see European bonds as attractive this year.

More generally within bonds, we're looking to earn higher bond yields (4%-6%) from global government and corporate bond markets.

Stocks

Our stock allocation is higher than usual and leans toward global equities which are heavy in US stocks. In addition, we retain a preference for high-quality, multi-national companies that can best manoeuvre the current environment.

Responsible investing

We incorporate responsible investing within our Royal Bank Invest funds. This means we consider environmental, social and governance (ESG) factors when making investment decisions. We believe responsible investing should be a priority and investors should have full transparency on what they're investing in.

While we believe responsible investing is a priority, there were media reports last year suggesting it was going out of fashion. There are, however, many reasons for continuing to believe in the importance of sustainable investing.

This includes:

- the Intergovernmental Panel on Climate Change documenting how global temperatures continue to rise
- unacceptably high rates of biodiversity loss, according to the United Nations Environment Programme
- increased levels of extreme poverty found in research by the International Monetary Fund.

Because these aren't going to be resolved overnight, there's still a need for investing in change. This is why we're exploring how we can continue to capture these issues within our responsible investing approach.

Managing risk

Asset managers have responsibility to make sure all investment decisions on behalf of clients are made with their best interests in mind. A survey by The World Economic Forum found the leading risks for private-sector risk managers in their two and 10-year horizons are all ESG-related. Therefore, factoring ESG into investment decisions plays an important role when reducing downside risks within varying time frames.

Rebuilding trust

There are ongoing challenges for responsible investors. Many in the financial services industry have fallen victim to greenwashing – the overstating of ESG efforts within marketing. This has led to a loss of trust in strategies labelled "ESG" or "sustainable".

To rebuild this trust, regulators are developing guidelines that asset management firms need to comply with. The UK's regulator, the Financial Conduct Authority, released its requirements in November and companies, including us, are now working through those rules.

IMPORTANT INFORMATION

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