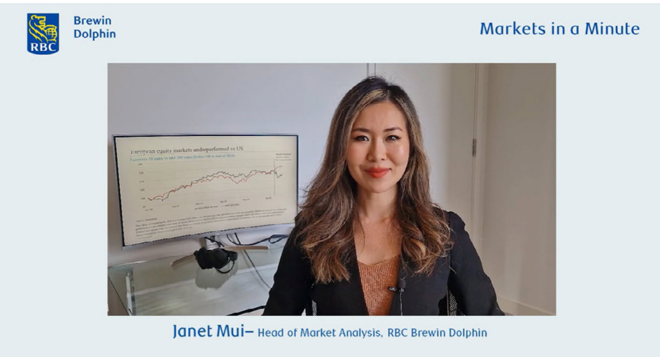
26 November 2024

Markets in a Minute

Janet Mui, Head of Market Analysis, analyses what's been driving the U.S. stock rally, Donald Trump's nomination of Scott Bessent as treasury secretary, and the economic outlook for the UK and Europe.



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Global equity markets were a mixed bag last week. U.S. stocks ended a pullback (a temporary dip in price) after their sharp post-election rally, while UK stocks were a relative bright spot. The rest of Europe lagged.

It's always right to think of the equity market in terms of the stocks it contains. However, in this instance, the weakness of the equity market does seem to be reflecting some downbeat economic prospects for continental Europe.

The ongoing conflict in Ukraine and the upcoming presidential transition in the U.S. have created a sense of uncertainty. Investors are watching closely for any developments that may impact the global economy.

Bitcoin rallies towards milestone high

Data released last week on U.S. Treasury sales showed Japan and China reduced their exposure to U.S. bonds over the last quarter. Efforts to reduce America's trade deficit with other countries can also lessen the need for those countries to hold as many dollars as they had previously. This can in turn lead to decreased demand for U.S. bonds. At a time when the U.S. is running a substantial budget deficit and may be considering further tax cuts, any reduction in foreign demand for U.S. Treasuries would be unhelpful.

These kinds of concerns have prompted investors to look at investments that protect their holders from the perils of government fiscal largesse. Two obvious examples are gold and Bitcoin, which both benefit from a limited supply. These two assets, which share many features, have diverged sharply in performance since the election; gold sank back while Bitcoin has marched onwards towards the milestone of $100,000 per coin!

Strictly speaking, the supply of Bitcoin is more limited than the supply of gold, as there's a finite limit to the number of coins that can eventually be released (only another 5% are able to be mined). In contrast, gold reserves already account for 25% of existing circulation, and it's possible more could be discovered.

But the reason for the difference in performance has been President-elect Donald Trump's perspective on Bitcoin. Trump's stance has changed from regarding Bitcoin as a scam that facilitates crime and requires heavy regulation to an apparent willingness to entertain a U.S. strategic cryptocurrency reserve.

The environmental impact of Bitcoin mining is a concern, as it generally requires much more power than gold mining, leading to the disposal of obsolete tech equipment. Bitcoin mining also consumes a lot of water.

Perhaps the biggest challenge for cryptocurrencies is that while the supply of one of them, like Bitcoin, may be finite, there are huge and growing arrays of other cryptocurrencies with no real limit on how many could be created. Some of these have been better designed, with more use cases and less environmental impact than Bitcoin. Bitcoin holding the top spot among crypto peers relies on its status of being the first cryptocurrency.

Gold and Bitcoin are traditionally priced in dollars, so they'll rise if the dollar falls. Introducing new stores of value as alternatives to the dollar might not be in America's interests – this would diminish the 'exorbitant privilege' enjoyed by the U.S. for being the issuer of the world's reserve currency.

Earnings season draws to an end

The draw of the U.S. equity market remains as we approach the end of the third quarter earnings season.

Nvidia's third quarter results have become something of a highlight. This quarter, its revenue beat expectations, and guidance for the next quarter is strong. The company's Blackwell architecture is expected to drive growth, although margins may be impacted in the short term.

The stock's valuation is a topic of vigorous debate. Its recent growth would easily justify its current multiple – but semiconductors are a cyclical industry, which makes estimating the length of the current upturn, as well as the depth of the next downturn, very challenging. This remains the main controversy around the current market darling.

What's next for UK interest rates?

A flurry of UK data last week has poured more doubt on forecasters' expectations for UK interest rates. This is partly reflected in the market already, as interest rates, which spent a year at 5.25%, have already fallen to 4.75%, with a limited number of further rate cuts expected in the short term.

The markets currently expect rates to fall to 4% by the end of 2025. The consensus of economists is 3.6%, but we expect those forecasts will edge upwards.

UK inflation high during October

In recent weeks, we've discussed how the government is drawing a lot of tax revenue from the economy, but despite this, it's increasing borrowing to fund spending – specifically over the next two years.

Pound for pound, government spending is assumed to boost the economy by more than taxes reduce it. This is because when measuring economic activity, everything the government spends will be included, while anything the government gives away in terms of tax cuts may be partly saved by those benefitting from the cuts.

The upshot is that there will be a big fiscal boost over the next couple of years, at a time when the economy has limited spare capacity (in other words, when unemployment's low). The risk is that this spending is inflationary, meaning that market interest rates need to rise to keep attracting bond buyers.

Inflation was indeed relatively high during October. Although some of this strength came from volatile air fares rebounding after a weak September, and a monthly increase in utility bills, these inflation numbers remain too high for us.

The annual rate of price growth rose above target at a time when energy prices (despite being higher this month) are still dragging inflation down compared to the year before. The persistence of inflation in core services should be worrying the Bank of England as it considers when it can afford to cut interest rates again.

The other consequences of inflation are higher expenditure and higher interest rate costs. Combined, these outweighed the consequent higher tax revenue and led to an overall increase in borrowing during October, which makes the current fiscal plans of the government look tenuous.

European services trend downwards

Finally, at the end of the week, we saw the early window into the current performance of many economies. The news is that Europe has seen no real progress. In fact, it seems European services are being dragged down towards the region's struggling manufacturing sector.

As earnings season winds up, there will be a lack of material economic or corporate news this week. And with Thanksgiving approaching, the focus will switch from Wall Street to the high street and one of the big retail weekends of the year.

However, we can probably expect the flow of news about the shape of President-elect Trump's new government to continue.

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