COLOMA
WEALTH MANAGEMENT

2024 INVESTMENT OUTLOOK

In the final quarter of last year central banks signalled a pause in the cycle of interest rate rises. This was sufficient to prompt a year-end stock market rally. Below we look at whether the more positive outlook will be sustained in 2024.

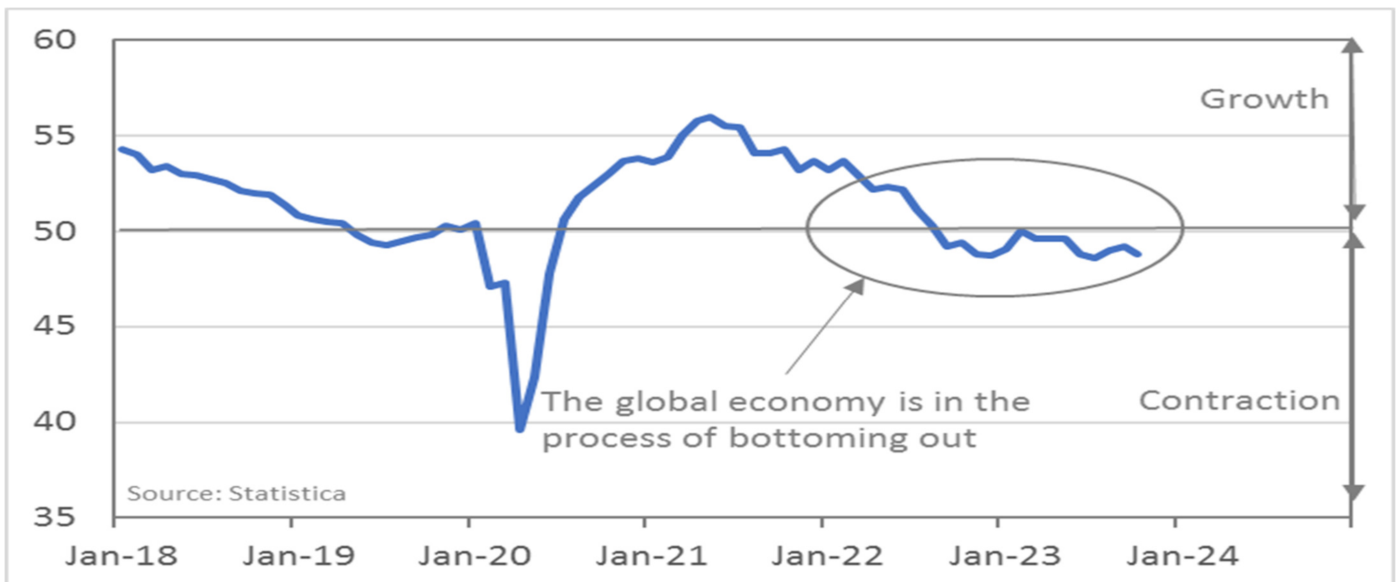
What is the outlook for economic growth in 2024?

The slowdown in economic growth, over the last year, has been driven by the impact of recent interest rate rises and a big de-stocking cycle. The latter was exaggerated by the pandemic. This is because during the pandemic businesses built up higher than usual stocks of goods due to the uncertainty of supply. As economies re-opened stocks were cut back aggressively. Whilst businesses are still reducing inventories the rate at which they are doing so has slowed. Indeed, surveys of manufacturers suggest that sector as a whole is stabilising (see chart 1). In the service sector an end to the relentless series of interest rate rises has boosted business sentiment in recent months. So, these and other indicators point to economic growth bottoming out in first half of the year. The second half of the year should see some modest growth.

What is the outlook for inflation and interest rates in 2024?

2023 saw inflation fall back across advanced economies. This reflected the unwinding of food and energy price inflation as well as a normalisation of global supply chains. However, wage growth has remained above recent historical norms due to tight post pandemic labour markets. In order to sanction interest rate cuts central banks will want to see wage growth moderate. So, the Spring wage round will be crucial.

CHART 1: GLOBAL MANUFACTURING SURVEY



5th Floor, Pinnacle House, 23-26 St Dunstan's Hill, London. EC3R 8HN
t: 020 3603 5910
f: 020 3603 5911

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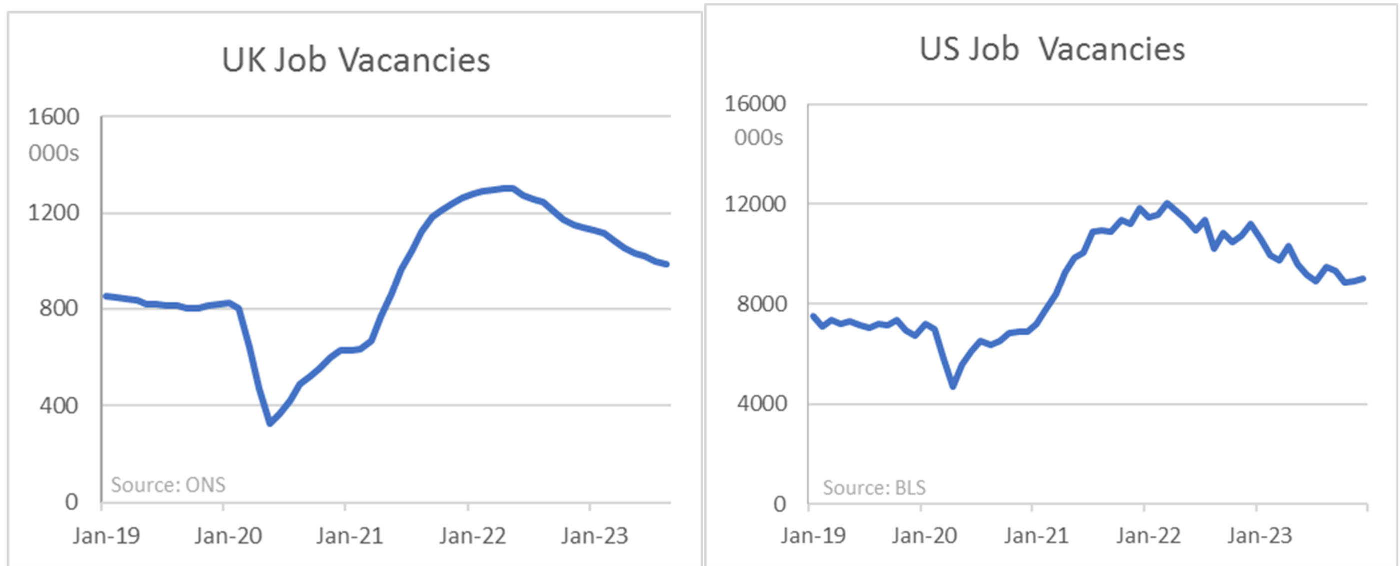
With job vacancies steadily falling (see charts 2 and 3), and headline inflation also on a downward trend, I would expect most settlements to come in below 5%. This is likely to be sufficient for central banks to begin cautiously reducing interest rates in the second half of the year. Interest rate cuts are unlikely to be aggressive as central banks have lost a lot of credibility from the recent spike in inflation.

CHARTS 2 AND 3 JOB VACANCIES ARE ON A STEADY DOWNWARD TREND



Will Artificial Intelligence deliver on the hype?

2023 was a momentous year for computing. Large Language Models, a type of Artificial Intelligence algorithm, represented a step change in what was possible with computers. Investors were also impressed and anything that was likely to have exposure to Artificial Intelligence (AI) was bought up aggressively. For example, Microsoft shares rose 57% in 2023 while the chip maker Nvidia gained an astonishing 240%. Our investment thesis remains that AI will take over a lot of the 'grunt work' that humans currently carry out. However, the process is likely to be a slow one. For example, Cloud services were first launched by Amazon in 2006, yet it took almost twenty years for the Cloud to reach fifty percent of its addressable market. To further re-enforce the point market research firm Gartner expects that in 2025 39% of world-wide organisations will be experimenting with AI and only 14% will be in the expansion phase. So, we expect Technology shares to correct this year. As developed economies begin to expand again in the second half of the year a broader range of growth opportunities will be available to investors. This will lead to a rotation out of Technology shares into more cyclical shares.

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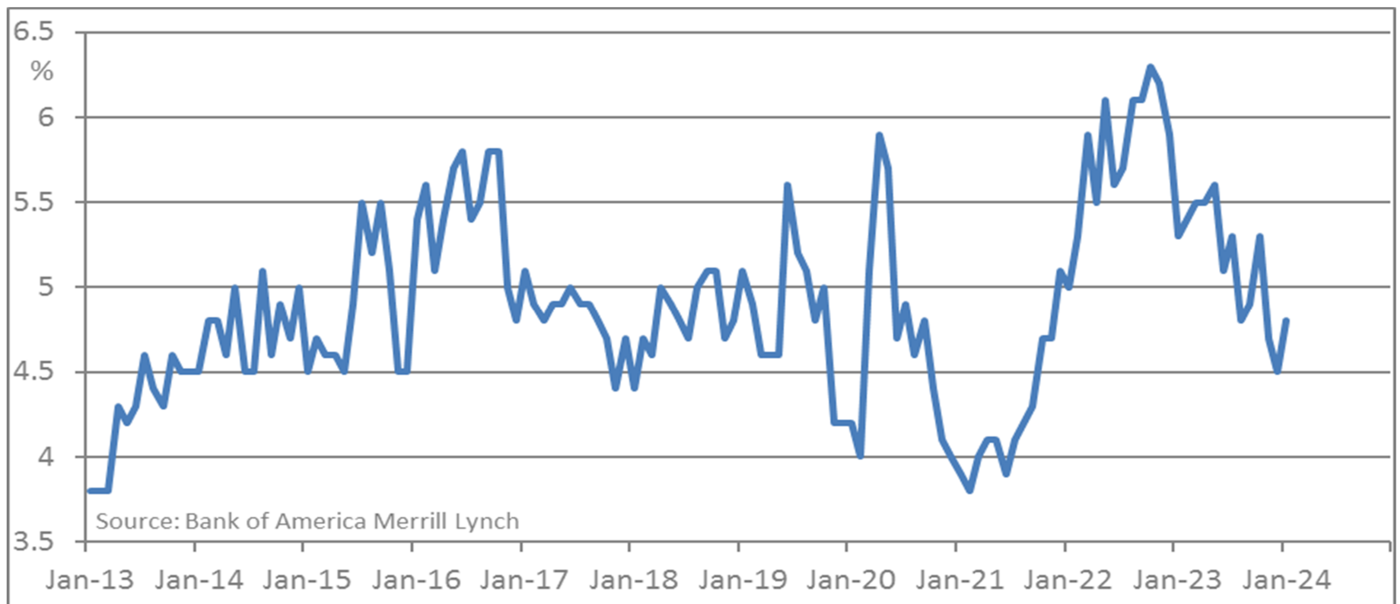
f: 020 3603 5911

What is the outlook for the Chinese economy?

Despite the lifting of Covid restrictions, 2023 was a disappointing year for the Chinese economy. This is because the property market in China is in the midst of a slump. A large inventory of unsold housing has built up due to the fact that population growth has turned negative and also because many property developers do not have access to the necessary funds to finish developments. In the medium-term property prices need to fall significantly to clear the glut. However, the authorities remain reluctant to sanction this as seventy percent of Chinese consumer wealth is invested in housing. So, unless the Chinese government unleashes a big fiscal stimulus (i.e. tax cuts and a big government funded investment programme) it remains prudent to limit exposure to China.

CHART 4: PORTFOLIO MANAGERS CASH LEVELS SUGGEST THE STOCK MARKET RALLY HAS FURTHER TO RUN



Conclusion

The prospect of economic growth bottoming out in the first half of the year and rate cuts in the second half of the year suggests that 2024 will be a good year for stock markets. As the wider economy begins to recover I would expect a rotation out of technology stocks into more cyclical stocks. Given the problems associated with the property market I think it is prudent to limit exposure to China as much as possible.

Robin Francis January 2024
Tel: 07838 360579
Email: rf@coloma-wealth.com

For information only. Investors should seek professional advice for their own circumstances before making an investment.

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