CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

April 2024

Balancing Interest

In recent months, the UK and the US have seen a rise in yields on 10-year Government bonds. However, speculation has been constant on possible cuts in short term interest rates. The conventional wisdom is that the US is generally the first major Western nation to reduce rates and it is now over 40 years since any other country preceded them. A growing number of influential forecasters now believe that the UK will be compelled to reduce short term rates should Consumer Price Inflation fall below 3%.

With short and longer term interest rates in apparent conflict it is worth recalling that there is now some talk in the US about easing Monetary Tightening, which along with the use of interest rates as a control mechanism, is another key route to slowing economic growth. While we are aware that supporting the economy, and peoples' wellbeing, required significant resort to the printing presses in the UK, it is alarming to note that Government Debt in the UK now exceeds 120% of Gross Domestic Product (GDP). A clue to a need for fiscal caution in the US can be seen where National Debt has now reached 140% of GDP.

There is pressure to reduce interest rates in the US as we are in Election year and almost every time the US economy is in recession the incumbent party loses the election. While the rise in 10-year interest rates signals concern regarding this ratio, political pressure to release the interest rate handbrake is growing. This is a major reason for tech stocks in the US reaching such high valuations, and why Gold has strengthened, as the fundamental backing for the US $ has declined.

Research from Bank Credit Analyst (BCA) suggests that the most favoured markets for equity investment are currently the US and the UK; the US is the dominant Western economy, and the UK is on the cusp of falling inflation and an imminent reduction in interest rates. With both economies perhaps just avoiding recession equities can be considered, and it may be that the persistent outflow of funds from the UK could start to reverse as a result. The sudden spike in UK rates at the time of the Truss Budget caught many unawares, and heavily indebted consumers, and companies have been under severe pressure ever since. This might be about to change or at least improve.

We have recently spent time with Joe Kalish, a co-founder of Ned Davis Research. NDR are a particularly settled team, veterans of many and varied market cycles. They too believe that US bond rates are now near a peak, and encouragingly the steadiness of recent US economic data suggests the strong possibility of a double-digit lift in equity values before the end of 2024. Such a firm tone in equity markets in the second half of the year is likely to bring a shift in sector preferences with a particular emphasis on growth stocks. We believe this will give good opportunities for capital growth and there is evidence that stocks that do deliver are finally being recognized in price terms. This supports our view that the increased flow of takeovers by acquiring corporates points to an undervaluation of UK listed stocks. Companies are aware of this, and clear evidence of their concern can be seen in substantial share buybacks, which are often allied to dividend increases and are adding value to current equity holdings.

W Forsyth
Executive Chairman and CIO
18 April 2024

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43 Charlotte Square
Edinburgh EH2 4HQ

T. 0131 624 7709
investments@csmanagers.com

www.csmanagers.com