ECONOMIC NEWSLETTER

SPEKTRA FINANCIAL SERVICES

NAVIGATING 2024: UNPACKING WHAT LIES AHEAD

December saw a positive end to what was a very strong year for markets, albeit a volatile one. Global developed market equities (measured by the MSCI World Index) returned 24.4% in USD over the course of 2023, while their emerging market counterparts (MSCI Emerging Market Index) ended the year with a very respectable return of 10.3%, also in USD.

Locally, our equity market (measured by the FTSE/JSE All Share Index) grew by 9.3% in ZAR, while our local bond market (FTSE/JSE All Bond Index) returned 9.7% to investors over the course of 2023. Investors who stayed the course and remained invested were well rewarded for their patience and would have generated returns well ahead of cash.

Looking forward, inflation, interest rates, and the prospect of a recession in the US remain the key areas of focus for markets in 2024. Below we have outlined how these factors can be expected to influence the different asset classes over the next 12 months and where we continue to see opportunities for investment portfolios.

2024 ASSET CLASS OUTLOOK

Cash

For as long as interest rates remain at elevated levels, cash will continue to offer attractive yields compared to historical levels, both locally and offshore. During the course of 2023 nearly $1.2tn was invested in money markets funds in the United States as investors sought to capitalize on the higher interest rates brought about by the Federal Reserve's interest rate tightening campaign. This is well ahead of the $1.8bn average annual flows into US Money Market Funds over the previous decade. The continued appeal of money market investments will be largely dependent on the timing, and speed, of the Fed's interest rate cutting regime. While Federal Reserve Chair Jerome Powell has hinted at the onset policy-easing cycle, expectations surrounding the timing remain varied across different economic and market commentators.

Equities

The path of equity markets over the course of 2024 will depend largely on the trajectory of forward earnings as well as the direction of interest rates. Generally, lower interest rates bode well for equity prices as lower interest rates reduce the discount rate of forward earnings, thereby increasing the present value of the equity basket. However, this benefit will only come into play if and when the Federal Reserve decide to cut interest rates during the course of 2024. As long as inflation remains meaningfully above the 2.0% target set out by the Fed, Jerome Powell will be compelled to keep US interest rates at elevated levels, placing pressure on US Equities.

Looking forward, investors can expect a high level of dispersion across equity markets, both on a sector and geographic basis. This volatility and dispersion calls for an active approach to portfolio positioning going forward, and taking a more granular approach to asset allocation views. As a result, alpha opportunities have the potential to play a larger role in the coming months, both locally and offshore. With this in mind, utilising investment expertise to maintain a pragmatic approach to portfolio construction and positioning will be key.

As always, we believe that a well-diversified portfolio will be best equipped to tackle the uncertainty posed by equity markets. As The Nobel Prize laureate, economist Harry Markowitz, said, "Diversification is the only free lunch" in investing. Actively managing the diversification of portfolios to adapt to the changing economic and market environment will help to reduce risk, while enhancing potential returns over the long term.

2024 ASSET CLASS OUTLOOK: CONTINUED

Fixed Income

The US 10yr Treasury bond yield has fallen below 4.0% from its cyclical high of over 5.0% in mid-October. Bond prices and bond yields tend to move in opposite directions, thereby creating an attractive return for bond investors over the last quarter.

On a more sustained level, bond yields will remain tethered to the level of interest rates in the US, as well as the resilience of the US Economy. Anticipating diverse outcomes in the market, and with consensus reflecting a broad range of expectations, yields are poised to experience volatility in response to incoming data, potentially making 2024 a turbulent year for yield fluctuations.

On a more granular basis, shorter-dated US bonds continue to offer higher yields than their longer-dated counterparts, while also exposing investors to lower levels of duration – making short-dated treasuries more attractive on a tactical basis.

Locally, our South African bond market continues to offer very attractive yields to fixed income investors, with the yield on our local 10yr government bonds trading at just under 11.50%. This provides investors with a real yield (removing the impact of inflation) of nearly 6.0% in our local fixed income market. The primary risks to our local fixed income market remain the economic and fiscal state of the country. The 2024 local elections, the state of ESKOM and the availability of electricity in South Africa, our Greylisting, and our sub-investment grade credit rating all pose threats to our local bond market and have the potential to drive yields higher.

Property & Infrastructure

For several years we have defined property as a sub-set of infrastructure, particularly on a global scale. Currently, Federal fiscal support for infrastructure remains supportive, fueled largely by president Biden’s Infrastructure Bill (renamed to the Infrastructure Investment and Jobs Act, or IIJA) as well as the Inflation Reduction Act. IIJA includes provisions related to federal highway aid, transit, highway safety, motor carrier, research, hazardous materials and rail programs, collectively amounting to an estimated $4 trillion in future infrastructure spending, creating a rosy outlook for investment returns.

As a result, the opportunities for investing in infrastructure look more appealing than those offered by the real estate sector alone, which are largely predicated on the prospects of long-term interest rates. Locally, our property market continues to offer little value, fueled predominantly by the lack of investment by both government and private businesses.

The bottom line for 2024: Investors can expect ongoing volatility and dispersion of returns across markets and asset classes, however this will bring with it the opportunity to earn excess alpha. A sound investment process will be key to harnessing these opportunities and reaching your investment goals.