# 2024 BOND AND INCOME INVESTMENT OUTLOOK

As UK inflation trends down towards the Bank of England's 2% target I look at the investment opportunities in bonds and income investing.

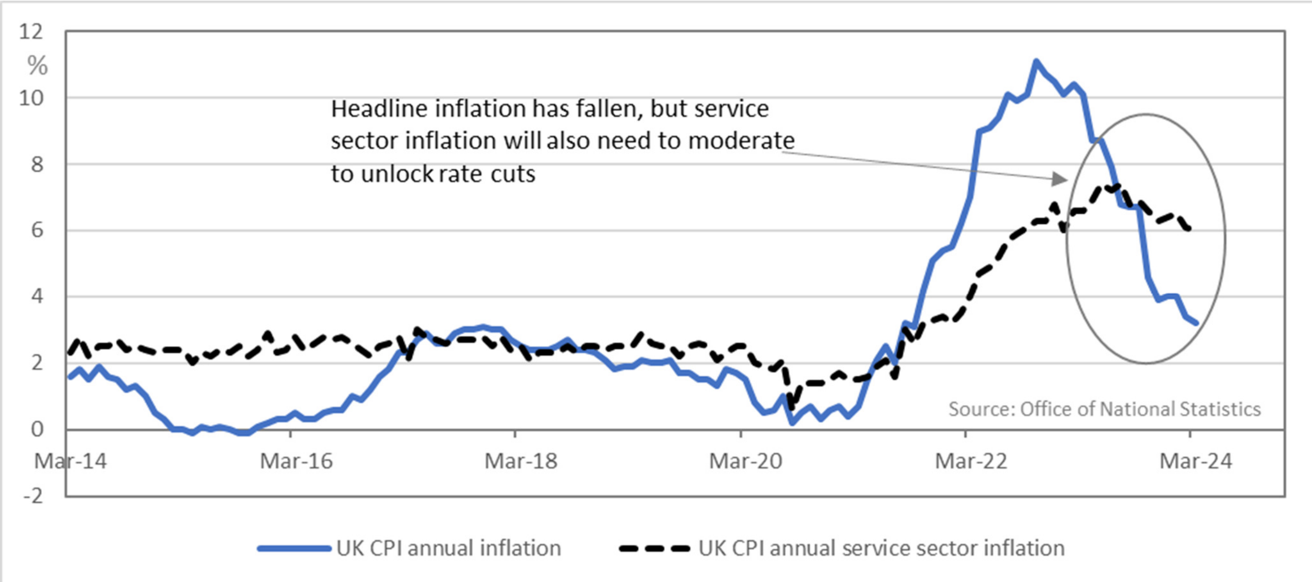
**What is the outlook for UK inflation?**

UK annual CPI inflation has fallen from a peak of 11.1% to its current rate of 3.2%. This has been driven by a normalisation of energy, food and goods price inflation. However, the service sector of the economy has remained hamstrung by inflation. In this sector annual inflation is currently 6% and has been kept elevated by the high wage settlements of recent years. It is a crucial part of the inflation picture as services account for roughly half of the overall Consumer Price Index calculation. Nevertheless, a recent survey by the Charted Institute of Personnel and Development suggests private sector pay settlements will be around 4% in the Financial Year 24/25. Certainly, the current low headline inflation rate, which is expected to fall to around 2% next month, should exert downward pressure on settlements. So as the year wears on, more moderate wage settlements should begin to push service sector inflation lower. This in turn would hold out the prospect of inflation falling below 2% in 2025 and 2026.

**What is the outlook for UK interest rates?**

As outlined above the key variable for the Bank of England is service sector inflation. This is because it is a good indicator of domestically generated inflation. It seems unlikely that the Bank of England will cut interest rates until it has moderated to 4%. Furthermore, there will need to be the prospect of it returning subsequently to its historical range of 2 to 3%. So, interest rate cuts are deemed unlikely to start before August.

CHART 1: UK HEADLINE AND SERVICE SECTOR INFLATION





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**The Middle East is a key risk factor to lower interest rates**

The war between Hamas and Israel, and its potential to spill over into a wider Middle Eastern conflict, is a key risk factor to lower interest rates via an inflationary increase in the oil price. However, I suspect that if there was an appetite for a more general war in the Middle East it would have already have happened. It should be noted that the recent exchange of missiles between Iran and Israel were targeted at military sites and were heavily telegraphed. Furthermore, whilst oil prices are high, it is now the case that the United States, due to the expansion of shale oil, produces twice as much oil as Saudi Arabia. So, the Middle East has less influence on the oil price than it once did.

**What is the interest rate outlook for other regions?**

The interest rate outlook for other regions does matter as it influences the exchange rate which in turn impacts on the cost of imported goods which then feeds into inflation. At present it looks like the US central bank is unlikely to cut interest rates before the autumn. However, the European Central Bank has signalled that it will start cutting interest rates from June onwards. As the majority of the UK's trade is still with Europe this would allow for an August Bank of England rate cut.

**Investment opportunities in bonds**

With interest rates at a sixteen year peak the key consideration in bond investing is to lock in the current high rates of interest for years to come. The best way to do this is to buy long dated bonds as this largely fixes the interest rate earned for the life of the bond. At present a ten year UK government bond yields around 4.25% which is roughly 2% in excess of the Bank of England's inflation target. It makes a pleasant change from the sub 2% yields of much of the last decade! Longer dated bonds issued by companies currently yield around 5%. For example, a nine year bond issued by Tesco currently yields around 4.8%.

**Other income investment opportunities**

Aside from bonds, property and infrastructure (e.g. utilities, schools and hospital buildings) also currently offer some attractive investment opportunities. For example, Primary Health Properties rents out surgeries to GPs and yields around 7%. It is currently achieving rental growth of circa 4% and has a track record of 27 years of consecutive dividend increases. Another attractive property company with a decade long track record of dividend increases is Londonmetric. The majority of its assets are in the logistics, convenience and healthcare sectors and following a merger with another property company will be on the edge of the FTSE 100. It currently yields 5%.

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