CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

January 2024

New Year, Same Diversification

2023 finished with a very welcome 'Santa rally', as the Federal Reserve Open Market Committee (FOMC) further spurred investors to believe that we have reached the peak in interest rates and that cuts may be relatively imminent. The dot plots (estimates from FOMC members on the path of future interest rates) pointed to three interest rates cuts in 2024, rather than the previously indicated two, and Jerome Powell did not take the opportunity to pour cold water on the market's exuberance in the subsequent press conference. This drove a strong finish to the year for the majority of asset classes, with interest rate sensitive areas such as smaller companies and cyclical sectors showing particular momentum.

A new year offers an opportunity to review 2024 macroeconomic and asset allocation outlooks, and draw our own conclusions on how we feel markets may progress in order to structure asset allocation and tactical tilts in portfolios.

The most recent rally in fixed income assets and drop in yields illustrates investor expectations that inflation will continue falling and interest rates will be cut. However, continued wage pressures and an uptick in some alternative inflation indicators point to a potential stalling or reversal in disinflationary momentum, once the benefit from declining goods inflation subsides. This suggests a preference for shorter dated fixed income where the yields on offer remain attractive and the price risks of a resurgence in yields and inflation are reduced.

Equities have enjoyed a strong run over recent months, broadly pricing in a 'soft landing' scenario. The main question facing equity investors is whether, and when, the rate hiking cycle will start to take more effect on the economy and corporate earnings, with the US economy in particular showing continued resilience relative to other developed markets. A more opaque economic picture across the globe drives a preference for quality companies with resilient cash flows and strong balance sheets that offer good stability.

Geopolitical tensions remain heightened in 2024, with wars ongoing in the Middle East and in Ukraine, as well as growing fragilities between China and Taiwan. These events are tragic, and also very difficult to predict. We view gold as a hedge within portfolios to these types of risks and see a falling real yield environment as a positive for gold pricing.

We run the risk of falling on our sword by making predictions around the upcoming year, and hence the preferences noted above are both broad and diverse. Indeed, year ahead outlooks or predictions can soon have you eating your words.

For instance, one house tipped the emerging markets region as looking attractive going into 2018, (citing strong recent performance, an attractive growth outlook, potential supportive monetary policy in select countries and an election year in Latin American countries with the potential for transformative economic policy). The region went on to be one of the weakest performers over the year following US-China trade tensions and a strong US Dollar, which adversely impacts emerging market countries by making US borrowing more expensive. Going into 2020, one article highlighted real estate investment trusts (REITs) as looking attractive based on anticipation of a continued low interest rate environment, resilient economic activity and a strong job market. What the author could not have foreseen was the global Coronavirus pandemic that emerged in 2020, leading to lockdown restrictions across the globe from March 2020, and driving weak returns across global REITs.

The moral of the story here being the importance of diversification. However, sound the rationale for them may be, unforeseen events can render predictions incorrect, as the above anecdotes highlight. We will continue to make active tilts to portfolios based on our perceptions of investment market dynamics, while maintaining a long-term and well diversified core within portfolios.

10th January 2024

William Forsyth, Executive Chairman & CIO

Important Information
Opinions constitute our judgement as of this date and are subject to change without warning Neither CS Managers Ltd, CS Investment Managers nor any connected company accepts responsibility for any direct or indirect or consequential loss suffered by you or any other person as a result of your acting, or deciding not to act, in reliance upon any information contained in this document. CS Investment Managers is a trade name of CS Managers Ltd, 43 Charlotte Square, Edinburgh EH2 4HQ. CS Managers Ltd is authorised and regulated by the Financial Conduct Authority. CSFP2 0124

43 Charlotte Square
Edinburgh EH2 4HQ

T. 0131 624 7709
investments@csmanagers.com

www.csmanagers.com