INVESTMENT OUTLOOK UPDATE

Stock markets retained their positive tone in the first half of the year. Below we look at the prospects for the remainder of the year.

What is the outlook for inflation and interest rates?

As headline inflation has fallen across the developed world wage growth has begun to adjust downwards as well. In the United States average hourly earnings has fallen to annual rate of 3.8% while in the UK annual average earnings growth of regular pay has slowed to 5.1%. These developments suggest that recent higher inflation is unlikely to be ‘locked in’ by continuing high wage settlements. This gives developed economy central banks scope for a series of interest rate cuts. The United States central bank is expected to start easing monetary policy this month while Bank of England and the European Central Bank are seen as continuing the interest cuts that began over the Summer.

What is the outlook for economic growth?

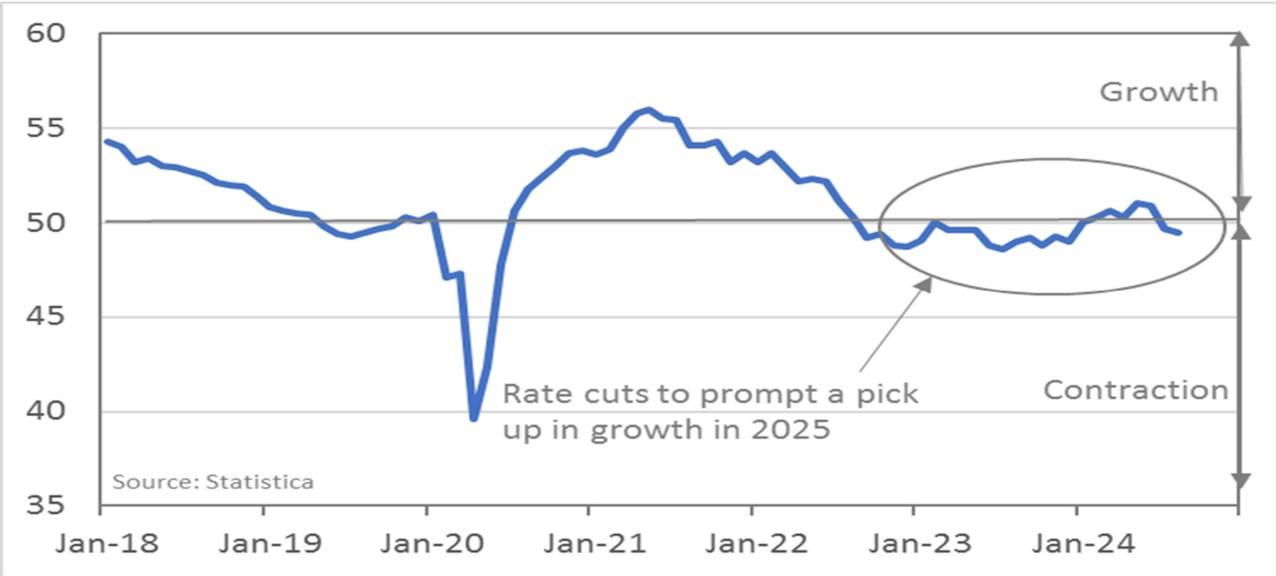
Whilst European growth has been relatively firm so far in 2024, growth does appear to be slowing in the United States. In particular employment growth has started to lose momentum and manufacturing survey data has also been weak. As the US economy is the largest in the world this has been a concern for global financial markets in recent weeks. However, US inflation has continued to slow in 2024 so there is now scope for a series of rate cuts. The signs are that the US central bank could be quite aggressive in the cutting rates. So, this and further rate cuts from other central banks around the world is likely to underwrite a pick-up in growth in 2025. This should also trigger an upturn in manufacturing output. In 2024 this has been slow and suggests that the current upturn is not all

CHARTS 1 &2: SLOWING WAGE GROWTH OPENS THE DOOR FOR INTEREST RATE CUTS

3rd floor Warwick House, 65/66 Queen Street, London. EC4R 1EB
t: 020 3603 5910

that firmly established.

CHART 3: GLOBAL MANUFACTURING IS EXPECTED TO PICK UP IN 2025



What is the outlook for the Chinese economy?

Chinese economic survey data remains weak and suggests that the Chinese economy is struggling to generate meaningful growth. At the heart of the problem is a large inventory of unsold houses and flats that has brought the Chinese property market to a standstill. The knock-on effect of this has been to lower consumer confidence and prompt a hiatus in property construction investment. Attempts to encourage local authorities to purchase vacant units for social housing have not been successful. Instead Xi seems more interested in developing China's technology base via increased loans to the manufacturing sector. As such a weak Chinese economy means that, at the margin, there is increased scope for interest rate cuts in advanced economies.

What is the outlook for technology shares?

Market enthusiasm for all things related to Artificial Intelligence continued unabated in the first half of the year. However, investors are beginning to focus on the likely revenue generated from the large expenditure associated with building out the Artificial Intelligence infrastructure. If previous technology advances are anything to go by adoption will be gradual. This is because it takes time for companies to become comfortable with new ways of doing things and adapt it to their specific circumstances. Indeed, an early survey of Microsoft's AI assistant, Copilot, found it saved an average of just 1.2 hours per week. As a result of this a rotation away from technology shares and into shares that will likely benefit from the forthcoming interest rate cuts has started. I would expect this has further to run into year end.

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What impact will the US presidential election have on the markets?

Currently Kamala Harris leads Donald Trump by a small margin in the opinion polls. Although the election will, as usual, be won by results in a few key marginal states. Whilst Harris is under pressure to differentiate herself from Joe Biden a victory for the vice president would largely represent a continuation of the status quo. A Trump victory, that also saw the Republicans gain control of Congress, would allow him to implement his plan to fund the lowering of taxes by the imposition of a universal tariff on imports. The market impact of this would likely be negative as it would tend to raise inflation and lower growth. However, as the opinion polls suggest that a sweeping Trump victory is unlikely his tariff and tax policies are likely to remain of academic rather than practical interest.

Conclusion

The prospect of a meaningful reduction of interest rates in the United States, as well as continuing reductions in Europe and elsewhere, is likely to boost investor sentiment and stock markets. However, as interest rate cuts take time to work through the economy we will likely have to wait until the second half of 2025 for firmer economic growth numbers. In this environment investors are likely to favour more cyclical shares and growth shares. The forthcoming US presidential election will be a major market event. As discussed above most outcomes seem likely to have limited medium term impact. The only exception is a sweeping Trump victory which the polls suggest is rather unlikely at present.

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

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