KEYSTONE

A Year of Promise

KEYSTONE CAPITAL
4TH JANUARY 2024

No forecast of the future would be complete without a reflection first of the year that has just gone by, and what a year it has been. This time last year markets were grappling with high inflation and reeling from the rapid monetary policy tightening by Central Banks. Equity and Bond markets had come off c.18% and c.15% through the course of 2022. A year on, inflation numbers have halved, global economies have largely managed to avoid tipping into a recession (so far at least), financial markets are expecting central banks to start cutting rates later this year and Equity and Bond markets are up c.21% and c.4% over the course of 2023. Looking back now at our Outlook for 2023, we are pleasantly surprised how much of what we had predicted has played out! We hope our assessment of the year ahead is similarly accurate, as currently 2024 looks as though it could be a Year of Promise.

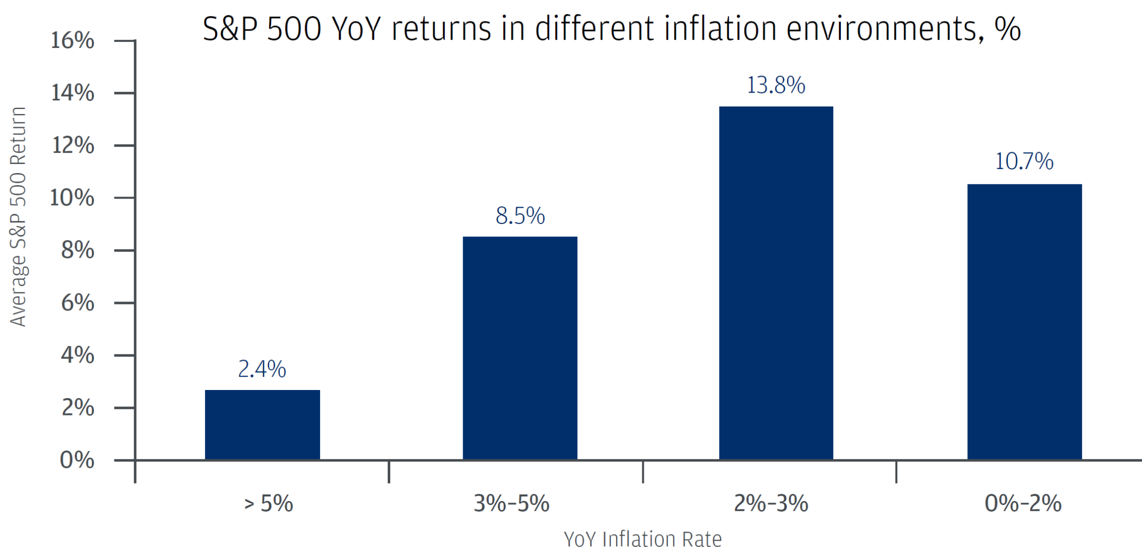
The normalisation of interest rates after over a decade of near zero rates has profoundly changed the investment landscape. There are now opportunities for decent returns across more asset classes than at any time since the financial crisis of 2008. Bond yields are attractive again, equity valuations look fair, real estate income has kept pace with inflation, private markets continue to offer premiums over public markets and are increasingly more accessible to investors. Even cash is looking good…for now.

INFLATION & CENTRAL BANK POLICY

Aggressive monetary policy tightening by Central Banks seems to have had the desired effect on tackling what was feared to be persistent inflation over the course of 2023. Inflation (CPI figures to 30-Nov-23) in the US is down from 6.4% to 3.1%, Europe is down from 8.6% to 2.4% and here at home it now stands at 3.9% compared to 10.1% just a year ago. The consensus amongst leading economists is that we have reached peak interest rates, and the question now is when will Central Banks start cutting rates to support economic growth and how fast and by how much. We believe Central Banks will not rush to cut rates until there are clear signs that inflation is unlikely to rebound and so any rate cuts will likely be early in the summer and not before. The pain of monetary policy tightening has been felt more sharply in Europe and the UK than in the US where businesses and consumers have been more insulated from its effects and therefore it is quite likely that BoE/ECB could lead the Fed in cutting rates. It is difficult to predict by how much we might see rates fall through 2024, but we anticipate it could be somewhere between 0.5-1% by the end of this year.

What has taken many economists by surprise is the sheer resilience of the US economy in the face of a cost-of-living crisis and rapidly tightening monetary policy. It looks increasingly like the US economy has avoided a recession and the Fed may well have successfully engineered a soft landing. We are not out of the woods yet in this regard, but if the US did technically slip into a recession in the first half of this year, it is likely to be shallow and short lived. Whilst we expect a slowdown in Global GDP growth over the next few years compared to what we have been used to in the last decade, it still remains positive with the consensus being an average growth rate of 2.3% in 2024 and 2.7% in 2025. Similarly, inflation is widely expected to settle between 2-3% and remain at these levels for a few years in contrast to sub 2% inflation in the previous decade. This is not necessarily bad news for markets as historically equities have tended to produce better returns with inflation in this range.

EQUITIES TEND TO DO WELL WHEN INFLATION RANGES BETWEEN 2% AND 3%



Source: Bloomberg Finance L.P.

53 Davies Street, Mayfair, London W1K 5JH +44(0)20 7078 4855 help@keystone-capital.co.uk

KEYSTONE

THE INVESTMENT LANDSCAPE

With interest rates peaking and inflation abating, the outlook for equities is continuing to improve. This is despite a slower anticipated pace of economic growth and interest rates potentially settling at higher levels. The case for equities is further supported by earnings growth picking up again after two/three consecutive quarters of earnings decline across most sectors and the fair valuation of equities today in many markets.

Government bond yields are at the highest they have been in quite some time. With interest rates peaking we expect bond yields to fall in 2024, which would support positive returns from bonds. As such, bonds are very much back to play a role in multi asset portfolios delivering attractive returns while mitigating risk through diversification. Real Estate income has historically kept pace with inflation and may provide a natural hedge if inflation settles down at a slightly higher level as anticipated. The same applies to Commodities which can serve as a hedge not just against inflation but geopolitical tensions too. Deglobalisation and the energy transition are both likely to drive demand for metals further supporting commodity prices.

With cash and bonds offering attractive yields and therefore imposing bigger hurdle rates for investment returns, alternatives as a diversifier in portfolios require more careful consideration now. They do however have their place in portfolios and are one of few asset classes with opportunities for asymmetric returns with an ability to contain volatility.

GEOPOLITICAL RISKS

We believe politics will play an outsized role this year as half of the world's population heads to the polls. However, the impact of political events seldom changes the direction of the world economy in the long term. Of course, there could be bouts of volatility with investor sentiment shifting in the run up to elections and the immediate aftermath, but these are almost certain to be temporary.

Any escalation of the ongoing Israel-Hamas and Russia-Ukraine wars, and the trade rivalry between the US and China has the potential to impact markets globally, particularly the inflationary effect that could have on energy & commodity prices and manufactured goods. The risk of yet another full-blown conflict in Southeast Asia firmly remains a possibility. When forming a long-term investment strategy, we simply need to be mindful that there is still a considerable degree of instability in many regions across the globe.

STRUCTURAL TRENDS

In previous outlooks, we have discussed some of the long-term structural trends we think are irreversible and none of these have changed. Advances in technology helps drive productivity gains and has a disinflationary effect (primarily through suppressing wage inflation). We anticipate continued growth in this sector as evidenced from the rise of Artificial Intelligence in recent years. The benefits of this will additionally start spilling over from technology to other sectors as their real-world applications increase. Another sector where demand is expected to remain strong is healthcare. With an aging population in many developed nations, investment in this sector is set to accelerate even further. From 2015 to 2050, the WHO estimates that the number of people over the age of 60 as a percentage of the world population will increase from 12% to 22%. Innovations in personalised medication, obesity control and preventative care will increasingly come into focus.

The transition from carbon-intensive to sustainable energy sources is accelerating. Thanks to OPEC insisting on maintaining a high floor to energy prices to protect their short-term interest, a major hurdle to the energy transition has been removed for the moment. The cost of electricity generation from major alternative sources such as wind and solar has now fallen below that from a newly built fossil-fuelled power plant. As long as this remains the case we can expect to see more investment in this area.

Extreme weather events across the globe are prompting governments to encourage private sector investment into greener technologies that will tackle climate change through generous tax breaks. We can expect the pace of new developments in areas like carbon capture, carbon offset, battery storage and recycling to ratchet up even further in the coming years.

53 Davies Street, Mayfair, London W1K 5JH +44(0)20 7078 4855 help@keystone-capital.co.uk

CONCLUSION

We think that 2024 may represent new beginnings, a Year of Promise for investors. Whilst we acknowledge the pace of growth will slow globally, we do not fear an imminent collapse in financial markets. We anticipate a slow start to the year but for the economic momentum to build in the second half of the year, which could greatly benefit investors with multi asset portfolios.

Given this backdrop, our asset managers prefer tilting equity allocations toward quality stocks that can deliver earnings growth even against a backdrop of slowing global growth. High Government Bond yields make them a compelling alternative to equities. Our managers are overweight Bonds locking in some of those high yields that are available now as well as positioning portfolios for an uplift in value as interest rates fall. Within alternatives, they have a preference for assets with long-dated, visible revenue streams and commodities where supply and demand dynamics could support prices over the medium term. Whilst cash is currently offering an attractive risk-free return, it has a poor track record of preserving real wealth over the long term. Our managers are holding some cash in portfolios to take advantage of tactical opportunities as and when they arise.

Our base case scenario is that we expect strong positive returns for multi asset portfolios in 2024. The rapid rise of social media means that information (or disinformation) is often amplified and has the potential to influence behaviors, popular opinions and impact financial markets at a great speed. The importance of having a clear strategy in place and ignoring the background noise cannot be overstated. A well-diversified and professionally managed portfolio will be very effective in hedging against downside risks. We have repeated this time and again but it’s still worth reminding ourselves that it is time in the market, not timing the market that separates winners from losers.

ASSET CLASS RETURNS OVER THE LAST 10 YEARS

2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Annualised
REITs 22.8%	Japan equities 9.9%	High yield 14.3%	China equities 54.3%	Cash 1.9%	U.S. equities 31.6%	China equities 29.7%	Commodities 38.5%	Commodities 22%	U.S. equities 27.1%	U.S. equities 12%
U.S. equities 13.4%	U.S. equities 1.3%	Infrastructure 12.4%	EM equities 37.8%	DM gov. debt -0.4%	Infrastructure 27%	U.S. equities 21.4%	REITs 32.5%	Cash 1.3%	Japan equities 20.8%	REITs 5.8%
Infrastructure 13%	Emerging debt 1.2%	U.S. equities 11.6%	Europe equities 26.2%	IG credit -3.5%	Europe equities 24.6%	EM equities 18.7%	U.S. equities 27%	Infrastructure -0.2%	Europe equities 20.7%	Infrastructure 5.7%
China equities 8.3%	REITs 0.6%	EM equities 11.6%	Japan equities 24.4%	High yield -4.1%	REITs 24.5%	Japan equities 14.9%	Europe equities 17%	High yield -12.7%	High yield 14%	Japan equities 5.3%
Emerging debt 5.5%	Cash 0.1%	Emerging debt 10.2%	U.S. equities 21.9%	U.S. equities -4.5%	China equities 23.7%	IG credit 10.1%	Infrastructure 11.9%	Europe equities -14.5%	REITs 11.5%	Europe equities 4.7%
IG credit 2.5%	Europe equities -2.3%	Commodities 9.7%	Infrastructure 20.1%	Emerging debt -4.6%	Japan equities 20.1%	DM gov. debt 9.5%	Japan equities 2%	IG credit -16.1%	Emerging debt 10.5%	High yield 3.6%
Cash 0.1%	High yield -2.7%	REITs 6.9%	High yield 10.4%	REITs -4.8%	EM equities 18.9%	High yield 7%	High yield 1%	Japan equities -16.3%	EM equities 10.3%	Emerging debt 3.1%
High yield 0%	DM gov. debt -3.3%	IG credit 6%	Emerging debt 9.3%	Infrastructure -9.5%	Emerging debt 14.4%	Europe equities 5.9%	Cash 0%	Emerging debt -16.5%	IG credit 10.2%	EM equities 3%
DM gov. debt -0.8%	IG credit -3.8%	Japan equities 2.7%	IG credit 9.3%	Commodities -10.7%	High yield 12.6%	Emerging debt 5.9%	Emerging debt -1.5%	DM gov. debt -17.5%	Infrastructure 6.8%	IG credit 2.1%
EM equities -1.8%	China equities -7.6%	DM gov. debt 1.7%	REITs 8.6%	Japan equities -12.6%	IG credit 11.8%	Cash 0.7%	IG credit -2.1%	U.S. equities -19.5%	Cash 5.1%	Cash 1.3%
Japan equities -3.7%	Infrastructure -11.5%	China equities 1.1%	DM gov. debt 7.3%	EM equities -14.2%	Commodities 11.8%	Infrastructure -5.8%	EM equities -2.2%	EM equities -19.7%	DM gov. debt 4.2%	China equities 1%
Europe equities -5.7%	EM equities -14.6%	Cash 0.4%	Commodities 1.7%	Europe equities -14.3%	DM gov. debt 5.6%	REITs -8.1%	DM gov. debt -6.6%	China equities -21.8%	Commodities 0%	Commodities 0.7%
Commodities -17.9%	Commodities -23.4%	Europe equities 0.2%	Cash 0.8%	China equities -18.7%	Cash 2.3%	Commodities -9.3%	China equities -21.6%	REITs -23.6%	China equities -11%	DM gov. debt -0.3%

Key: Lowest return ----------- highest return

Source: BlackRock Investment Institute with data from LSEG Datastream

KEYSTONE

This document is issued by Keystone Capital Limited. Keystone Capital Limited is an appointed representative of Best Practice IFA Group Limited which is authorised and regulated by the Financial Conduct Authority. Company registered in England, number 11867169.

Registered Office: 53 Davies Street, Mayfair, London W1K 5JH.

The information contained within this document has been compiled by Keystone Capital Limited from sources believed to be reliable, but no representation or warranty, express or implied, is made by Keystone Capital Limited, as to its accuracy, completeness or correctness. Nothing in this document should be deemed to constitute the provision of financial, investment or other professional advice in any way. Past performance is not a guide to future performance. The value of an investment and the income from it may go down as well as up and investors may not get back the amount originally invested. This document may include forward-looking statements that are based upon opinions, expectations and projections. We undertake no obligation to update or revise any forward-looking statements.

This document is prepared for general circulation to clients of Keystone Capital Limited and does not have regard to the particular circumstances or needs of any specific person who may read it. To the full extent permitted by law neither Keystone Capital Limited, nor any other person, accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or the information contained herein. No matter contained in this document may be reproduced or copied by any means without the prior consent of Keystone Capital Limited.

www.keystone-capital.co.uk